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Deductibility of Lobbying, Initiative and Referendum Expenses: A Problem for Congressional Consideration

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Considering the magnitude of lobbying and legislative expenditures, including initiative or referendum expenditures,¹ the question of their deductibility for tax purposes is worthy of dispassionate debate and rational decision—to date it has been accorded neither. Under the present Internal Revenue Code the problem is cast in terms of whether the expenses are “ordinary and necessary” business expenses.² There is nothing intrinsically wrong with these criteria, provided taxpayers and the Treasury are willing to abide by them. But they are rather empirical tests; and the Treasury, presumably representing the public, finds it difficult to resolve so sensitive a question by application of such uncritical standards.³ The tendency has been to impose restrictions on deductibility which are not spelled out in the

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¹ Expenditures of 150 corporations for appearances before congressional committees, contributions to trade associations which directly or indirectly influenced legislation, and nontrade advertising from January 1947 through May 1950 totaled \$33,145,249.31. H.R. REP. NO. 3238, 81st Cong., 2d Sess. 43 (1951). The chairman of the Natural Gas and Oil Resources Committee testified before a senate special committee that assessments and contributions received by his Committee between December 1, 1954 and March 31, 1956 totaled \$1,972,545.58. *Hearings Before the Special Committee to Investigate Political Activities, Lobbying and Campaign Contributions*, 84th Cong., 2d Sess. 114 (1956). The Internal Revenue Service apparently proposes to disallow all of such assessments or contributions as income tax deductions. 15 CONG. Q. WEEKLY REP. 125 (1957). Expenditures reported to the Secretary of State in connection with the 1956 Oil and Gas Conservation initiative measure in California totaled \$4,861,653.51. Letter from the Secretary of State to the author, Dec. 18, 1956. See San Francisco Chronicle, Dec. 7, 1956, p. 12, col. 1.

² INT. REV. CODE OF 1954, § 162(a). For the general meaning of this language see *Deputy v. du Pont*, 308 U.S. 488, 496 (1940); *Welch v. Helvering*, 290 U.S. 111, 113 (1933).

³ See AMERICAN BAR ASSOCIATION TAX SECTION, REPORT 54-61 (1954). The report recommends an amendment to § 162(a) of the Code which would permit deduction of expenditures for lawful lobbying activities—but not for political contributions. See Paul, *The Use of Public Policy by the Commissioner in Disallowing Deductions*, 1954 SO. CALIF. TAX INST. 715; Note, *Tax Treatment of Lobbying Expenses and Contributions*, 67 HARV. L. REV. 1408 (1954).

statute.⁴ This high-mindedness on the Treasury's part may indicate a desire to serve the public weal; but it is debatable whether such zeal is not misplaced.

The plain fact is that expenditures to influence the law-making process are unique. The extent to which money should be spent to promote or defeat legislation and be deducted for tax purposes is one of serious concern to any thinking person. On the one hand, the right of the people to petition the Government for a redress of grievances, guaranteed by the first amendment to the Constitution, must be protected; limitations on the deductibility of expenditures for legislative matters raise serious questions in this area.⁵ On the other hand, the purity of our legislative processes and the integrity of our tax structure should be safeguarded. These are the relevant policy considerations. But there is no proper place for them if the inquiry is limited to whether the expenses are "ordinary and necessary" business expenses. The situation cries aloud for congressional review and for relief from judicial and administrative pulling and hauling over the scope of these words which has characterized the discussion to date.

Three aspects of the problem are here considered: First, the deductibility of expenditures incurred in advocating or opposing legislation; second, the deductibility of expenditures incurred in advocating or opposing initiative or referendum measures, including state or federal constitutional amendments; and third, the deductibility of dues paid to nontaxable trade associations which carry on legislative activity for their members.

It is the thesis of this Article that: (1) business expenditures for lobbying for the promotion or defeat of legislation or for initiative or referendum measures are presently deductible for tax purposes so long as the activities carried on are not illegal, and therefore the Treasury's regulation declaring such expenditures to be nondeductible is invalid; and (2) Congress should recognize the question as one calling for careful weighing of competing policy considerations and provide specific rules governing the deductibility of these expenditures.

⁴ For the earlier regulations under the 1939 Code see note 6 *infra*.

⁵ In *United States v. Harriss*, 347 U.S. 612 (1954), the Supreme Court noted the restrictive manner in which the Federal Regulation of Lobbying Act, 60 STAT. 812 (1946), 2 U.S.C. § 261 (1952), must be construed in order to preserve the right to petition the Government for a redress of grievances guaranteed by the first amendment to the Constitution. See also *United States v. Rumely*, 345 U.S. 41 (1953). Denial of tax deductions in this era is certainly as stringent a restriction as the registration requirements which caused the Supreme Court concern in the *Harriss* case.

I

EXPENSES FOR THE PROMOTION OR DEFEAT OF LEGISLATION

The Treasury's Position

The Treasury's position has the merit of clarity and simplicity. The regulation proposed under the 1954 Code states:⁶

Expenditures for lobbying purposes, for the promotion or defeat of legislation, for political purposes, or for the development or exploitation of propaganda (including advertising other than trade advertising) relating to any of the foregoing purposes, are not deductible from gross income. No payment made, either directly or through any organization, for the specific purpose of attempting to promote or defeat legislation shall be deductible.

The Treasury has successfully applied the comparable regulation under the 1939 Code in a variety of cases, the most striking of which is that of the *Delaware Steeplechase & Race Ass'n.*⁷ Petitioner was in the race-track business. A major source of its income was from commissions on pari-mutual betting pools. During 1941 the Ways and Means Committee of the United States House of Representatives was considering the imposition of an excise tax on pari-mutual betting. In 1942 petitioner paid \$742.72 to a law firm as its share of the fee for appearances by the firm before the House Ways and Means Committee. The Tax Court sustained the disallowance of any deduction for this expenditure, pointing out that the expenditure was obviously "for the promotion or defeat of legislation" and therefore nondeductible under the regulation. The same view was expressed in the earlier case of *Mary E. Bellingrath*,⁸ where the cost of assembling facts and arguments for presentation to the legislature was disallowed despite a finding that⁹

all these activities were normal and in no way sinister or objectionable. . . . They were engaged in a proper and legal attempt to prevent injury to their

⁶ U.S. Treas. Proposed Reg. 1.162-15(c) (1956). This regulation is patterned after U.S. Treas. Reg. 118, §§ 39.23(q)-1(a), and 39.23(o)-1(f) (1953), and is in keeping with long-standing Treasury policy on political or legislative expenditures. In T.D. 2137, 17 TREAS. DEC. INT. REV. 48, 57-58 (1915), applicable to the Act of October 3, 1913, c. 16, § 2, 38 STAT. 167, the Treasury ruled that amounts expended by corporations for lobbying purposes were not deductible. The history of the regulation is set forth in *Textile Mills Securities Corp. v. Commissioner*, 314 U.S. 325, 337 (1941). While the regulation under the 1939 Code appeared under the contribution sections rather than the business expense section, courts held it equally applicable under the latter. *Id.* at 338; *McClintock-Trunkey Co.*, 19 T.C. 297 (1952), *rev'd on other grounds*, 217 F.2d 329 (9th Cir. 1954).

⁷ 9 CCH Tax Ct. Mem. 893 (1950).

⁸ 46 B.T.A. 89 (1942).

⁹ *Id.* at 92.

business by persuading the legislature that the proposed legislation was unwise, unfair, and unwarranted.

In these and similar cases¹⁰ there was no finding that the activities of the taxpayers and their representatives were illegal, immoral, or in contravention of any defined public policy.¹¹ Yet no deduction was allowed because of the existence of the regulation. It is thus apparent that under the Treasury's proposed regulation if the president of a company were called to Washington by a senate committee to testify at an open public hearing on legislation which would have material bearing on the company's business, the expenses incurred by the company would be nondeductible. Even if the very existence of the taxpayer's business depended on the course of certain legislation, any expenditures made to promote or defeat such legislation would be nondeductible on the ground that such expenditures are not "ordinary and necessary" business expenses. This strange result, which is certainly not in keeping with conventional notions of deductible expenses, is generally defended on two grounds: (1) A comparable regulation was upheld by the United States Supreme Court in the case of *Textile Mills Securities Corp. v. Commissioner*¹² and (2) the validity of the proposed regulation is sustained by the "re-enactment rule."¹³

In the *Textile Mills* case the taxpayer was a Delaware corporation employed to represent certain German textile interests whose properties had been seized during World War I. It was employed with a view toward procuring legislation, was to be compensated on a percentage basis if successful, and was to bear all the costs and expenses. The employment resulted in the passage of the Settlement of War Claims Act of 1928.¹⁴ Taxpayer claimed deductions for the amount paid to its publicist and two lawyers. The Commissioner disallowed the deductions. The Supreme Court sus-

¹⁰ In *McClintock-Trunkey Co.*, 19 T.C. 297, 304 (1952), *rev'd on other grounds*, 217 F.2d 329 (9th Cir. 1954), the Tax Court observed that the comparable regulation under prior law "is to be given the force of law . . . and no expenditure coming within its terms may be permitted as a deduction even under Section 23(a)." For cases on initiative or referendum expenditures which have been disallowed solely because of the regulation see note 64 *infra*.

¹¹ The high-water mark in disallowing legislative expenditures without regard to their propriety was reached in *Cammarano v. United States*, Civil No. 1873, W.D. Wash., March 1956, where Boldt, J., with becoming candor, said: "It seems to me that it is admitted by the record here that these sums were spent by the taxpayer for the purpose of defeating the enactment of certain legislation and that being so, those sums are not deductible from gross income. Now, this is not to indicate that there is anything wrong or evil or corrupt about spending money for these purposes. . . . They had a right to do that. *There is no problem about its being evil or improper in any manner, shape or form. But that has nothing whatever to do with whether the sums they spent are deductible for income tax purposes. There, we are controlled by this regulation . . .*" (Emphasis added.)

¹² 314 U.S. 326 (1941).

¹³ See *Lilly v. Commissioner*, 343 U.S. 90, 95 (1952).

¹⁴ 45 STAT. 254.

tained the disallowance and, so it is claimed, approved the regulation by the following language:¹⁵

Petitioner's argument that the regulation is invalid likewise lacks substance. The words "ordinary and necessary" are not so clear and unambiguous in their meaning and application as to leave no room for an interpretative regulation. . . . Contracts to spread such insidious influences through legislative halls have long been condemned. . . . [T]he general policy indicated by those cases need not be disregarded by the rule-making authority in its segregation of non-deductible expenses. There is no reason why, in the absence of clear Congressional action to the contrary, the rule-making authority cannot employ that general policy *in drawing a line between legitimate business expenses and those arising from that family of contracts to which the law has given no sanction*. The exclusion of the latter from "ordinary and necessary" expenses certainly does no violence to the statutory language.

On its facts the *Textile Mills* case involved expenditures made in connection with a contingent fee lobbying contract which was of questionable validity.¹⁶ The Treasury obviously interprets this decision as a blanket approval of the regulation.

The theory of the re-enactment rule is that if Congress re-enacts a statute which has been administratively construed, Congress is deemed to have approved that construction.¹⁷ Since the regulation has existed in substantially its present form since 1917,¹⁸ a *prima facie* case for its validity must be conceded to the extent that the re-enactment rule is a reliable guide to statutory construction.

Criticism of the Treasury's Position

Any analysis of the validity of the Treasury's position must start with the provisions of section 162(a) of the Code, which permit a deduction for all the "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."

The 1954 Code is not an essay in morality. It is not a treatise on good

¹⁵ 314 U.S. at 338. (Emphasis added.)

¹⁶ See *Brown v. Gesellschaft Fur Drahtlose Telegraphie M.B.H.*, 104 F.2d 227 (D.C. Cir.), *cert. denied*, 307 U.S. 640 (1939). It may be argued that expenditures in the performance of a void contract are unnecessary. Two judges on the court of appeals so reasoned in *Commissioner v. Textile Mills Securities Corp.*, 117 F.2d 62, 65 (2d Cir. 1940). *But see* *Herman Goedel*, 39 B.T.A. 1 (1939), holding that the Commissioner could not show a contract to be unenforceable once it was actually performed. See also *Denhoff & McKay Co.*, 2 B.T.A. 444 (1925); 34 TAXES 765 (1956).

¹⁷ 1 MERTENS, *FEDERAL INCOME TAXATION* §§ 3.22-25 (1956). Of course, the re-enactment rule cannot validate a regulation which contravenes the express terms of the statute. *Koshland v. Helvering*, 298 U.S. 441 (1936); PAUL, *STUDIES IN FEDERAL TAXATION* 435 (3d ser. 1940).

¹⁸ See note 6 *supra*.

government. The income tax is modestly concerned with the problem of determining a businessman's net accretion in wealth during the taxable year after due allowance for operating costs of the business.¹⁹ If it does this and does it well, it has accomplished enough for one law. And if, in order to achieve other aims, be they ever so laudable, it departs from this primary objective, it has failed in its purpose.

In view of the Treasury's attempt to limit the deductibility of political or legislative expenditures on the theory that they in some way contravene public policy, it is illuminating to consider the legislative history of the income tax law. That history amply demonstrates that vague concepts of "lawfulness" and "public policy" were never considered by the framers of the income tax law to be proper criteria of "ordinary and necessary" business expenses. The 1913 Act²⁰ allowed a deduction for "necessary expenses actually paid in carrying on any business"; authorized individuals to deduct "losses actually sustained during the year, incurred in trade"; and allowed corporations to deduct "all losses actually sustained within the year."²¹ Senator Sterling argued that the bill was too generous. He suggested it be "qualified by some such expression as 'losses incurred in legitimate and ordinary trade pursued by the party' or equivalent words."²² Senator Williams, a prominent member of the Finance Committee who was in charge of the bill, vigorously opposed the suggestion:²³

Mr. Williams: "Mr. President, the object of this bill is to tax a man's net income; that is to say, what he has at the end of the year after deducting from his receipts his expenditures or losses. It is not to reform men's moral characters, that is not the object of the bill at all."

Two later attempts by Senator Sterling to confine deductible losses to those incurred in "legitimate" trade or "lawful" trade were also rejected.²⁴

Despite the legislative history of the revenue acts, it is quite apparent that the courts have imposed some limitations on the deductibility of "or-

¹⁹ The regulations point out that although taxable income is a statutory concept, it follows in general "the lines of commercial usage," U.S. Treas. Reg. 118, § 39.21-1(b) (1953), and the statutory deductions "are in general . . . expenditures . . . connected with the production of income," U.S. Treas. Reg. 118, § 39.21-1(a)(3) (1953).

²⁰ Revenue Act of 1913, 38 STAT. 114, 166.

²¹ *Id.* at 167, 172.

²² 50 CONG. REC. 3849 (1913); see SEIDMAN, LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS, 1938-1861, at 995-96 (1938).

²³ 50 CONG. REC. 3849 (1913).

²⁴ *Id.* at 3850, 4613; see SEIDMAN, LEGISLATIVE HISTORY OF FEDERAL INCOME TAXATION, 1938-1861, at 995-96 (1938). While Senator Sterling's proposals were directed in part to deductible "losses" rather than deductible "expenses," the tone of the congressional debates makes it perfectly clear that Congress had no intention of limiting *either* deduction in the manner proposed.

dinary and necessary" business expenses.²⁵ For example, the Tax Court has refused to allow the deduction of legal expenses of an illegal business,²⁶ although courts of appeal have disagreed with this view.²⁷ Similarly, the courts have refused to permit deduction of fines or penalties²⁸ or expenditures which themselves violate the law.²⁹ And deductions which would "frustrate sharply defined national or state policies proscribing particular types of conduct"³⁰ have been disallowed.³¹ But the Supreme Court has carefully limited the "public policy" doctrine by its decision in *Lilly v. Commissioner*.³² Taxpayer, an optician, "kicked back" to doctors, who prescribed the eye glasses which taxpayer sold, one-third of the retail sales price received for the glasses. The kick-back payments were held deductible as ordinary and necessary business expenses. The Court pointed out that such payments were an established and widespread practice; therefore they were ordinary in the generally accepted meaning of that word. The pay-

²⁵ See C. W. Thomas, 16 T.C. 1417 (1951) (attorney's fees paid in criminal prosecution); Anthony Cornero Stralla, 9 T.C. 801 (1947) (gambling ship); Estate of Lashells, 11 CCH Tax Ct. Mem. 274 (1952); cf. Commissioner v. Heininger, 320 U.S. 467 (1943); Commissioner v. Pacific Mills, 207 F.2d 177 (1st Cir. 1953). See also 4 MERTENS, FEDERAL INCOME TAXATION § 25.131 (1954); Schwartz, *Business Expenses Contrary to Public Policy: An Evaluation of the Lilly Case*, 8 TAX L. REV. 241 (1953); Note, *Income Tax Advantages of Political Activities*, 57 COLUM. L. REV. 273, 281 (1957); Note, *Public Policy and Federal Income Tax Deductions*, 51 COLUM. L. REV. 752 (1951); Note, *Deductions of Business Expenses: Illegality and Public Policy*, 54 HARV. L. REV. 852 (1941).

²⁶ Albert D. McGrath, 27 T.C. No. 13 (1956) (rent paid by bookmaker disallowed); Sam Mesli, 25 T.C. 513 (1955) (wages paid by bookmaker disallowed), *rev'd*, _____ F.2d _____ (7th Cir. 1957).

²⁷ Sullivan v. Commissioner, 241 F.2d 46 (7th Cir. 1957); Commissioner v. Doyle, 231 F.2d 635 (7th Cir. 1956). These differences may soon be resolved by the Supreme Court. See Tax Barometer, ¶ 832, April 13, 1957. In the *Doyle* case the court distinguished Commissioner v. Heininger, 320 U.S. 467 (1943), on the ground that Heininger's business was not illegal, but only certain practices. To the same effect see Cohen v. Commissioner, 176 F.2d 394 (10th Cir. 1949) ("legitimate" expenses are deductible, but not protection payments).

²⁸ Lentin v. Commissioner, 226 F.2d 695 (9th Cir. 1955) (Emergency Price Control Act violations); Commissioner v. Longhorn Portland Cement Co., 148 F.2d 276 (5th Cir. 1945) (penalties for violation of state anti-trust laws); Great No. Ry. v. Commissioner, 40 F.2d 372 (8th Cir.), *cert. denied*, 282 U.S. 855 (1930) (federal safety statutes violated); Bonnie Bros., Inc., 15 B.T.A. 1231 (1929) (prohibition law violated).

²⁹ United States v. Sullivan, 274 U.S. 259, 264 (1927); R. E. L. Finley, 27 T.C. No. 46 (1956) (purchase of whiskey in Oklahoma); Charles A. Clark, 19 T.C. 48 (1952) (illegal protection payments); Frank Maddas, 40 B.T.A. 572 (1939), *aff'd on other grounds*, 114 F.2d 548 (3d Cir. 1940); The Lorraine Corp., 33 B.T.A. 1158 (1936) (purchase of liquor during prohibition); Kelley-Dempsey Co., 31 B.T.A. 351 (1934) (bribe); see Note, *Unlawful Expenditures and the Income Tax*, 31 COLUM. L. REV. 1344, 1346 (1931).

³⁰ Commissioner v. Heininger, 320 U.S. 467, 473 (1943).

³¹ Rugel v. Commissioner, 127 F.2d 393 (8th Cir. 1942) (payments to politician to obtain state printing contract); William F. Davis, Jr., 17 T.C. 549 (1951) (insider's repayment of profits made on corporate securities in violation of SEC regulations); cf. Commissioner v. Heininger, *supra* note 30; Laurence M. Marks, 27 T.C. No. 51 (1956) (payment to avoid possible liability for "insider's profits" deductible).

³² 343 U.S. 90 (1952). See Schwartz, *Business Expenses Contrary to Public Policy: An Evaluation of the Lilly Case*, 8 TAX L. REV. 241 (1952).

ments were necessary since they enabled petitioners to establish their business and maintain it. And the Court further said:³³

There is no statement in the Act, or in its accompanying regulations, prohibiting the deduction of ordinary and necessary business expenses *on the ground that they violate or frustrate "public policy."*

. . . .

Assuming for the sake of argument that, under some circumstances, business expenditures which are ordinary and necessary in the generally accepted meanings of those words may not be deductible as "ordinary and necessary" expenses under § 23(a)(1)(A) when they "frustrate sharply defined national or state policies proscribing particular types of conduct," *supra*, nevertheless the expenditures now before us do not fall in that class. *The policies frustrated must be national or state policies evidenced by some governmental declaration of them.*

It is not the purpose of this Article to explore the precise limits of the "public policy" exception to deductibility, nor to debate the soundness of cases holding that expenditures tainted with illegality or which violate public policy are not deductible. For purposes of this discussion the rationale of these cases may be accepted at face value. But how can this rationale be relied on to disallow legislative expenses which are legal and contravene no public policy, much less a policy "evidenced by some governmental declaration" thereof? How can it be said, for example, that the taxpayer in the *Delaware Steeplechase & Race Ass'n* case, who incurred expenses in presenting his case to an appropriate committee of Congress, was violating any public policy; or that the taxpayers in the *Bellingrath* case who incurred expenses in a "proper and legal attempt to prevent injury to their business" violated some unwritten taboo? Where money is spent to "propagandize" the public or stimulate "letter campaigns" to Congress, the question at first blush may appear different. But is it? Who is to say whether the money is being spent to "propagandize" the public or to "educate" the public? Whether the campaign is to "bring out the facts" or "obfuscate the issue"? To say the least, reasonable people may differ on just what the "public policy" is on these matters.³⁴ The incisive observation made many years ago by an English jurist is not inappropriate:³⁵

[Public policy] . . . is a very unruly horse, and when once you get astride it you never know where it will carry you. It may lead you from the sound law. It is never argued at all but when other points fail.

This much is true: *Congress* has manifested no disposition to abolish

³³ 343 U.S. at 94, 96-97. (Emphasis added.)

³⁴ Compare Note, *Improving the Legislative Process: Federal Regulation of Lobbying*, 56 YALE L.J. 304 (1947) with 90 CONG. REC. 2876-83 (1952); see H.R. REP. NO. 3138, 81st Cong., 2d Sess. 23 (1950).

³⁵ *Richardson v. Mellish*, 2 Bing. 229, 252, 130 Eng. Rep. 294, 303 (C.P. 1824).

lobbying or other activities for the promotion or defeat of legislation. In fact, by passage of the Federal Regulation of Lobbying Act,³⁶ Congress has indicated that lobbying is both permissible and proper if the lobbyist reveals his identity by a registration procedure and discloses certain information. Here are the "national or state policies evidenced by some governmental declaration of them" to which the Supreme Court adverted in the *Lilly* case. The boundaries of permissible activity having been delineated by Congress, it is not for the administrative authority to redraft these boundaries to suit some vague notions of public policy nowhere defined.

However, the regulation which the Treasury has proposed applicable to lobbying or legislative expenditures goes far beyond the limitations on deductions which have just been described. The expenses to which it refers are proscribed simply because they are expenses for the promotion or defeat of legislation.

The *Textile Mills* case, upon which the Treasury primarily relies, is not inconsistent with the foregoing analysis. The language in that case is equivocal. The Tax Court has concluded that the Supreme Court approved the Treasury regulation in its entirety.³⁷ But this may be a more generous construction of the *Textile Mills* case than is warranted. The Supreme Court may have intended only to approve the regulation as applied to the pernicious lobbying there involved. After first stating the facts and quoting the regulation, the Court said:³⁸

Plainly, the regulation was applicable. *The ban against deduction of amounts spent for "lobbying" as "ordinary and necessary" expenses of a corporation derived from a Treasury Decision in 1915.*

But did the Supreme Court mean to approve the broadest possible construction and application of the regulation? The line which the Supreme Court finally drew in its opinion was between "legitimate business expenses" and those arising from that "family of contracts to which the law has given no sanction." It is by no means clear that the Court's approval of the regulation was not limited to that portion of the regulation referring to "lobbying" and in particular to lobbying expenses of the type there involved—contingent fee lobbying. Moreover, the guarded language used by the Supreme Court in *Commissioner v. Heininger*³⁹ and *Lilly v. Commissioner*⁴⁰ when referring to *Textile Mills* seems significant. In the latter case the Court

³⁶ 60 STAT. 839 (1946), 2 U.S.C. §§ 261–70 (1952).

³⁷ *William T. Stover Co.*, 27 T.C. No. 48 (1956). See text at notes 8 and 10 *supra*.

³⁸ 314 U.S. at 337. (Emphasis added.)

³⁹ 320 U.S. 467 (1944). The Court referred to the *Textile Mills* case as denying the deduction of "expenses for *certain types* of lobbying and political pressure activities." *Id.* at 473. (Emphasis added.)

⁴⁰ 343 U.S. at 95.

said only that in *Textile Mills* it "accepted" a Treasury regulation which disallowed "*certain expenditures*" for lobbying purposes, not all expenses for the promotion or defeat of legislation. In short, the regulation covers a variety of expenditures. It is one thing to "accept" the clause precluding deduction of expenditures made under the *Textile Mills* type contingent fee lobbying contract; it is quite another to approve the sweeping language in its entirety. The *Textile Mills* language is equivocal. The *Heininger* and *Lilly* cases indicate that a restrictive interpretation of the opinion is in order.⁴¹ Read together, the cases do not support the kind of construction of the words "ordinary and necessary" as applied to legislative expenditures which is contained in the Treasury's proposed regulation.

It is also questionable whether the so-called re-enactment rule really sustains the proposed regulation. To begin with, the rule is based on the highly questionable premise that Congress read and approved the predecessor regulation before re-enacting the law. But there is little evidence that Congress was even aware of the regulation,⁴² much less that it seriously considered the problem and approved of the solution presented by the regulation.⁴³ In another connection the Supreme Court itself has recently referred to the limitations on the re-enactment rule:⁴⁴

Re-enactment—particularly without the slightest affirmative indication that Congress ever had the *Highland Farms* decision before it—is an unreliable indicium at best.

A second criticism of the re-enactment rule as applied to this proposed regulation is that even if the *Textile Mills* case is viewed as a blanket endorsement of the regulation, there has been no real re-enactment of the

⁴¹ Cf. Note, *Tax Treatment of Lobbying Expenses and Contributions*, 67 HARV. L. REV. 1408, 1414 (1954), where the view is expressed that "the rule of *Textile Mills* seems unimpaired." Professor Surrey apparently shares this view: "There is also a rule in the tax field which is contained in Treasury regulations and supported by case law but not directly reflected in the statute, that business expenses incurred in lobbying or the promotion or defeat of legislation are not deductible. Here again there can be the same questions of interpretation as are involved in the interpretation of the Lobbying Act. Here also the courts and the Treasury Department, as far as I can see, extend this phrase, 'lobbying or the promotion or defeat of legislation,' to indirect lobbying as we have considered it, and business expenses incurred in indirect lobbying would, under the present Treasury regulations and cases, be denied deduction." *Hearings Before Special Senate Committee to Investigate Political Activities, Lobbying, and Campaign Contributions*, 84th Cong., 2d Sess. 591 (1956). The same approach is reflected in Webster, *Deductibility of Lobbying and Related Expenses*, 42 A.B.A.J. 175 (1956).

⁴² To any student of federal income taxation "it is obvious that the ordinary presumption as to congressional familiarity with administrative interpretation is an archaic fiction." 1 MERTENS, *FEDERAL INCOME TAXATION* § 3.24 (1956). Compare the understanding of Senator Goldwater as to deductibility of such expenditures, *Hearings, supra* note 41, at 213, with that of Senator Thyne, *id.* at 172, and Senator Anderson, *id.* at 133. Of course, by the time the hearings were concluded, the Senators were well-advised of the Treasury's regulations.

⁴³ See *Jones v. Liberty Glass Co.*, 332 U.S. 524 (1947); Paul, *Use and Abuse of Tax Regulations in Statutory Construction*, 49 YALE L.J. 660 (1940).

⁴⁴ *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

statute since that case was decided in 1941. The Internal Revenue Code was enacted in 1939 and section 23(a)(1)(A) remained unchanged from that date until the adoption of the Internal Revenue Code of 1954.⁴⁵ Since there is no blanket re-enactment of the Internal Revenue Code but merely amendments to various sections and since the language of section 23(a)(1)(A) was not re-enacted following the *Textile Mills* case, the pure re-enactment rule is technically inapplicable.⁴⁶ It is true that the 1954 Code constitutes a complete re-enactment of the Code, but by 1954 the *Lilly* and *Heininger* cases, indicating possible reservations about the sweeping application of the *Textile Mills* case, had been decided.

A third and more forceful criticism of the re-enactment rule as applied to the Treasury's regulation on legislative expenses is that the pre-1939 re-enactment of a series of revenue acts generally *supports* the deductibility of expenditures for the promotion or defeat of legislation. The forerunner of the current regulation was first adopted in 1917.⁴⁷ Between 1917 and 1939 there were some twelve revenue acts which constituted substantial re-enactments of the entire law, thus presenting the re-enactment rule in its purest form. During this period there were a number of court decisions relating to the deductibility of expenses for the promotion or defeat of legislation.⁴⁸ These cases generally held that if the expenditures were legal and were in connection with the taxpayer's trade or business, they were deductible. For example, in *Lucas v. Wofford*⁴⁹ the taxpayer was engaged in selling a motor fuel known as Woco Pep. In 1920 the state legislature met to consider legislation prescribing standards for gasoline. Petitioner, knowing that Woco Pep would not meet the contemplated standards, employed an attorney to forestall the adverse legislation. The attorney drafted a bill and appeared before several committees of the legislature to advocate its passage. The court held the attorney's fee for services was deductible, pointing out that in order to keep his business alive petitioner employed an attorney to protect his interest; that the services which the attorney was employed to render were entirely legitimate; and that the expense was ordinary and necessary.⁵⁰

⁴⁵ Section 121(a) of the Revenue Act of 1942 made a slight change in the heading of § 23(a). Section 121(d) made the amendment applicable to taxable years beginning after December 31, 1938.

⁴⁶ *Helvering v. Hallock*, 309 U.S. 106 (1940); 1 MERTENS, *FEDERAL INCOME TAXATION* § 3.23 (1956).

⁴⁷ U.S. Treas. Reg. 33, art. 143 (rev. 1918).

⁴⁸ See cases cited at note 53 *infra*.

⁴⁹ 49 F.2d 1027 (5th Cir. 1931).

⁵⁰ In *Los Angeles & S.L. R.R.*, 18 B.T.A. 168 (1929), the Board observed that expenses to invalidate legislation by judicial proceedings had been held deductible and "There is no difference in principle between an expenditure of money to invalidate legislation already enacted and an expenditure to avert or forestall the enactment of legislation, assuming that in each instance the means or methods employed are legitimate." *Id.* at 179. See *George Ringler & Co.*, 10 B.T.A. 1134 (1928); *Independent Brewing Co.*, 4 B.T.A. 870 (1926).

Similarly, in *Los Angeles and S.L.R.R. Co.*⁵¹ taxpayer contributed \$3,415 to the Association of Railway Executives. Ten-sixteenths of the contribution was disallowed by the Commissioner as the portion used in advertising and publicity campaigns incident to the enactment of federal legislation returning the railroads to their owners after World War I. The money had been expended for a nation-wide advertising and publicity campaign aimed at educating the public and obtaining sympathy for the railroads' position. The Board of Tax Appeals held that the expenditures were deductible, saying that in their opinion:⁵²

[T]he expenditure in question was for a legitimate purpose vitally connected with the welfare and for the benefit of the petitioner's business, that it was made in a legal and ethical manner, and that it was an ordinary and necessary expense of the petitioner's business

These and similar cases are typical of the climate of judicial opinion prior to the *Textile Mills* case.⁵³ In view of the repeated re-enactment of the statute following these prior decisions, a strong argument can be made that Congress intended to limit the application of the regulation to cases of the "insidious" type presented in the *Textile Mills* case. At best, the re-enactment rule proves little; it is a slender reed upon which to rely for a proper answer to a difficult problem of statutory interpretation.⁵⁴

The Treasury has taken a bold position on political and legislative expenses. Its proposed regulation prohibits deduction of "expenditures for lobbying purposes, for the promotion or defeat of legislation . . . or for the development or exploitation of propaganda (including advertising other than trade advertising) relating to any of the foregoing purposes . . ." The proposed regulation poses two very real problems: 1) a legal question: Is the regulation valid? and 2) a policy question: Should all lobbying and legislative expenses be accorded the same treatment for tax purposes?

⁵¹ 18 B.T.A. 168 (1929).

⁵² *Id.* at 179.

⁵³ See, e.g., *Kansas City So. Ry.*, 22 B.T.A. 949 (1931), *rev'd on other grounds*, 75 F.2d 786 (8th Cir. 1935); *Missouri Pac. R.R.*, 22 B.T.A. 267 (1931); *Norfolk So. R.R.*, 22 B.T.A. 302 (1931), *rev'd in part and aff'd in part on other grounds*, 63 F.2d 304 (4th Cir.), *cert. denied*, 290 U.S. 672 (1933); 4 MERTENS, *FEDERAL INCOME TAXATION* § 25.135 n.64 (1954), where the cases are collected. *But cf.* *Sunset Scavenger Co. v. Commissioner*, 84 F.2d 453 (9th Cir. 1936) (expenses of promoting the adoption of a municipal ordinance disallowed solely because they were held to be for the promotion or defeat of legislation); *accord*, but without any mention of the regulation, *Old Mission Portland Cement Co. v. Commissioner*, 69 F.2d 676 (9th Cir.), *aff'd on other grounds*, 293 U.S. 289 (1934). Other countries have generally permitted deduction of lawful lobbying expenses. *Morgan v. Tate & Lyle, Ltd.*, [1953] 2 All E.R. 162 (C.A.) (expenditures to defeat proposed nationalization of sugar industry deductible); *McGarry v. Lime-rick Gas Comm.*, [1932] Ir. R. 125.

⁵⁴ See *F. W. Woolworth Co. v. United States*, 91 F.2d 973, 976 (2d Cir. 1937), *cert. denied*, 302 U.S. 768 (1938); 1 MERTENS, *FEDERAL INCOME TAXATION* § 3.24 (1956).

In the author's opinion the regulation is of questionable validity. The Treasury undoubtedly relies heavily on the *Textile Mills* case and the reenactment rule, but these are rather insubstantial support for so sweeping a regulation.

Even if "public policy" is to be used as the *raison d'être* for disallowing ordinary and necessary business expenses, it is doubtful whether the Treasury can point to any public policy which precludes deduction of expenses of the type usually encountered in this area.⁵⁵

It is submitted that the Treasury regulation, if extended beyond the facts in the *Textile Mills* case, is without foundation in law. If the statute is not to be changed by Congress, then the regulation should be limited to disallowance of the class of expenditures considered in that case, to wit, expenditures arising out of "that family of contracts to which the law has given no sanction" and expenditures which violate the Federal Regulation of Lobbying Act or similar state statutes.

No doubt there may be difficulties in drawing the line between proscribed and proper expenditures.⁵⁶ But such difficulties do not change the issue; they only enhance the need for clear analysis of the problem. There is much truth in Mr. Justice Holmes' observation: "Neither are we troubled by the question where to draw the line. That is the question in pretty much everything worth arguing in the law."⁵⁷

II

EXPENSES INCURRED IN CONNECTION WITH PRESENTATION OF INITIATIVE AND REFERENDUM MEASURES TO THE PUBLIC

The Treasury's Position

The proposed regulation under discussion not only prohibits deduction of expenditures "for the promotion or defeat of legislation" but prohibits deduction of expenditures "for political purposes."⁵⁸ This phrase is clearly broad enough to encompass expenses incurred in attempting to promote or defeat measures which are voted on by the electorate such as initiative constitutional amendments or statutes. In this respect the proposed regulation is broader than the prior regulation. The regulation under the 1939 Code made no reference to expenditures "for political purposes"; it pro-

⁵⁵ Courts of other countries, deciding the issue without the aid of administrative regulations, have not considered the "public policy" objection a bar to deductibility. See cases cited at note 53 *supra*; 4 MERTENS, FEDERAL INCOME TAXATION § 225.131 (1954); Note, *Deduction of Business Expenses: Illegality and Public Policy*, 54 HARV. L. REV. 852, 858 (1941).

⁵⁶ See Note, *Tax Treatment of Lobbying Expenses and Contributions*, 67 HARV. L. REV. 1408, 1417 (1954).

⁵⁷ *Irwin v. Gavit*, 268 U.S. 161, 168 (1925).

⁵⁸ See text at note 6 *supra*.

scribed only "deduction of expenditures for lobbying purposes, for the promotion or defeat of legislation . . ."⁵⁹

The difference is significant because under the 1939 Code the Tax Court held, and the Treasury acquiesced in the view, that expenditures for the promotion or defeat of an initiative constitutional amendment did not fall within the proscription of the regulation because no *legislation* was involved. In the leading case of *Luther Ely Smith*,⁶⁰ petitioner contributed \$2,500 to the Missouri Institute for the Administration of Justice, an organization having as its immediate purpose the establishment by constitutional amendment of a modified appointive system for the selection of judges. Petitioner was an attorney who was motivated by civic considerations and also by a desire to protect and improve the practice of law, in which he was engaged. The court held the contribution deductible, saying:⁶¹

It should be noted that the institute engaged in no lobbying of any kind before any legislative body. No legislation was needed or involved in its plan. It contemplated an amendment to the constitution, proposed by the initiative of the people, voted upon at a general election, and becoming self-operative thirty days thereafter, without the necessity of any action or approval by either the legislature or the governor.

The proposed regulation obviously repeals sub silentio the rule of the *Smith* case. It is now apparent that all expenditures connected with elections are nondeductible in the eyes of the Treasury.

Criticism of the Treasury's Position

What has been said heretofore regarding the scope of the *Textile Mills* case applies with even greater force to this phase of the problem. The *most* that can be said of *Textile Mills* is that it held valid the portion of the old regulation carried over to the proposed regulation which disallows expenditures for the "promotion or defeat of legislation." But as the Tax Court noted in the *Smith* case, constitutional amendments are not legislation and therefore do not fall within the ambit of the regulation. While this argument is technical, it is no more technical than the argument to which it is addressed. If the Treasury chooses to rely upon the regulation, rather than the statute, it should not be heard to complain that its regulation is being

⁵⁹ U.S. Treas. Reg. 118, §§ 39.23(q)-1(a), 39.23(o)-1(f) (1953); see note 6 *supra*.

⁶⁰ 3 T.C. 696 (1944).

⁶¹ *Id.* at 702. On review by the full court there were no dissents to the *Smith* decision, and subsequently the Commissioner acquiesced in the decision. Rev. Rul. 11907, 1944 CUM. BULL. 26. Thereafter on several occasions the Commissioner issued private rulings holding that expenditures for the promotion or defeat of a constitutional amendment were deductible, provided they otherwise met the usual tests of being ordinary and necessary business expenses. *Colorado United, Inc.* (Priv. Rev. Rul. 1949); *J. W. Jackson Beverage Co. of Fayetteville, Inc.* (Priv. Rev. Rul. 1950).

read literally. Where a regulation is of questionable validity because broader than the statute, there is scant reason to enlarge it by inference.⁶²

Neither does the re-enactment rule provide support for making initiative or referendum expenditures nondeductible. The *Smith* case was decided in 1944, acquiescence was published in 1944, and as late as 1950 private rulings were issued in line with the *Smith* case.⁶³ In 1954 the new Code was enacted. If we are to impute to Congress a desire to codify existing and established tax rules—and certainly the *Smith* case meets that test—then such expenditures as were involved in the *Smith* case should be deductible.⁶⁴

Further Problems in Connection with Expenditures for Initiative or Referendum Measures

There is usually little question but what the ordinary expenditures for legislative or lobbying work are legal, whatever one may think of their desirability. But the same cannot be said for expenditures which involve initiative or referendum measures. As to these expenditures it is necessary to consider whether they violate either the Federal Corrupt Practices Act⁶⁵ or the Hatch Act.⁶⁶ If the expenditures are illegal, they are of doubtful deductibility irrespective of the regulation.⁶⁷

The Corrupt Practices Act prohibits *corporations*⁶⁸ from making any expenditure "in connection with any election" at which federal representa-

⁶² Since the portion of the proposed regulation proscribing expenditures "for political purposes" is new, it could not possibly have received approval in the *Textile Mills* case.

⁶³ See note 61 *supra*.

⁶⁴ There is no policy reason to distinguish between initiative constitutional amendments and similar statutes. Expenditures to "educate" or "influence" the electorate for either type of measure should be treated the same. Despite the absence of any such apparent policy considerations, the courts have not applied the reasoning of the *Smith* case to initiative or referendum statutory measures. *Sunset Scavenger Co., Inc. v. Commissioner*, 84 F.2d 453 (9th Cir. 1936) (local initiative); *Old Mission Portland Cement Co. v. Commissioner*, 69 F.2d 676 (9th Cir.), *aff'd on other grounds*, 293 U.S. 289 (1934) (referendum); *National Campaign Comm. v. Rogan*, 69 F. Supp. 679, 684 (S.D. Cal. 1945) (initiative); *Herbert Davis*, 26 T.C. 164 (1956) (referendum); *McClintock-Trunkey Co.*, 19 T.C. 297 (1952), *rev'd on other grounds*, 217 F.2d 329 (9th Cir. 1954) (initiative); *accord*, *Revere Racing Ass'n v. Scanlon*, 232 F.2d 816 (3d Cir. 1956) (referendum); *Mosby Hotel Co.*, 13 CCH Tax Ct. Mem. 996 (1954). *Mosby* involved expenditures to repeal the prohibition laws of Kansas by a constitutional amendment. The expenditures were disallowed as tax deductions, but the case may be distinguishable from the *Smith* case because some of the funds may have been used to promote proper enabling legislation by the legislature. See *Holzman*, *Tax Classics*, 30 TAXES 149 (1952).

⁶⁵ 43 STAT. 1070 (1925), as amended, 2 U.S.C. §§ 241-56 (1952). The portion of the original act here relevant is now codified as positive law in 18 U.S.C. § 610 (1952).

⁶⁶ 53 STAT. 1147 (1939), as amended, 5 U.S.C. §§ 1181-n; 18 U.S.C. §§ 594, 595, 598, 600, 601, 604, 605, 608, 610, 611 (1952).

⁶⁷ See note 28 *supra*.

⁶⁸ The act applies only to *corporations*. This is of some significance in determining the scope of the companion Hatch Act, as discussed in the text beginning at note 73 *infra*.

tives are elected.⁶⁹ Where the initiative or referendum measure is voted on at the same time as are federal representatives, it may be argued that a contribution in respect of the initiative or referendum election is "in connection with" an election at which federal representatives are elected. If so, it would apparently be illegal and nondeductible.

But constitutionally, the states conferred only limited power on the federal government with respect to elections.⁷⁰ The residue of power they reserved, including power over the legislative function of the electorate, that is, local or state initiative or referendum elections. As to these elections, the federal government has no power. Thus, it may be argued that when Congress enacted the Corrupt Practices Act it was exercising only its delegated power over federal elections and was not purporting to regulate elections and expenditures in connection therewith over which the states have reserved power.⁷¹

This view was accepted in the only case in which the point was considered, *De Mille v. American Federation of Radio Artists*.⁷² De Mille contended that a contribution which he was required to make as a member of the American Federation of Radio Artists was not enforceable because the union was using the money in violation of the Corrupt Practices Act to oppose a state initiative measure. The California Supreme Court rejected this contention and in effect held that the Federal Corrupt Practices Act does not apply to expenditures made in connection with state initiative or referendum elections. If the *De Mille* case is correct, corporate expenditures "in connection with" a state initiative or referendum election would not be il-

⁶⁹ 18 U.S.C. § 610 (1952).

⁷⁰ The Corrupt Practices Act was enacted by Congress in the exercise of the power conferred on it by U.S. CONST. art. I, § 4, cl. 1: "The Times, Places, and Manner of holding Elections for Senators and Representatives, shall be prescribed in each State by the Legislature thereof; but the Congress may at any time by Law make or alter such Regulations, except as to the Places of choosing Senators."

In *Newberry v. United States*, 256 U.S. 232 (1921), the Supreme Court pointed out that Congress has only delegated and limited power over elections, and held invalid § 8 of the Corrupt Practices Act as applied to a primary election of candidates for a seat in the Senate.

⁷¹ The Corrupt Practices Act has been very narrowly construed by the courts in order to avoid constitutional issues under the first amendment to the Federal Constitution. *United States v. CIO*, 335 U.S. 106 (1948) (editorial in CIO News did not constitute a violation); *United States v. Painters Union*, 172 F.2d 854 (2d Cir. 1949) (small payments by labor union for publicity no violation); *United States v. Construction Laborers Union*, 101 F. Supp. 869 (W.D. Mo. 1951) (labor union's payments to employees who engaged in political activities did not constitute a violation). In *United States v. CIO*, *supra* at 121, the Supreme Court said: "If § 313 [18 U.S.C. § 610] were construed to prohibit the publication, by corporations and unions in the regular course of conducting their affairs, of periodicals advising their members, stockholders or customers of danger or advantage to their interests from the adoption of measures, or the election to office of men espousing such measures, the gravest doubt would arise in our minds as to its constitutionality."

⁷² 31 Cal. 2d 139, 187 P.2d 769 (1947).

legal and therefore should be deductible, provided no state or local law is violated, if otherwise ordinary and necessary business expenses.

A second problem regarding deductibility is the effect of the Hatch Act. The relevant portion of that Act, section 611, provides as follows:⁷³

Whoever, entering into any contract with the United States . . . if payment . . . is to be made . . . from funds appropriated by the Congress, during the period of negotiation for, or performance under such contract . . . directly or indirectly makes any contribution of money . . . or promises . . . to make any such contribution, to any political party, committee, or candidate for public office or to any person *for any political purpose or use* . . . shall be fined

The argument runs that any business which had a contract of the type described⁷⁴ would violate the act if it made a contribution in connection with any initiative or referendum measure since this would clearly be a contribution for a "political purpose or use."⁷⁵ If the act is violated, the expenditure would be illegal and hence nondeductible.

The argument heretofore alluded to regarding Congress's power to regulate state election matters is equally applicable to the Hatch Act.⁷⁶

Furthermore, it is reasonably clear that the above quoted section dealing with government contractors *does not apply to corporations*. The statute defines the word "whoever" to include an individual, partnership, committee, association, *corporation*, or any other organization or group of persons;⁷⁷ but this definition applies only to sections 597, 599, 602, 609, and 610.⁷⁸ Section 611 is conspicuously absent. Thus a plausible argument can be made that the word "whoever" as used in section 611 does not include a corporation. The trouble with this argument is that it proves too much. It proves that the word "whoever" as used in section 611 does not include an individual, partnership, committee, or association, and thus has no meaning at all. Nevertheless, if the legislative history of the Hatch Act is examined, it appears rather clear that section 611 was not intended to apply to corporations. The provisions now contained in section 611 were first added in

⁷³ 18 U.S.C. § 611 (1952). (Emphasis added.)

⁷⁴ Obviously, any business having dealings with the federal government might find itself within the coverage of the act.

⁷⁵ The words "political purpose" include any purpose to be attained at an election whether the voters at such election are asked to vote on issues or for or against candidates. *State ex rel. Green v. Cleveland*, 33 N.E.2d 35, 37 (Ohio 1940). A "political" purpose is a purpose to influence the exercise of political rights. *Commonwealth v. McCarthy*, 281 Mass. 253, 183 N.E. 495 (1932) (campaign against city charter); see *United States v. Wurzbach*, 31 F.2d 774 (W.D. Texas 1929), noting the requirement of strict construction of a penal statute.

⁷⁶ In exacting the act Congress was exercising its delegated power under U. S. CONST. art. I, § 4, cl. 2.

⁷⁷ 18 U.S.C. § 591 (1952). (Emphasis added.)

⁷⁸ *Ibid.*

1940.⁷⁹ As then enacted the section read, "no person or firm, entering into any contract"⁸⁰ Here again the language might be considered ambiguous. Do the words "person" or "firm" include a corporation? Apparently not. The words were first used by Senator Byrd in an amendment to Senate Bill 3046.⁸¹ But in Senator Byrd's proposed amendment the introductory words were "no person, firm, *or corporation*, entering into any contract" With reference to this amendment and the striking of the words "or corporation," the following exchange took place on the floor of the Senate:⁸²

Mr. Hatch: "There is one thing in connection with it, however, which I think should be corrected. I see in the first line—and probably this was my error in the first instance—that the prohibition runs against a corporation making a campaign contribution. As I understand, the present Corrupt Practices Act precludes and prohibits any campaign contribution by a corporation. This might be construed as lessening or loosening in some degree the present Corrupt Practices Act, and rather than do that I will ask the Senator from Virginia if he will not agree that we may strike out the words 'or corporation' where they appear in the amendment; and after the word 'firm,' strike out the words 'or corporation' where they appear in the amendment. And also that there be inserted between 'person' and 'firm' the word 'or,' so as to read 'no person or firm.'"

Mr. Byrd: "I agree to the modification proposed by the Senator from New Mexico to the bill which he prepared 5 years ago."

It therefore seems clear that the Hatch Act does not make political expenditures by corporate government contractors illegal.⁸³

Proposed constitutional amendments or initiative statutory measures appear on the ballots in practically every state of the Union. Many of these measures mean life or death to various businesses. It is ridiculous to say that no expenditure relating to the election at which such issues are decided is an "ordinary and necessary" business expense for those who are vitally concerned with the outcome.

Such expenditures may or may not be desirable from the standpoint of good government, but that is not the issue under the present statutory test. If Congress feels it should be the issue, Congress should say so. An argument can be made that expenditures in connection with initiative or referendum measures are less mischievous than "lobbying" expenditures, but this is certainly debatable.⁸⁴ Legislators may be less easily fooled than the vot-

⁷⁹ 54 STAT. 772.

⁸⁰ *Ibid.*

⁸¹ S. 3046, 76th Cong., 3d Sess. (1940), was introduced by Senator Hatch to extend the coverage of the Hatch Act. (Emphasis added.)

⁸² 86 CONG. REC. 2982 (1940).

⁸³ Noncorporate government contractors would be subject to the act except for the argument that it does not reach state initiative and referendum elections.

⁸⁴ See H.R. REP. NO. 3138, 81st Cong., 2d Sess. 23 (1950); H.R. REP. NO. 3139, 81st Cong., 2d Sess. (1950).

ing public, and if expenditures to influence the public are favored, as opposed to legislative expenditures, the pressure group with the greatest resources is clearly benefited. But this is the kind of question which Congress should debate and decide.

III

DEDUCTIBILITY OF DUES PAID TO TRADE ASSOCIATIONS WHICH ENGAGE IN LEGISLATIVE ACTIVITY

One reason why the legislative expense problem has not caused more concern in the past is that a substantial part of the legislative work of an industry is customarily done through a trade association.⁸⁵ Being a non-taxable entity,⁸⁶ it is of little moment to the trade association whether an expense item is deductible. However, since dues paid to a trade association are ordinarily deductible, the maximum effect of the Treasury's prior regulation was never felt by the members. Under the 1939 Code dues were customarily disallowed as deductions only where the association was operated "primarily" for legislative purposes.⁸⁷ Where legislative activities were only "incidental," dues were not disallowed.⁸⁸

The proposed regulation rejects the "primary" test in favor of the "incidental" test.⁸⁹

⁸⁵ See H.R. REP. NO. 3137, 81st Cong., 2d Sess. (1950); H.R. REP. NO. 3238, 81st Cong., 2d Sess. (1951).

⁸⁶ Trade associations are exempt from tax as business leagues under INT. REV. CODE OF 1954, § 501(c)(6).

⁸⁷ *American Hardware & Equipment Co. v. Commissioner*, 202 F.2d 126 (4th Cir.), *cert. denied*, 346 U.S. 814 (1953) (National Tax Equality Ass'n); *Roberts Dairy Co. v. Commissioner*, 195 F.2d 948 (8th Cir.), *cert. denied*, 344 U.S. 865 (1952) (National Tax Equality Ass'n); *Herbert Davis*, 26 T.C. 49 (1956) (Anderson County Liquor Dealers Ass'n).

However, in 1952 the Tax Court apparently extended the "primary" test and applied the "substantial part" test. *McClintock-Trunkey Co.*, 19 T.C. 297 (1952), *rev'd on other grounds*, 217 F.2d 329 (9th Cir. 1954). On a finding that "a substantial part of the activities of the organizations to which petitioner's contributions were made [Taxpayer's League, Good Roads Ass'n, and the Washington Wholesalers' Beer Ass'n] . . . was devoted to 'lobbying purposes, the promotion or defeat of legislation, (and) the exploitation of propaganda'" the court disallowed the deduction for dues. See *id.* at 304. The theory of this case has been criticized. See LAMB & KITTELLE, *TRADE ASSOCIATION LAW AND PRACTICE* § 17.20 (1956); *Bison*, *New Tax Threats Face Trade Associations*, 5 AM. TRADE ASS'N EXEC. J. 25, 37 (April 1953). In another connection it has been held that something less than five per cent is not a "substantial part" of an organization's activities. *Seasongood v. Commissioner*, 227 F.2d 907 (6th Cir. 1955).

⁸⁸ *Smith-Bridgman & Co.*, 16 T.C. 287 (1951) (contribution to United States Chamber of Commerce deductible); *Addressograph-Multigraph Corp.*, 4 CCH Tax Ct. Mem. 147 (1945) (assessment paid to National Ass'n of Manufacturers held deductible); Rev. Rul. 54-442, 1954-2 CUM. BULL. 131; see Webster, *Deductibility of Lobbying and Related Expenses*, 42 A.B. A.J. 175 (1956).

⁸⁹ U.S. Treas. Proposed Reg. 1.162-15(c) (1956) states: "Other payments . . . when made as dues or contributions to a trade or business organization, may be deductible under some circumstances, even though influencing or attempting to influence legislation is *incidentally*

A substantial question exists whether the "incidental" test is valid. Where the organization is *primarily* engaged in legislative activities, a plausible argument can be made that the association is merely a conduit and that the members should not be permitted to deduct indirectly—by dues payments—that which they may not deduct directly, assuming expenditures for such activities are nondeductible in the first instance. But this argument loses much of its force when the "incidental" test is applied. The trade association, particularly in those cases where it is a corporation, is not the alter ego of its members.⁹⁰ The "incidental" test in the proposed regulation is inconsistent with many rulings which have been promulgated dealing with deductibility of dues paid to trade associations and other exempt organizations. In such rulings dues have been considered deductible although applied by an exempt organization in such a manner that if the same expenditure were by a member it would not be deductible. For example, when a chamber of commerce makes a capital expenditure which is obviously nondeductible, the Commissioner does not disallow all or an aliquot portion of the member's dues.⁹¹ Likewise the Commissioner has held that contributions are deductible when made to an association exempt under section 116(g) of the 1954 Code which was organized for the purpose of maintaining a reserve for the payment of the anticipated losses of its members,⁹² although it is clear that an individual taxpayer may not deduct reserves which it establishes for anticipated losses.⁹³ Similarly, it is held that payments made by members of the New York Stock Exchange to a gratuity fund maintained by the Exchange for the benefit of families of deceased members of the Exchange are deductible.⁹⁴ Such payments if made by the

involved in the use by such organization of such payments. Thus, the payment of such amounts as dues or contributions . . . for the furtherance of the general purposes and program of such an organization in promoting the common economic interests represented shall be deductible in full if the activities of such organization which consist of lawfully attempting to promote or defeat legislation are *incidental* to the organization's general purposes and program." (Emphasis added.)

⁹⁰ If a corporation has a business purpose, its corporate entity must be recognized for tax purposes, unless fraud is present or the corporation "is a bald and mischievous fiction." *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, 439 (1942).

⁹¹ See Rev. Rul. 160, 1953-2 CUM. BULL. 114, permitting deduction of a contribution to an exempt organization to build a hospital. See also *Woodside Cotton Mills Co.*, 13 B.T.A. 266 (1928). But the Commissioner has not been consistent. Under the 1939 Code, Internal Revenue Agents frequently disallowed the *part* of the members' dues attributable to "legislative activities" of the association. In *Los Angeles & S.L. R.R.*, 18 B.T.A. 168, 177 (1929), the court rejected a partial disallowance of contributions, but on the ground that the entire expenditure of the association to influence legislation was proper.

⁹² Rev. Rul. 55-189, 1955-1 CUM. BULL. 265.

⁹³ *Brown v. Helvering*, 291 U.S. 193 (1934).

⁹⁴ *Whitney v. Commissioner*, 73 F.2d 589 (3d Cir. 1934); I.T. 3925, 1948-2 CUM. BULL. 28.

donors directly to the families involved would clearly be nondeductible gifts.⁹⁵

There is far less reason to ignore the corporate entity of the organization where some part of its income is used to influence legislation—the only objection to such outlays, even when made *directly*, being the tenuous one based on vague notions of public policy—than if some part of the income is used for a clearly nondeductible purpose such as a capital expenditure. Certainly it cannot be contended that the use of the organization's funds to influence legislation is a flagrant and fraudulent abuse of the corporate form.

In short, the proposed regulation again appears to be broader than justified by the statute. It is quite obvious that if legislative expenditures are to be proscribed, indirect expenditures for the prohibited purpose must be similarly circumscribed. But the Treasury may find it difficult to carry this torch alone without the assistance of any specific statutory provisions.

CONCLUSION

The extent to which expenditures relating to legislation—whether by legislative bodies or by direct vote of the people—may be deducted for tax purposes should be decided on its merits. To date the real issue has been avoided. Taxpayers conceal their legislative expenditures under “legal” or “advertising” or “public relations” expenses. The Treasury arms itself with a regulation of larger caliber than the statute and then eases the pressure by applying the regulation only in the more conspicuous cases. The courts flounder from one case to the next trying to reconcile their disallowance of expenditures for legislative purposes on the ground that they violate public policy, with the fact that the only established public policy, the Federal Regulation of Lobbying Act and similar state statutes, sanctions the legislative expenditures customarily encountered. This approach is neither sound nor healthy. The question is one which should be resolved by appropriate congressional action.

The first question for Congress to consider is the extent to which lobbying or legislative activities are necessary or desirable. In view of the complexity of modern legislative problems, it is by no means clear that all such activities are to be condemned.⁹⁶ The second question is whether the tax

⁹⁵ In Rev. Rul. 56-304, 1956 INT. REV. BULL. No. 27, at 15, it is held that a charitable foundation may make payments to needy individuals without thereby forfeiting its exempt status, although similar expenditures made by individuals would be nondeductible.

⁹⁶ See *Hearings Before Senate Special Committee to Investigate Political Activities, Lobbying, and Campaign Contributions*, 84th Cong., 2d Sess. 136, 180, 212-13, 559-96 (1956). A strong argument can be made that pressure groups serve a useful function in the law-making process, provided there is adequate disclosure of their special interest in the particular legislation. On the importance of disclosure see *id.* at 567, 570-71.

laws should be used indirectly to implement any value judgments which are made.

Having answered these two questions, Congress will be in a position intelligently to settle the confusion which now exists. It is the author's view that the questions cannot be properly resolved if the debate is confined to the question of whether the expenses are "ordinary and necessary" business expenses. Any such solution will result only in distorting the generally accepted meaning of these words. It is far better to treat such expenditures as *sui generis* and to examine independently the considerations bearing on deductibility.