Influencing the Public: Policy Considerations Defining the Tax Status of Corporate Grassroots Lobbying

Anne M. Krauskopf

Follow this and additional works at: https://scholarship.law.edu/lawreview

Recommended Citation
Available at: https://scholarship.law.edu/lawreview/vol28/iss2/5

This Comments is brought to you for free and open access by CUA Law Scholarship Repository. It has been accepted for inclusion in Catholic University Law Review by an authorized editor of CUA Law Scholarship Repository. For more information, please contact edinger@law.edu.
INFLUENCING THE PUBLIC:
POLICY CONSIDERATIONS
DEFINING THE TAX STATUS OF
CORPORATE GRASSROOTS LOBBYING

“Grassroots” lobbying has become a powerful means for business, labor, and other interest groups to make their demands known to Congress. While it is not a new method of influencing government action, this lobbying technique and the laws regulating its practices have recently become the subject of heated controversy. Purported victories by grassroots lobbyists have spawned a backlash movement aimed at insuring that indirect lobbying is used fairly. In an attempt to monitor grassroots lobbying activities more closely, the House of Representatives passed a lobbying reform bill that included a provision requiring organizations to report indirect appeals to Congress in addition to their presently reported direct lobbying.

1. Grassroots lobbying does not seek to persuade legislators directly, but attempts to influence public opinion about legislative matters and encourage communication of that opinion to elected representatives.

2. The potency of this weapon has been demonstrated by the significant legislative victories attributed to it. For example, the common situs picketing bill, H.R. 4250, that would have allowed unions with a grievance against a single contractor to picket and potentially to close down an entire construction site, was defeated by the House of Representatives. AFL-CIO Building and Construction Trades Department President Robert A. Georgine stated that some congressmen claimed that they voted against the bill “because they got more pressure from business than from us.” Similarly, the consumer agency bill, H.R. 6805, was defeated in the House of Representatives by a narrow vote. Supporters of the bill, including White House Press Secretary Jody Powell, attributed the loss to a well organized and effective opposition. See also Cohen, New Lobbying Rules May Influence Grass-Roots Political Action, NAT'L J., May 27, 1978, at 832.

Impressed by the successes of business, labor interests also adopted the grassroots technique to their advantage in a lengthy Senate battle over the labor reform bill, H.R. 8410. Ultimately, the bill was recommitted to the Senate Human Resources Committee—a maneuver considered tantamount to killing a bill—following rejection of a sixth cloture attempt. Senator Dale Bumpers, one of the few initially uncommitted Senators in the fifth cloture vote to end filibuster on the labor bill, stated, “[l]abor felt senators were impressed by the volume of mail they were getting, so they felt they had to generate a like volume.” Bumpers also complained that grassroots lobbying at one point threatened to paralyze his office operations by the sheer volume of mail it produced. Dewar, “Grass-Roots” Lobbying in Full Flower, Wash. Post, May 28, 1978, § A, at 2, cols. 3 and 1.
activities. In another significant reform effort, a House subcommittee has initiated a campaign to curb widespread abuses of the tax laws governing grassroots lobbying. Although the Internal Revenue Code prohibits deductions for business' grassroots lobbying expenses, recent congressional investigations reveal that substantial taxpayer noncompliance and ineffective Internal Revenue Service (IRS) enforcement of this law exist, resulting in estimated losses to the Treasury of millions of dollars annually.

Much more is at issue, however, than the mere loss of revenue. To the extent that a corporation improperly deducts its grassroots lobbying expenses, it gains an unfair advantage over other businesses and over individual taxpayers, for whom these expenses are also nondeductible. This advantage amounts to federal subsidization of corporate propaganda programs, since the dollars expended are those properly subject to income taxation. There is legitimate public concern that this subsidy, when com-

3. See H.R. 8494, 95th Cong., 2d Sess. § 6(b)(7) (1978). The Senate version of this bill, S. 2971, 95th Cong., 2d Sess. § 6(b)(5) (1978), also requires registration of "lobbying solicitations." The bill was stalled in committee indefinitely, and prospects for passage of a lobbying reform bill in the 96th Congress are uncertain.

4. I.R.C. § 162(e)(2)(B). This section states that businesses will not be allowed a deduction as an ordinary and necessary expense for amounts paid or incurred "in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums." The direct lobbying expenses of businesses (i.e., costs of appearances before Congress or other legislatures) are deductible under I.R.C. § 162(e)(1)(A). For further discussion of these Code provisions, see text accompanying notes 86-106, infra. As of May, 1978, of the total 24,802 tax cases pending before all courts, only eleven involved improper deductions for grassroots lobbying expenses. IRS Administration of the Tax Laws Relating to Lobbying (Part 1): Hearings Before the Commerce, Consumer, and Monetary Affairs Subcomm. of the House Comm. on Government Operations, 95th Cong., 2d Sess., at 204 (1978) (Statement of Lester G. Fant, III, Attorney, Cohen & Uretz, Washington, D.C.) [hereinafter cited as Hearings].

5. This loss of tax revenue has been estimated to reach tens of millions of dollars each year. See Hearings, supra note 4, at 380 (opening statement of Chairman Benjamin S. Rosenthal). The Subcommittee, investigating IRS enforcement of I.R.C. § 162(e)(2)(B) since the summer of 1977, also estimates that at least $1 billion is spent on grassroots lobbying per year. Id.

6. I.R.C. § 212 only allows individuals a deduction for ordinary and necessary expenses incurred for the production or collection of income, the management, conservation or maintenance of property held for the production of income, or the determination, collection or refund of taxes. Business expenses may be deducted by individual taxpayers only to the extent allowable under § 162(a). Since § 162(e)(2)(B) is a limitation on § 162(a), its prohibition of deductions for grassroots lobbying expenses extends to individuals as well as businesses. For an application of this theory allowing an individual to deduct his business-related direct lobbying expenses under §§ 162(e)(1)(A) and (B), 162(a), and 212, see Jordan v. Commissioner, 60 T.C. 770 (1973).
bined with multi-million dollar corporate budgets, would allow large business interests to overwhelm the public with political advocacy to such an extent that other viewpoints would be smothered.\(^7\)

On the other hand, denying a deduction for these activities could violate the constitutional rights of corporations. The Internal Revenue Code does not prohibit corporations from attempting to influence the public; instead, it merely requires that they pay for these activities out of their own pockets. At the same time, the Code permits charitable organizations to retain their tax exempt status while engaging in grassroots lobbying.\(^8\) One trade association has therefore claimed that because of this differential tax treatment, the Code denies corporations the equal protection of the laws.\(^9\) In addition, because disallowance of deductions for grassroots lobbying could discourage constitutionally protected debate on issues of public significance,\(^10\) the denial arguably chills the exercise of corporate first amendment rights.\(^11\) Given the sixteenth amendment's mandate that all income from whatever source derived may be taxed,\(^12\) however, this argument presents a conflict at the constitutional level.

More important is the problem of defining a nondeductible grassroots lobbying expense. While Internal Revenue Code section 162(e)(2)(B) prohibits business deductions for grassroots lobbying activities, the implementing regulations allow corporations to deduct the cost of goodwill and social interest messages.\(^13\) Therefore, a great deal of confusion exists regarding the tax status applicable to a broad range of advertisements which

---


\(^8\) New I.R.C. § 4911, introduced in the Tax Reform Act of 1976, Pub. L. No. 94-455, § 1307(b), 90 Stat. 1520, allows a § 501(c)(3) charity to elect to spend a declining percentage, ranging from 20% to 5% of its overall exempt purpose expenditures for lobbying. Up to a quarter of this permissible lobbying expenditure may be used for grassroots lobbying. See text accompanying notes 225-234, infra.

\(^9\) This equal protection argument is one of the issues currently being litigated in National Ass'n of Mfrs. v. Blumenthal, No. 78-0874 (D.D.C., filed May 16, 1978), discussed infra at text accompanying notes 223-241.

\(^10\) Although a grassroots lobbying campaign may merely request that the recipient express his support of the campaign's objectives by mailing his congressman a form letter, the individual's response has been characterized as "the purest form of the right to petition the government." *Hearings, supra* note 4, at 375 (Statement of David E. Landau, Counsel, American Civil Liberties Union).

\(^11\) The proposition that corporate political speech is protected by the first amendment was firmly established by the Supreme Court's recent decision in First Nat'l Bank v. Bellotti, 435 U.S. 765 (1978), discussed infra at text accompanying notes 192-204.

\(^12\) "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. CONST., amend. XVI.

arguably could be deductible. In response to congressional pressure, the IRS recently issued four revenue rulings which clarify the meaning of “grassroots”. These rulings define the boundaries of deductible trade association communications, and make clear that lobbying solicitations are not deductible if they attempt to develop a grassroots point of view by words, pictures, or other means, even in the absence of an explicit request to contact legislators.

Corporate observers have nevertheless challenged the revenue rulings by claiming that they enlarge the scope of nondeductible activities beyond the prohibitions of the Internal Revenue Code. These critics argue that the rulings impose unauthorized additional costs which would curtail, and in some cases halt, corporate grassroots lobbying communications.

It is thus apparent that the tax status of corporate grassroots lobbying expenses raises significant policy issues. This comment assesses the current status of these expenses in light of the history of the Internal Revenue Code section 162(e)(2)(B) and the effectiveness of recent corporate grassroots lobbying endeavors.

I. GRASSROOTS LOBBYING DEFINED

A. Evolution of the “Tax Neutrality” Premise

“Deductions are a matter of grace, not of right.” This oft-repeated maxim is the key to understanding the vagaries of tax law. In the exercise of its constitutionally granted taxing power, Congress possesses unfettered discretion to grant or deny deductions as it chooses. In 1913, Congress first exercised this discretion by providing a deduction for “necessary” business expenditures in determining taxable net income. Later codified as a deduction for all “ordinary and necessary” business expenses, these

14. The IRS' “panicky” reaction to the investigation conducted by the House Subcommittee on Commerce, Consumer, and Monetary Affairs is discussed in Owen, Grassroots Lobbying Activities—Examining the IRS' Reaction, Legal Times of Washington, July 20, 1978, at 13, col. 3.
16. The question of whether these Revenue Rulings properly interpret § 162(e)(2)(B), and the underlying issue of that section’s constitutionality in light of the first amendment, are also being litigated in National Ass’n of Mfrs. v. Blumenthal, supra note 9. These issues are discussed in detail at text accompanying notes 175-241 infra.
Influencing the Public

deductions encompass a wide variety of corporate expenditures that are “appropriate and helpful” and do not frustrate sharply defined national or state policies. It is apparent that the purpose of this deduction was to promote free enterprise by insuring that businesses are taxed only on income in excess of operating costs. In spite of the impact that grassroots lobbying expenditures could have upon the growth of corporate activities, they have traditionally been excluded from “ordinary and necessary” business expenses.

Section 162(e)(2)(B) of the Internal Revenue Code disallows a deduction for any amount “paid or incurred in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums.” Early Treasury Regulations disallowed deductions “for lobbying expenses, the promotion or defeat of legislation, and the exploitation of propaganda other than trade advertising.”

The historical reasons for denying a deduction for these activities are unclear. The proscription originally appeared in regulations primarily addressed to the denial of corporate deductions for charitable contributions, and initially may have been considered a restriction on deductions for such contributions rather than for business expenditures. While the Revenue Act of 1934 did not prohibit the deduction of lobbying expenditures as business expenses, it did restrict the tax exemption for charitable organizations. Only those organizations which did not engage in substan-

21. “Ordinary” has been defined primarily in the negative to refer to those expenses that are not incurred to acquire capital assets, Midland Empire Packing Co. v. Commissioner, 14 T.C. 635 (1950), are not personal, Smith v. Commissioner, 40 B.T.A. 1038 (1939), aff’d without opinion, 113 F.2d 114 (2d Cir. 1940), and do not contravene public policy, Commissioner v. Heininger, 320 U.S. 467, 473 (1943). “Necessary” has been construed as imposing only the minimal requirement that the expenses be “appropriate and helpful” to the taxpayer’s business, Welch v. Helvering, 290 U.S. 111 (1933).


23. The previous administrative provisions are contained in T.D. 2137, 17 Treas. Dec. Int. Rev. 48, 57-58 (1915); Treas. Reg. 33, art. 143 (1918); Treas. Reg. 62, art. 562 (1922); Treas. Reg. 74, art. 262 (1931); Treas. Reg. 101, arts. 23(o)-1, 23(q)-1 (1938); and Treas. Reg. 118, §§ 39.23(o)-1(f), 39.23(q)-1(a) (1953).


25. See Cooper, supra note 22, at 805.
tial propaganda or other attempts to influence legislation were allowed to remain tax exempt and receive deductible contributions.\textsuperscript{26} When allowance of the charitable contribution deduction was extended to corporations in 1935, this lobbying limitation was included.\textsuperscript{27} Thus, the early regulatory prohibition against lobbying as an ordinary and necessary business deduction may have been confused with the statutory disallowance of deductions for charitable contributions to organizations engaged in lobbying. In turn, this confusion may have led courts to believe that there existed a statutory basis for the regulation when apparently there was none.\textsuperscript{28}

The correct interpretation of the statutory prohibition on tax exempt charities' lobbying activities was established in Judge Learned Hand's opinion in \textit{Slee v. Commissioner of Internal Revenue}.\textsuperscript{29} This case involved the denial of a deduction for the taxpayer's gifts to the American Birth Control League. The Second Circuit ruled that since the League had included among its declared objects the enlistment of legislative support to effect the repeal of laws dealing with the prevention of conception, its purposes were not exclusively charitable, scientific or educational.\textsuperscript{30} Therefore, contributions to the League were denied deductibility.\textsuperscript{31} Had the League's political activities been limited to attempts to relieve itself of legal restraints in order to better conduct its charity, a deduction would have been permissible. The more general nature of those activities, however, precluded its purposes from qualifying as the requisite exclusively charitable, educational or scientific character.\textsuperscript{32} The court determined that: "[P]olitical agitation as such is outside the statute, however innocent the aim. . . . Controversies of that sort must be conducted without public subvention; the Treasury stands aside from them."\textsuperscript{33} Thus, although the holding of \textit{Slee} was limited to construction of the statute regulating deduction of charitable contributions, its announcement of the "tax neutrality premise" was significant to the corporate grassroots lobbying issue.

\textsuperscript{26} The statute further required the organization to be established and operated exclusively for religious, charitable, scientific, literary or educational purposes to qualify for exemption and deductible contributions. Revenue Act of 1934, ch. 277, \S 23(o)(2), 48 Stat. 690. The current parallel provisions are I.R.C. \S\S 170(c)(2) (deductible charitable contributions) and 501(c)(3) (tax exempt charitable organizations).

\textsuperscript{27} Revenue Act of 1935, ch. 829, \S 102(c), 49 Stat. 1016, \textit{adding} \S 23(r), which appeared as Int. Rev. Code of 1939, ch. 1, \S 23(g), 53 Stat. 15. The lobbying limitation on charitable deductions is currently codified at I.R.C. \S 170(c)(2)(D).

\textsuperscript{28} \textit{See} Liles, \textit{supra} note 22, at 1167.

\textsuperscript{29} 42 F.2d 184 (2d Cir. 1930).

\textsuperscript{30} \textit{Id.} at 184-85.

\textsuperscript{31} \textit{See} note 26, \textit{supra}, explaining the statutory standards for deductible contributions.

\textsuperscript{32} 42 F.2d at 185.

\textsuperscript{33} \textit{Id.}
Also apposite was *Grosjean v. American Press Co.*, a case examining the constitutionality of a state license tax imposed upon newspapers selling advertising with circulations in excess of 20,000 copies weekly. The tax was challenged as an abridgement of freedom of the press in contravention of the due process clause and a denial of the equal protection of the laws. The Supreme Court reiterated that, while a corporation is not a "citizen" within the meaning of the privileges and immunities clause, it is a "person" meriting protections under the equal protection and due process clauses. Looking at the effect of the tax, the Court noted that it created a double restraint: first, by curtailing the amount of revenue realized from advertising, and second, by restricting circulation. Drawing an analogy to the role that British "taxes on knowledge" had played in fomenting the American Revolution and in precipitating adoption of the first amendment, the Court held the taxes invalid. That early invidious use of taxation had made evident that "mere exemption from previous censorship was . . . too narrow a view of the liberty of the press." The words "Congress shall make no law . . . abridging the freedom of speech, or of the press . . ." were thus found to bring within their scope the modes of restraint embodied by these forms of taxation. Since the state license tax was "a deliberate and calculated device in the guise of a tax to limit the circulation of information," it was found to violate the first amendment as applied to the states by the fourteenth. The Court concluded that the tax was unconstitutional under the due process clause because it impermissibly abridged the freedom of the press.

34. 297 U.S. 233 (1936).
35. The question presented by *Grosjean* was whether the state license tax violated the fourteenth amendment's provisions that "[n]o State shall . . . deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." U.S. CONST. amend. XIV, § 1.
36. 297 U.S. at 244 (citing Paul v. Virginia, 75 U.S. (8 Wall) 168 (1868), regarding the privileges and immunities clause ("No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States." U.S. CONST. amend. XIV, § 1, and Covington & Lexington Turnpike Rd. Co. v. Sandford, 164 U.S. 578, 592 (1896), and Smyth v. Ames, 169 U.S. 466, 522 (1897), regarding the equal protection and due process of law clauses.)
37. 297 U.S. at 244-245.
38. *Id.* at 246. In 1712, the British Parliament levied a tax on advertisements and, in 1765, imposed a stamp tax on newspapers sent to the colonies. Revenue, however, was only a subordinate concern; the dominant motive was to prevent dissemination of information on governmental affairs.
39. *Id.*
40. *Id.* at 248.
41. *Id.* at 250.
42. The Court found it unnecessary to consider whether the tax constituted a denial of the equal protection of the laws. *Id.* at 251.
Although the Supreme Court in *Grosjean* carefully scrutinized the impact of a state license tax upon the constitutional guarantee of a free press, early judicial interpretation of the regulations denying businesses a deduction for lobbying activities gave no consideration to first amendment issues. Initially, courts interpreted the regulations to allow deductions if the activities involved were not illegal, illegitimate, or unethical. Nevertheless, these early decisions turned not only on the legality of the expenditures, but on the fact that they were ordinary and necessary to the taxpayers' businesses. In *Los Angeles & Salt Lake R. Co. v. Commissioner*, the Board of Tax Appeals allowed a railroad to deduct a goodwill campaign undertaken in anticipation of railroad deregulation, reasoning that the expenditure was vitally connected with the railroad's business. Similarly, the Fifth Circuit allowed an attorney to deduct the costs incurred in successfully advocating proposed legislation before the Alabama governor and state legislature in *Lucas v. Wofford*. As in *Salt Lake Railroad*, the court regarded the activities as an integral business expense and distinguished them from lobbying.

This trend toward deductibility was reversed by *Sunset Scavenger Co. v. Commissioner*, which disallowed deductions for expenses incurred by a garbage collectors' association to prevent passage of unfavorable legislation. The Court reasoned that by reenacting the business expense provision without adding a deduction for lobbying expenses, Congress had declared the administrative interpretation consistent with the intent of the statute. Thus, the ambiguous reenactment rule of statutory construction was employed to broaden the interpretation of the regulation, invalidating the deduction of lobbying expenses arguably ordinary and necessary to the taxpayer's business.

The question of the regulation's scope reached the Supreme Court in *Textile Mills Security Corp. v. Commissioner*, which presented a persuasive fact situation for upholding the broader interpretation. An American

---

43. 18 B.T.A. 168 (1929).
44. 49 F.2d 1027 (5th Cir. 1931).
45. 84 F.2d 453 (9th Cir. 1936), rev'g 31 B.T.A. 758 (1934). This decision noted the results in *Lucas*, 49 F.2d 1027 (5th Cir. 1931), and *Salt Lake Railroad*, 18 B.T.A. 168 (1920), but pointed out that in both of those cases the effect of the regulation had been disregarded entirely, and that they were therefore not sound authority. 84 F.2d at 457.
46. Id. Under the reenactment rule, legislative silence in reenacting a statute that has been interpreted administratively indicates approval of the administrative interpretation. The doctrine is based on the unreliable assumption that Congress read and approved the predecessor regulation before reenacting the law. Spiegel, *Deductibility of Lobbying, Initiative and Referendum Expenses: A Problem for Congressional Consideration*, 45 CALIF. L. REV. 1, 10 (1957).
47. 314 U.S. 326 (1941).
corporation, hired by German textile interests to secure passage of legislation permitting recovery of properties seized during World War I, sought to deduct salaries paid to a publicist and two lawyers involved in this campaign. The Court dismissed the argument that the regulation did not apply because it appeared under the charitable contribution section rather than under the business deduction section of the Code. Further, the Court determined that the Treasury had neither usurped the legislative function nor contravened any congressional policy by segregating this particular group of expenses and declaring them nondeductible. Like the Ninth Circuit in *Sunset Scavenger*, the *Textile Mills* Court did not address any first amendment considerations.

The relationship between taxation and first amendment rights was defined with clarity, however, in *Speiser v. Randall*. This decision overturned a California statute requiring the taking of a loyalty oath as a condition for a property tax exemption. The Court’s ruling was based on the precept that discriminatory denial of an exemption for engaging in speech is a limitation on free speech. The Supreme Court stated that the denial of an exemption to parties who engaged in certain forms of speech penalized them for such speech, and further, that it deterred them from engaging in the speech as if a fine had been imposed in violation of protected constitutional guarantees. The Court rejected the argument that because a tax exemption is a privilege rather than a right, its denial would not infringe speech; accordingly, it ruled that the denial was “frankly aimed at the suppression of dangerous ideas.”

*Speiser’s* holding, however, rested on narrow, procedural grounds. The Court assumed, without deciding, that the state could deny tax exemptions to persons engaging in proscribed speech, and focused its inquiry only on the procedural safeguards accorded protected speech. While the purpose

---

48. *Id.* at 338. The regulation in question, Treas. Reg. 74, art. 262, promulgated under the 1928 Act, was entitled “Donations by Corporations” and provided: “Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income.”


51. *Id.* at 519 (quoting *American Communications Assn. v. Douds*, 339 U.S. 382, 402 (1950)).

52. See text accompanying notes 40-42 *supra*.

53. 357 U.S. at 520.
of the oath had been to relieve the tax assessor of the burden of ascertaining the facts, it had placed a burden on the appellants to justify their claim of exemption. Since the burden of proving his speech outside the proscribed category rested on the taxpayer throughout the entire judicial process, the Court held that the California provision did not provide adequate procedural due process to defend constitutionally protected speech. Analogizing to an alleged criminal’s right to retain his liberty until proven guilty, the Supreme Court held that “when the constitutional right to speak is sought to be deterred by a State’s general taxing program due process demands that the speech be unencumbered until the State comes forward with sufficient proof to justify its inhibition.” This holding affirmed the due process principles announced in *Grosjean*.

Although *Speiser* demonstrated that the grant of a tax exemption could not be conditioned so as to chill constitutionally protected speech, it did not consider whether the regulations’ denial of a deduction for corporate grassroots lobbying expenses imposed an unconstitutional restriction on protected speech. Furthermore, the narrow facts of *Textile Mills* raised doubt as to whether the regulations proscribed the deduction of grassroots lobbying expenses under all circumstances. These questions were resolved by the Supreme Court’s opinion in *Cammarano v. United States*.

In *Cammarano* and its consolidated companion case, *F. Strauss & Son, Inc. v. Commissioner*, wholesale liquor distributors had deducted dues paid to trade associations that waged statewide publicity campaigns aimed at persuading voters to defeat referenda to establish state-owned liquor stores and prohibition. The Commissioner’s disallowance of the deductions was affirmed by the District Court in *Cammarano* and the Tax Court in *Strauss*, and by both courts of appeals. The liquor distributors made four arguments for reversal. First, they contended that expenditures made to promote or defeat the passage of legislation through persuasion of the general public were distinguishable from expenditures made to influence legislative bodies directly. The regulations could not

54. *Id.* at 517. The Court distinguished cases holding valid the loyalty oaths required of public employees because in those cases “there was no attempt directly to control speech but rather to protect, from an evil shown to be grave, some interest clearly within the sphere of governmental concern.” *Id.* at 527.

55. *Id.* at 528-29.


60. *Cammarano v. United States*, 246 F.2d 751 (9th Cir. 1957); *F. Strauss & Son, Inc. v. Commissioner*, 251 F.2d 724 (8th Cir. 1958).
properly be construed as applicable to the expenses of running a campaign aimed at the voters. Second, they suggested that the regulations in any case were inapplicable in connection with initiative measures. Third, they maintained that expenditures incurred to prevent the liquidation of a business were clearly "ordinary and necessary" under the business deduction section of the Code, rendering the regulations invalid as contrary to the Code. Finally, they argued that the regulations were unconstitutional under the first amendment.

The Court responded to the first argument by stating that Textile Mills could not be read to limit the regulations to direct dealings with legislators because the deductions at issue in that case included publicity expenditures. Furthermore, the courts of appeals had consistently applied the regulations to expenditures for publicity directed to the general public on legislative matters. The Court also observed that such a reading would make the entire regulation, except for the reference to "lobbying", mere surplusage. The distributors' second argument fared no better. Initiatives were held to be "legislation" within the meaning of the regulations because, had they been passed, the measures involved would have had the force of law as much as if they had been enacted by the legislature. The Court also noted that all prior courts considering the issue had found the regulation applicable to referenda.

62. 358 U.S. at 504.
63. Id.
64. Id. at 505 (citing Revere Racing Ass'n v. Scanlon, 232 F.2d 816 (1st Cir. 1956) (deductions disallowed for expenditures by dog-racing corporation to persuade majority of voters to vote the affirmative on whether system of pari-mutuel betting should be permitted in the county)); American Hardware & Equip. Co. v. Commissioner, 202 F.2d 126 (4th Cir. 1953) (contributions to tax association organized to carry on propaganda with ultimate objective of revision in tax structure held not deductible); Roberts Dairy Co. v. Commissioner, 195 F.2d 948 (8th Cir. 1952) (disallowed deductions for Dairy's contributions to nonprofit organization established to conduct research on disparities in tax status of competitor dairies and to disseminate information).
65. 358 U.S. at 505. This judicial comment is significant in light of the Court's prior decisions in United States v. Rumely, 345 U.S. 41, 47 (1953), and United States v. Harriss, 347 U.S. 612, 620 (1954) holding that the term "lobbying", as used in the Federal Regulation of Lobbying Act, 2 U.S.C. §§ 261-270 (1976), is to be construed to refer only to "lobbying in its commonly accepted sense" of direct communication with members of Congress on pending or proposed legislation, and not as extending to attempts "to saturate the thinking of the community."
66. 358 U.S. at 505-06.
67. Id. at 506 (citing Revere Racing Ass'n v. Scanlon, 232 F.2d 816 (1st Cir. 1956)); Old Mission Portland Cement Co. v. Commissioner, 69 F.2d 676 (1934), aff'd on other grounds, 293 U.S. 289 (1934) (contribution by cement company to fund to promote state-wide referendum for increased gasoline sales tax levy held not deductible); Mosby Hotel Co. v. Com-
The Court also disagreed with petitioners' third and primary contention that expenditures incurred to preserve a business from destruction were deductible as ordinary and necessary business expenses as a matter of law. Distinguishing prior Supreme Court precedent in which a mail-order dentist was able to deduct attorney's fees incurred in defending against a postal fraud charge that would have terminated his business, the Cammarano Court emphasized the "sharply defined national or state policies" clearly expressed by the regulation in the instant case. The Ninth Circuit in Sunset Scavenger, the Court also drew on the reenactment doctrine to validate the interpretation of the regulation denying deductibility for these expenses. The Court relied upon congressional denial of an exemption to otherwise tax exempt charitable organizations that engage in lobbying activities, as well as upon the parallel denial of deductions to individuals and corporations contributing to such organizations as further evidence of a statutory policy. In interpreting this congressional action as statutory authority to deny business expense deductions for lobbying expenses, the Cammarano Court overlooked the fact that Congress had never placed a similar lobbying limitation on the tax exemption of trade associations or labor unions. Those organizations were allowed to remain tax exempt regardless of the extent or type of lobbying they practiced. Thus, the Court's conclusion that the regulations codified the tax neutrality premise announced by Judge Hand in Slee rested on no statutory foundation.

With respect to the liquor distributors' fourth argument that the regulation presented a constitutional issue under the first amendment, the Court replied that:

Petitioners are not being denied a tax deduction because they

missioner, 23 T.C.M. (P-H) ¶ 54,288 (1954) (contributions to organization formed to secure repeal of Kansas prohibition laws held not deductible); McClintock-Trunkey Co. v. Commissioner, 19 T.C. 297 (1952), rev'd on other grounds, 217 F.2d 329 (9th Cir. 1954) (contributions to Good Roads Association and Taxpayer's League, associations that engaged in lobbying activities, held not deductible).

69. 358 U.S. at 508.
70. 84 F.2d 453 (9th Cir. 1936), discussed in text accompanying notes 45 and 46 supra.
71. 358 U.S. at 510.
72. 314 U.S. 326 (1941), discussed in text accompanying notes 47-49, supra.
74. Int. Rev. Code of 1939, Ch. 1, §§ 101(1) and (7), 53 Stat. 33 (current version at I.R.C. §§ 501(c)(5) and (6)) did not condition these organizations' exemptions on abstention from political activity.
75. 358 U.S. at 512. See text accompanying notes 33 supra.
engage in constitutionally protected activities, but are simply being required to pay for those activities entirely out of their own pockets, as everyone else engaging in similar activities is required to do under the provisions of the Internal Revenue Code. Non-discriminatory denial of deduction from gross income to sums expended to promote or defeat legislation is plainly not 'aimed at the suppression of dangerous ideas.' Rather, it appears to us to express a determination by Congress that since purchased publicity can influence the fate of legislation which will affect, directly or indirectly, all in the community, everyone in the community should stand on the same footing as regards its purchase so far as the Treasury of the United States is concerned.76 (Citations omitted.)

The petitioners had based their first amendment argument on the Speiser opinion. Although the facts of Cammarano appear to be analogous, close examination of the two cases shows that they are more than nominally distinguishable. The denial of an exemption in Speiser was clearly aimed at the suppression of "dangerous ideas"77 and imposed a special tax only on those who refused to disavow advocacy of the overthrow of the United States government. Cammarano, on the other hand, did not discriminate against a particular type of constitutionally protected speech on the basis of content, but merely denied deductions to all businesses for their expenses incurred in attempts to influence legislation. The decision was thus distinguishable from Grosjean as well. The license tax at issue in that case was found to violate the first amendment because it was designed to restrict speech on the basis of the speaker's identity.78 The deduction disallowance approved in Cammarano, however, did not create such a prior restraint but left all businesses equally free to voice any political opinion.

The absence of a first amendment violation was underscored by Justice Douglas' concurrence. He observed that if Congress had denied all deductions for "ordinary and necessary" expenses to businesses spending money to promote a legislative view, it would have placed a penalty on the exercise of first amendment rights coextensive with that invalidated in Speiser. Since Congress had disallowed only some of these expenses in

76. Id. at 513.
77. 358 U.S. at 519.
78. In Grosjean, the Court invalidated a tax imposed solely upon newspapers of a certain size and character — those most effective in conveying information to the public. But the Grosjean Court specifically cautioned:

It is not intended by anything we have said to suggest that the owners of newspapers are immune from any of the ordinary forms of taxation for support of the government. But this is not an ordinary form of tax, but one single in kind, with a long history of hostile misuse against the freedom of the press. Grosjean v. American Press Co., 297 U.S. 233, 250 (1936).
Cammarano, it followed that such a penalty had not been realized. Douglas emphasized that deductions are a matter of discretion, not of right.\textsuperscript{79} He also stressed that a decision permitting a deduction for expenses incurred to influence public opinion would endorse the dubious view that first amendment rights cannot be fully realized unless subsidized by the government through tax exemptions. This proposition was found to contradict prior Supreme Court decisions,\textsuperscript{80} and to conflict with the premise that first amendment rights are most effectively realized when the government maintains a completely hands-off policy toward speech.\textsuperscript{81}

Cammarano's introduction of the "tax neutrality" policy into the field of business deductions was further justified by the unique nature of expenses designed to influence legislation.\textsuperscript{82} The amount of money that can be spent to promote or defeat legislation and be deducted for tax purposes was and remains a matter of concern to the extent that it allows parties possessing inordinate wealth to deduct the purchase of legislation supporting their interests. Recognizing that the right of the people to petition the government for redress of grievances is paramount, the Court decided that this right, along with the purity of the legislative process and the integrity of the tax structure, could be preserved only by denying businesses a deduction for these expenses. While the tax neutrality premise did not ensure that all points of view would be accorded equal consideration, it guaranteed that presentation of one would not be subsidized at the expense of any other. Cammarano was thus correctly distinguishable from Speiser and Grosjean because, although its denial of a deduction might inhibit first amendment speech, the denial was not discriminatory.

B. Development of the Statutory Framework

In the wake of the Cammarano decision, the IRS instituted a program of vigorous enforcement of the lobbying regulations, including revision of the regulations to incorporate the novel aspects of Cammarano.\textsuperscript{83} For the

\textsuperscript{79} 358 U.S. at 515 (Douglas, J., concurring).
\textsuperscript{81} 358 U.S. at 515-16 (Douglas, J., concurring) (citing McCollum v. Board of Education, 333 U.S. 203 (1947)).
\textsuperscript{82} It is important to remember that the regulation interpreted in Cammarano disallowed deductions for expenditures for appearances before and submissions to Congress and other legislatures as well as expenditures incurred to influence the public.

For cases following Cammarano, see Barkett v. Commissioner, 31 T.C. 126 (1959) (tax-
most part, the revision did little to clarify existing law. The indefinite terms "lobbying" and "promotion or defeat of legislation" were retained, but "propaganda" was limited only to propaganda related to those two proscribed activities. The new regulation allowed deductions for "institutional advertising" but provided no definitional guidelines. In addition, ambiguous rules were added concerning the deductibility of dues paid to trade associations. Dues were deductible in full, provided that a "substantial part" of the organization's activities did not constitute "lobbying". When "substantial lobbying" took place, however, the taxpayer was allowed to deduct only that portion of the dues attributable to other activities. The burden of proof as to the allocation was placed on the taxpayer.

Before the enforcement program could be fully developed, Congress passed the Revenue Act of 1962, adding section 162(e) as the first legislative pronouncement on the issue of lobbying expense deductions. This section completely upset the tax equilibrium policy by allowing a business expense deduction for all ordinary and necessary expenses incurred in connection with direct lobbying. Congress lifted the ban on deductibility of these lobbying activities in order to create a parity with expenses incurred in communications with the executive branch and in litigation before the taxpayer.

84. Compare this de minimis rule with the all or nothing approach taken by the Tax Court in McClintock-Trunkey Co. v. Commissioner, 19 T.C. 297 (1952), rev'd on other grounds, 217 F.2d 329 (9th Cir. 1954).
85. Deduction of special assessments collected specifically for lobbying purposes was also disallowed. Treas. Reg. § 1.162(c)(2) (1960).
86. I.R.C. § 162(e)(1). The full text of the section reads:

(1) IN GENERAL.—The deduction allowed by subsection (a) shall include all the ordinary and necessary expenses (including, but not limited to, traveling expenses described in subsection (a)(2) and the cost of preparing testimony) paid or incurred during the taxable year in carrying on any trade or business—

(A) in direct connection with appearances before, submission of statements to, or sending communications to, the committees, or individual members, of Congress or of any legislative body of a State, a possession of the United States, or a political subdivision of any of the foregoing with respect to legislation or proposed legislation of direct interest to the taxpayer, or

(B) in direct connection with communication of information between the taxpayer and an organization of which he is a member with respect to legislation or proposed legislation of direct interest to the taxpayer and to such organization, and that portion of the dues so paid or incurred with respect to any organization of which the taxpayer is a member which is attributable to the expenses of the activities described in subparagraphs (A) and (B) carried on by such organization.
judicial branch, both of which were deductible. The House Ways and Means Committee Report stated that the prior rule might have discouraged businessmen from passing on to legislators information concerning the impact of present or proposed laws on their businesses, information essential to the proper evaluation of any legislation. The Committee further stated that such a deduction was necessary to determine real income for tax purposes because direct lobbying activities could be essential to a business' survival. Thus, to some extent, Congress intended section 162(e)(2)(A) to limit the applicability of Cammarano.

This congressional endorsement of a lobbying subsidy was significant in light of the legislature's familiarity with the less savory aspects of the institution. Traditionally, lobbying has been associated more with self-interest than with the public weal. Lobbying operates with such secrecy as to make it difficult to oppose the sponsor's point of view, and persuades through personal appeal rather than by a convincing demonstration of the merits. Prior congressional response to lobbying had evinced displeasure with these characteristics: Congress had initiated several investigations into lobbying, all of which were critical, and had enacted legislation requiring disclosure and periodic reports by lobbyists.

Further analysis of the legislative history of section 162(e), however, provides at least limited insight to Congress' changed attitude toward lobbying. The original House bill preserved the tax neutrality policy. The provision allowing deduction of direct lobbying expenses was added by the House Ways and Means Committee for the reasons presented in its report, but in the Senate, Senator Douglas trenchantly criticized the departure from the neutrality premise as an unwarranted tax reduction, provided where least needed. In his opinion, the discrimination between business and nonbusiness lobbying expenses was impossible to justify be-

89. See Weaver, supra note 22 at 946.
92. See text accompanying notes 87 and 88, supra. The bill was then passed by the House under a closed rule which prohibited amendments and allowed a vote only for or against the bill as a whole, thus foreclosing significant debate on the amendment. 108 Cong. Rec. 5433 (1962). See also 108 Cong. Rec. 18486-87 (1962) (remarks of Sen. Douglas).
93. 108 Cong. Rec. 17768 (1962) (remarks of Sen. Douglas). Douglas also criticized the language of the section, describing it as full of "ambiguities which will create continuing uncertainty as to its exact meaning. . ." Id.
because there was no evidence that the tax neutrality rule deterred business taxpayers from lobbying. Such discrimination was made even less attractive by the fact that preferential treatment magnified as the amounts spent for lobbying increased.

In spite of these arguments for the maintenance of tax neutrality, Congress voted to endorse the lobbying subsidy. In this action, Congress may have intended to establish a different type of neutrality: since the government, as the nation's largest lobbyist, used the taxpayer's money to advocate legislation harmful to particular businesses, equity demanded that business funds used in advocating the opposing position be deductible. Congress also found it desirable to afford small businesses, for whom nondeductibility of lobbying expenses was a genuine hardship, a better opportunity to present their views.

Despite this generally indulgent attitude, the Senate rejected a provision of the bill that allowed a business deduction for expenses incurred as a result of communications with employees or stockholders about legislation of direct interest to the business. The provision had been adopted by the Senate Finance Committee after a proposed extension of deductibility for communications to the general public was rejected. The Committee had concluded that such communications to shareholders and employees were vital to businesses and therefore should be deducted as an ordinary and necessary business expense. During the floor debates, Senator Proxmire stated that the motion to strike the provision raised the question of why it would be a necessary expense to tell shareholders or employees about proposed legislation unless the business wished them to put pressure on a leg-

94. The Senate amendment to strike section 3 (section 162(e)(1)(A) from the bill was defeated 51-13. 108 CONG. REC. 18498 (1962). It appears that the lack of statutory authority for the neutrality premise, its inapplicability to lobbying before executive agencies, and business' general success in actually deducting these costs through ignorance of the rules, indifference to them, or inadequate recordkeeping were the decisive considerations. See 108 CONG. REC. 18486-87 (1962) (remarks of Sen. Douglas); and Weaver, supra note 22, at 952.

95. Webster, Expenses with Respect to Legislative Matters, 48 A.B.A.J. 774 (1962). It is interesting to note that both the Kennedy and Eisenhower administrations opposed the measure. 108 CONG. REC. 17768 (1962) (remarks of Senator Proxmire).


97. 108 CONG. REC. 18496 (1962). The rejected amendment would have allowed deductions "[i]n direct connection with communication of information between the taxpayer and an employee or stockholder with respect to legislation or proposed legislation of direct interest to the taxpayer." 108 CONG. REC. 18491 (1962).

98. Prior to consideration of H.R. 10650, Congress had reviewed three bills that would have made the cost of all efforts to influence legislation—except political contributions—tax deductible. In the second session of the 86th Congress, the House Ways and Means Committee reported favorably H.R. 2173, H.R. 610 and H.R. 6101, submitted in the 87th Congress, were never reported from committee. Weaver, supra note 22, at 952.

islature to take particular action.\textsuperscript{100} By rejecting the amendment,\textsuperscript{101} the Senate appears to have concluded that management's responsibility to keep stockholders and employees informed of legislation affecting their business was not of sufficient magnitude to make the cost of such communications deductible in light of its potential for grassroots lobbying solicitation.\textsuperscript{102} Moreover, this decision indicates that Congress intended shareholders and employees to be part of "the general public" for the purposes of section 162(e)(2)(B). It is clear from the section's language that section 162(e)(2)(B), unchallenged on the floor or in committee, was intended only as a limitation on the changes effected by section 162(e)(1):

(2) Limitation—the provisions of paragraph (1) shall not be construed as allowing the deduction of any amount paid or incurred (whether by way of contribution, gift, or otherwise)—

(A) for participation in, or intervention in, any political campaign on behalf of any candidate for public office, or

(B) in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums.\textsuperscript{103}

The primary interpretation advanced for the disparate treatment accorded direct and indirect lobbying expenses turns on the relative sophistication of their respective audiences. In direct lobbying, money is less likely to be a decisive factor because Congressmen are presumed to be familiar with the subtleties of the legislation at hand and aware of the interests represented. At the grassroots level, however, arguments are more likely to be oversimplified and directed toward emotions rather than reason. The sheer volume of propaganda afforded by a larger purse conceivably could make a substantial difference in the public perception of an issue.

In this context, the House Ways and Means Committee Report\textsuperscript{104} can be viewed to imply that Congress, because of its expertise, regarded itself, rather than the general public, as the appropriate party to be petitioned for aid in business-related matters. Indeed, the deduction allowance is designed to encourage businesses to present their views on legislation affecting their interests, which in turn enhances congressional expertise. The

\textsuperscript{100} Id. at 18494 (remarks of Sen. Proxmire).

\textsuperscript{101} This provision (section C) of section 3 was defeated by a vote of 40 to 29. Id. at 18496.

\textsuperscript{102} Senator Miller opined that such expenses would be deductible under the tax laws then in effect. He drew a distinction between supplying information to shareholders and appealing to them to write to their Congressmen concerning particular bills. Id. at 18494.

\textsuperscript{103} I.R.C. § 162(e)(2).

\textsuperscript{104} H.R. Rep. No. 1447, 87th Cong., 2d Sess. 17 (1962), discussed at text accompanying notes 87-88 supra.
benefits of the deduction are therefore mutual: the business gets a deduction because the expenditure is in fact helpful—and therefore "necessary"—to its business activities, and Congress receives more information on which to base its decisions. Indirect lobbying does not offer this advantage because businesses solicit only grassroots expression of their own views. Consequently, Congress does not benefit by receiving additional, varied and informative opinions.

Unfortunately, the language of 162(e)(2)(B) provides little clue to the specific grassroots lobbying activities at which it is aimed. It has, in fact, lived up to the criticism Senator Douglas leveled at 162(a)(1)’s allowance of deductions for direct lobbying: the ambiguous language of the provision has created continuing uncertainty as to its true meaning, and, more importantly, to its relationship to the entire process by which citizens seek to influence legislation at all levels of government. While subsequent regulations under section 162 have attempted to define the terms "general public" and "legislative matters," they have by no means succeeded in clarifying the scope of the section.

C. Administrative and Judicial Interpretations Following Promulgation of Section 162(e)

The first case of any consequence after the enactment of section 162(e) was Southwestern Electric Power Co. v. United States. Decided in 1963, the case relied upon Cammarano’s interpretation of the regulation, rather than the recently-enacted section 162(e). The Southwestern Electric Power Company had launched a series of advertisements in its service area designed to develop a spirit of opposition to a congressionally-approved plan for construction of a publicly-owned competitor power company. The ads claimed that government ownership of electric power companies was contrary to the American system of free business enterprise because it allowed the government to shift its losses to the taxpayers, and would result in socialism and eventual government control. The Court of Claims concluded that since legislation authorizing the federal project had already been passed, the ads were not aimed primarily at promoting or defeating

105. I.R.C. § 162(a).
106. 108 Cong. Rec. 17768 (1962), see note 95 supra.
107. 312 F.2d 437 (Cl. Ct. 1963).
109. 312 F.2d at 440.
Nevertheless, the court ruled that the ads were nondeductible in light of the regulatory language disallowing deductions for expenses incurred in "the exploitation of propaganda, including advertising other than trade advertising." The fact that Southwestern placed its name at the bottom of each advertisement did not render the messages "trade advertising," and, as in Cammarano, the threat of business injury was insufficient to justify a deduction. During the same tax years, Southwestern's officers had appeared before congressional subcommittees, urging the rejection of funds for use in the federal project and questioning the legality of the proposed appropriations. The Court of Claims overruled the Commissioner's decision concerning the nondeductibility of the expenses incurred in making these appearances. The court concluded that a mere appearance before a legislative committee could not be construed as "lobbying", and characterized the appearance contesting the legality of an appropriation as Southwestern's duty. Thus, Southwestern Electric established guidelines for the determination of an advertisement's deductibility and placed significant limitations on the definition of direct lobbying.

Regulation 1.162-15(c), promulgated shortly after Cammarano, added further guidelines concerning the deductibility of advertisements and trade association dues. This regulation disallowed business deductions for the cost of advertising designed to promote or defeat legislation or to influence the public as to the desirability of proposed legislation, even though the legislation might directly affect the taxpayer's business. On the other hand, it also permitted deductions for the expense of institutional or goodwill advertising designed to keep the taxpayer's name before the public, provided the expenditures were related to patronage the taxpayer might reasonably expect in the future. The regulation specifically allowed deductions for the cost of advertisements encouraging contributions to the Red Cross, the purchase of savings bonds and the like, and for ad-

110. Id. at 444.
111. Id. at 442, Treas. Reg. 111, § 29.23(q)-1 (1949).
112. 312 F.2d at 442.
113. Id. at 444. The Court of Claims also noted that the Regulation of Lobbying Act, specifically exempts mere appearances before a Committee of Congress from its definition of lobbying. 2 U.S.C. 267 (1976).
115. For a case relying on this aspect of the regulation, see Pickrick, Inc. v. United States, 65-2 U.S. Tax. Cas. ¶ 9543 (1965) (jury charged that a deduction for advertisements purchased by a restaurant owned solely by Lester Maddox should be denied if made for these purposes).
117. This "Red Cross" provision concerning goodwill advertising can be traced to the
Advertisements presenting views on economic, social and other subjects of a general nature unrelated to pending legislation.

The regulation also acknowledged that a corporation might circumvent the rule by deducting payments to other organizations to conduct grassroots lobbying. Consequently, it provided for the full deduction of dues and other payments to labor unions, trade associations, or similar organizations that otherwise met the requirements of the regulations under section 162, unless a significant part of the organization's activities consisted of grassroots lobbying. If the organization engaged in substantial grassroots activities, the member was allowed a deduction only for that portion of its dues or other payments it clearly could establish were attributable to the organization's other activities. The regulation required that "all the facts and circumstances" be considered in order to determine whether grassroots lobbying constituted a substantial part of an organization's activities. Since the total amount of dues would be deductible unless the recipient organization engaged in "substantial" grassroots lobbying, the regulation created a significant loophole in the enforcement scheme. A business legitimately could deduct all dues paid to an organization that engaged in a small amount of such activities.

The regulation currently in force contains the same basic language, but provides further definitional guidance. Under its provisions, "[l]egislation or proposed legislation of direct interest to the taxpayer" contained in code section 162(e)(1)(A) includes "bills and resolutions introduced by a member of Congress or other legislative action submitted to the legislative body or to a committee or member of such body." To meet the direct interest test, the legislation or proposed legislation must reasonably be expected to affect the trade or business of the taxpayer. Although the actual effect on business is irrelevant to this determination, legislation that has only a remote or speculative effect cannot meet the requisite criteria. Legislation qualifies as being of direct interest to a membership organization if it is of direct interest to the organization itself.

Second World War, when many corporations sold all their products directly to the Government for the military effort, but published advertisements to keep their names before the public. Hearings, supra note 4, at 200 (Testimony of Lester G. Fant, III, Attorney, Cohen & Uretz, Washington, D.C.).

119. Treas. Reg. § 1.162-20; T.D. 6819, 1965-1 C.B. 91, as amended by T.D. 6996, 1969-1 C.B. 88. The provision regarding "institutional" or "good-will" advertising is contained in § 1.162-20(a)(2). The "substantial part" rule concerning deductibility of dues is contained in § 1.162-20(c)(3).
122. Id.
or to one or more of its members. For example, the regulation considers legislation that would improve community services to be of direct interest to local employers because the improvements would make the community more attractive to prospective employees. On the other hand, presentations to Congress opposing a bill on the ground that its passage would prevent reduction of federal taxes would have too speculative an effect to warrant a deduction. The regulation is thus both reasonable and clear in defining which direct lobbying activities are sufficiently "ordinary and necessary" to the management of a business to merit a deduction under 162(e)(1)(A).

In defining nondeductible grassroots lobbying activities, however, the regulation adds nothing to the limited guidance provided by the Internal Revenue Code itself. The treasury regulation merely disallows deductions under section 162(a) for any amounts expended to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums. In addition, it specifies that no deductions shall be allowed for expenses incurred in connection with grassroots campaigns to encourage the public to contact legislators for the purpose of expressing an opinion on legislation.

The regulation applies the direct interest test to dues payments to organizations, and permits the deduction of the portion of such dues paid for direct lobbying activities. Part of the regulation retains almost verbatim, however, the ambiguous "substantial part" test of the 1960 regulation, which took "all the facts and circumstances" into account when determining whether a substantial part of an organization's activities consisted of grassroots lobbying. At one time, the Secretary of the Treasury indicated that a five percent test would be used in measuring substantiality, but did not specify whether the test would apply to man-hours, dollar expenditures, or some other base. More recently, IRS field personnel have

123. Id.
125. Id.
128. Id.
129. See text accompanying note 120, supra.
130. See text accompanying note 118, supra.
133. See Cooper, supra note 22, at 824.
employed a fifteen percent test to determine substantiality.\textsuperscript{134}

IRS enforcement of these current regulations has been minimal\textsuperscript{135} and has provided little aid to their interpretation. In \textit{Consumers Power Company v. United States}, the only reported circuit court case applying the regulations,\textsuperscript{136} the Sixth Circuit did no more than reaffirm \textit{Southwestern Electric}'s principle that corporate political propaganda is nondeductible,\textsuperscript{137} disallowing advertising costs although no legislation was pending. In \textit{Consumers Power}, Consumers, an electric utility company, had paid the Electric Companies Advertising Program its pro rata share of the cost of a national advertising campaign. The purpose of the campaign was twofold: to explain how electricity could make living more comfortable, and to point out the negative features of publicly-owned power companies as compared to privately-owned utilities. The district court disallowed deductions only for the latter category, rejecting Consumer's argument that only the portion of advertising costs proportionate to the total number of words attacking public power should be disallowed.\textsuperscript{138} The court stated that such an interpretation would contravene the regulation, which did not authorize a "cutting and pasting job" on computations of lobbying expenditures.\textsuperscript{139} Without discussing this issue, the Sixth Circuit affirmed, disallowed the advertisements, and deferred to the district court's judgment regarding borderline advertisements.\textsuperscript{140} The circuit court did discuss the regulation's limitations, however, stating that the regulation could not be used to disallow deductions for the costs of competitive message advertisements in a situation where no legislation was pending and a company's chief competitor was governmentally owned.\textsuperscript{141}


\textsuperscript{136} 427 F.2d 78 (6th Cir. 1970), cert. denied, 400 U.S. 925 (1970). W. K. Coors, 60 T.C. 368, 409 (1973), applied the regulation to disallow deductions for "dues and subscriptions" paid to organizations whose purpose the IRS had determined to be to influence legislation. Since Coors introduced no evidence on the issue, the Tax Court sustained the IRS determination. The case does not discuss the type of activities that resulted in the disallowance.

\textsuperscript{137} See text accompanying notes 110-111, supra.


\textsuperscript{139} Id. at 1183-84.

\textsuperscript{140} 427 F.2d 78, 79 (6th Cir. 1970).

\textsuperscript{141} Id. at 79-80.
II. CONGRESSIONAL CONCERN AND THE IRS' RESPONSE

The minimal enforcement of section 162(e)(2)(B) by the IRS came to congressional attention in the early 1970's. The first comprehensive inquiry into the Service's practices regarding grassroots advertising arose in 1974 as a result of hearings conducted by the Senate Subcommittee on the Environment. The subcommittee investigated corporate advertising on energy and environmental issues and the manner in which such advertisements were subsidized through illegal tax deductions.142 A review of advertisements submitted to the subcommittee prompted the late Senator Hart, then Chairman, to write to IRS Commissioner Alexander, requesting a description of existing audit procedures for determining the deductibility of advertising expenditures under section 162(e)(2). Senator Hart also was interested in the extent to which that section had been used to disallow advertising expense deductions over the past five years. Hart inquired whether the IRS found any ambiguity in the current section 162(e)(2) or the regulations thereunder regarding the criteria for deductibility, and requested comment on the tax status of contributions to trade associations made during 1973.143

Commissioner Alexander replied that because the IRS cannot reveal confidential tax information,144 he was unable to discuss the deductibility of the advertisements before the subcommittee. His response closely reflected the regulations when he stated that the determination of deductibility requires “an examination of all of the facts and circumstances surrounding the expenditures involved, and must, of necessity, be made on a case-by-case basis.”145 The Commissioner cited Revenue Ruling 74-407,146 which disallows deductions for grassroots lobbying communications to shareholders, as representative of the principles involved in advertising deductions. As to auditing procedures, Alexander stated that regular procedures were used and that there were no specific guidelines for advertising expenses. The Commissioner could not answer Hart's inquiry as to the extent of violations of section 162(e)(2) because the IRS had not maintained detailed statistical information providing such data. Alexander felt,

145. Letter from Donald Alexander, Commissioner, Internal Revenue Service, to Senator Philip Hart (Nov. 15, 1974), reprinted in Hearings, supra note 4, at 1635. See text accompanying notes 118 & 130, supra.
however, that neither section 162(e)(2) nor the associated regulations were ambiguous. While the Commissioner's "cavalier rejection" of any need for reform was disconcerting in view of the problems discovered during Senator Hart's hearings, Alexander's decision to send the advertisements in question to district directors for their evaluation indicated the possibility of improved enforcement.

At about the same time as the Hart inquiry, Senator Stevenson requested the United States General Accounting Office [GAO] to review the auditing procedures used by the IRS and the Federal Power Commission [FPC] in evaluating "political advertising." Three years passed before the results of GAO's investigation were publicly announced. The GAO found that the FPC consistently had allowed improper cost allocations with respect to political advertising, and its findings regarding the IRS were even more troubling. Like Senator Hart, the GAO encountered the Service's refusal to grant access to audit reports, which handicapped a review of IRS administration of 162(e)(2)(B). The GAO did conclude, however, that the instructions provided by the IRS furnished little guidance to aid auditors in evaluating the political nature of advertisements.

Subsequent to the GAO's report, the House Subcommittee on Commerce, Consumer and Monetary Affairs wrote to the IRS to inquire whether the Service had examined the advertisements submitted by Senator Hart and had reached any conclusions as to their deductibility. The IRS reported that out of the ninety-nine ads it had forwarded to field offices as a result of the Hart inquiry, only four, totalling $133,000, had been disallowed by the Service. The remaining advertisements either had been found allowable or had not yet been evaluated. Thus, nearly four years after the initial Hart inquiry, the IRS had not completed its investigation.

On August 2, 1977, the subcommittee also sent a letter of inquiry to 467 large American corporations requesting information about their "representational activities," defined as "activities to influence legislation, ad-

147. Letter of Donald Alexander, reprinted in Hearings, supra note 4, at 165.
148. Hearings, supra note 4, at 69 (statement of Harvey J. Shulman, Executive Director, Media Access Project).
149. This term was defined to include advertising that would be nondeductible under section 162(e)(2)(B) and/or a "below the line" expense under Account 426.4 of the FPC's Uniform System of Accounts. 16 U.S.C. § 825 (1976).
150. See Hearings, supra note 4, at 71 n.1 (citing Comptroller General of the United States, "Auditing of Political Advertising by Electric Utilities and Gas and Oil Companies" (1976)). Although the GAO dated the report July 16, 1976, it was not publicly released until late 1977.
151. See Hearings, supra note 4, at 71-72 (statement of Harvey J. Shulman, Executive Director, Media Access Project) for a more detailed discussion of GAO's findings.
152. Id. at 166 (Appendix D).
ministrative decision-making and public opinion on public policy issues." This inquiry attempted to ascertain the dollar amounts spent by the companies on these activities in 1976 and part of 1977; whether the companies belong to trade associations that engaged in such activities and, if so, what portion of their trade association dues were included as part of their own lobbying expenses for tax purposes.

The Congressional Research Service analyzed the responses and concluded that the companies may have experienced difficulty in complying with section 162(e)(2) and the corresponding regulations. While this conclusion may be valid, it must be considered in light of the subcommittee's definition of "representational activities," a definition that is broader than the nondeductible activities enumerated in section 162(e)(2)(B). A more accurate conclusion therefore might be that the companies did not employ recordkeeping methods that would facilitate response to the subcommittee's inquiry.

The GAO, as a result of the subcommittee's interest, reexamined IRS guidance in this area to determine whether the Service had made any changes since the GAO had completed its 1976 inquiry. Since the IRS' audit technique handbook remained unchanged, the GAO subsequently recommended that the Service clarify its existing regulations to provide taxpayers and auditors with better definitions for classifying grassroots lobbying expenses for tax purposes. In addition, the GAO suggested that the IRS systematically test the advertising and lobbying practices followed by various industries to determine the extent of noncompliance and the need for corrective action.

153. *Hearings*, supra note 4, at 458 (statement of Suzanne Laurencell, Analyst for Congressional Research Service). The inquiry was addressed to five categories of companies: (1) Fortune 500 companies; (2) banks; (3) gas and electric companies; (4) transportation companies; and (5) miscellaneous.

154. *Id.* at 459. Only 268 (57%) of the companies replied, 98 merely in a pro forma fashion.

155. Congressional Research Service attributed this difficulty to inadequate record keeping practices, confusion concerning the types of activities considered grassroots lobbying, and a lack of awareness of trade association activities. *Id.* at 460.

156. See text accompanying note 153, supra.

157. *Hearings*, supra note 4, at 463 (statement of Rogelio Garcia, analyst for Congressional Research Service). Some respondents did, however, indicate specifically that they kept no separate account for grassroots lobbying activities. *Id.* at 462. Twenty companies also demonstrated confusion concerning the meaning of grassroots lobbying by stating that they did not engage in such activities, but providing information that indicated that they did. *Id.* at 463.

158. The GAO also recommended that the IRS provide its agents with more specific audit criteria, including a listing of advertising themes, for use in segregating grassroots lobbying expenses from allowable deductions. Letter from Richard L. Fogel, Associate Director, General Government Division, Tax Group, U.S. General Accounting Office, to Je-
Influencing the Public

In response to this pressure, the IRS has taken several steps to clarify the rules governing grassroots lobbying expenditures for tax purposes. On February 3, 1978, the Service amended its field manual to abolish the fifteen percent test used to determine whether a trade association engages in substantial grassroots lobbying. Importantly, factors that examiners will now consider in auditing tax-exempt organizations include the percentage of nondeductible expenditures, the dollar level of those expenditures, and the tax consequences to the individual members. Whenever a proposed adjustment will result in a material tax change to the individual member, the IRS may disallow a portion of dues payments, without considering the percentage of an organization's total expenditures attributable to nondeductible grassroots activities. As in the regulations, special assessments for these activities are not subject to allocation but are nondeductible in full.

The IRS further demonstrated its intent to improve the enforcement of section 162(e)(2)(B) by issuing four revenue rulings that clarify many of the ambiguities present in the regulations. Revenue Ruling 78-111 states

rome Kurtz, Commissioner, Internal Revenue Service, (Nov. 9, 1977), reprinted in Hearings, supra note 4, at 230.

159. Audit Survey of "Grassroots" Lobbying and Certain Other Activities Conducted by IRC 501(c)(5) and (c)(6) Organizations, I.R.M. Supp. 7(10)G-26/4(11)G-57 § 6.05 (Feb. 3, 1978). The IRS stated that the purpose of the substantiality requirement was not to provide a safe harbor for grassroots activities, but to preclude de minimis assessments on individual members of an organization.

160. Real estate boards, boards of trade, business leagues, chambers of commerce and the like are tax-exempt under I.R.C. § 501(c)(6). Labor, agricultural, and horticultural organizations are tax exempt under § 501(c)(5). These are the two categories of membership organizations that would render their dues nondeductible under Treas. Reg. § 1.162-20(c)(4) (1965, as amended 1969) by engaging in grassroots lobbying. Both § 501(c)(5) and (c)(6) organizations may engage in any amount of legislative activity without losing their exempt status. Rev. Rul. 61-177, 1961-2 C.B. 117.

161. I.R.M. Supp. 7(10)G-26/4(11)G-57 § 6.05 (Feb. 3, 1978). The IRS also announced as goals for fiscal 1978 mandatory audits for at least two labor unions of varying size per district and at least five percent of the section 501(c)(6) filers in each district, focusing primarily on those with budgets of $500,000 or greater. Id. at §§ 2.04 & 4.04. See Krebs, supra note 134, at 518 for a discussion of the new substantiality standards.

In view of IRS' failure to prosecute violations of section 162(e)(2)(B) (see Hearings, supra note 4, at 240 (statement of Lester G. Fant, III, Attorney, Cohen and Uretz, Washington, D.C.)), this directive to step up enforcement is long overdue. Abolition of the 15% test for substantiality is welcome because it eliminates a loophole. While the new tests employing the percentage of nondeductible expenditures and their dollar level are obviously reasonable, the direction to consider disallowance where it would result in a material tax change to the contributor initially appears unjustified. This provision is necessary, however, because the disallowance is directed at the member/contributor's deductions—not at the organization, which remains tax exempt. The provision thus effectuates the regulation's policy that the member taxpayer should not be allowed to receive, by means of a contribution, a deduction that it could not take if it performed grassroots activities on its own.

that a corporation may not deduct the costs of printing and distributing to its shareholders its president’s remarks before a state legislature expressing the corporation’s opposition to certain proposed legislation.\textsuperscript{163} This ruling is an expansion of Revenue Ruling 74-407,\textsuperscript{164} promulgated in response to Senator Hart’s inquiry, which disallowed deductions for costs incurred in distributing to shareholders copies of a pamphlet suggesting that the shareholders contact their congressmen concerning proposed legislation. Revenue Ruling 74-407 specifically noted that this disallowance was consistent with the Senate’s rejection of the amendment that would have allowed deductions for such communications.\textsuperscript{165} Revenue Ruling 78-111, which states that a corporation may not deduct communications to its shareholders which express the corporation’s views on legislative matters, is significant in that it eliminates the requirement that the corporation request the shareholders to contact their representatives. This decision is realistic in assuming that shareholders possess sufficient sophistication to heed an inferential request to write to their representatives concerning a measure harmful to their corporation. To state the opposite would make it possible for a business to circumvent section 162(e)(2)(B) and Revenue Ruling 74-407 in their entirety merely by omitting any explicit request to contact legislators. Moreover, Revenue Ruling 78-111 is consistent with congressional intent to preclude a deduction for communication of information between a corporation and its employees and stockholders regarding pending or proposed legislation of direct interest to the corporation.\textsuperscript{166}

Revenue Ruling 78-112 concerns nondeductible advertising expenses. In this decision, the IRS ruled that it is unnecessary for an advertisement to request explicitly the general public or a segment thereof to contact their representatives to invoke the sanctions of section 162(e)(2)(B). As long as an advertisement attempts to develop—through words, pictures, or any

\textsuperscript{163} The legislation at issue in the ruling would have required manufacturing companies to meet new antipollution guidelines. The president’s remarks set forth recommendations for an alternative program, and noted that if the proposed bill were passed, the corporation would have to incur substantial capital expenditures to meet the new guidelines. \textit{Id.} at 7.


\textsuperscript{165} 108 CONG. REC. 18491 (1962). \textit{See} discussion at text accompanying notes 97-102, \textit{supra}.

\textsuperscript{166} It is worthy of note that both the House and Senate versions of the lobbying reform bill would require registration only of lobbying solicitations that explicitly request the recipients to contact their representatives. H.R. 8494, 95th Cong., 2d Sess. \S 6(a)(7) (1978); S. 2971, 95th Cong. 2d Sess. \S 6(b)(5) (1978). \textit{See also} Rev. Rul 78-111, 1978-1 C.B. 41. While efficiency may dictate that this is a reasonable place to draw the line for registration purposes, the tax law is aimed at preventing subsidization of communications that have a grassroots lobbying effect. Thus for tax purposes the absence of a specific request to contact Congress should be irrelevant if the advertisement reasonably may be interpreted to solicit such conduct.
other means—a grassroots point of view by influencing public opinion on legislation, its costs will be nondeductible.\textsuperscript{167} Since section 162(e)(2)(B) specifically disallows deductions in connection with any attempt to influence the general public, however, this ruling adds nothing to enlarge the scope of nondeductible grassroots expenditures. Instead, the ruling indicates that the focus of the IRS' analysis will not be limited to the words of a message but will examine its impact as a whole. This alerts corporations to observe carefully the minor differences distinguishing a deductible goodwill advertisement from a nondeductible grassroots lobbying message.\textsuperscript{168}

Since these differences are neither statutorily nor administratively defined, the effect of Revenue Ruling 78-112 is an \textit{in terrorem} one. The ruling thus suggests that an advertisement that on its face may appear to be a deductible general social or economic comment may be a nondeductible grassroots lobbying solicitation if published at a time when arguably related legislation is under consideration.\textsuperscript{169}

---

\textsuperscript{167} The taxpayer, a residential land developer, had placed an advertisement in all major state newspapers that set forth its objections to a proposed bill regarding land use planning and suggested what it considered a more workable plan. Rev. Rul. 78-112, 1978-1 C.B. 42.


\textsuperscript{169} The following Pennwalt Corporation advertisement, published in the May 1, 1976 issue of Forbes Magazine, is an example of this situation:

\textbf{The Modern Little Red Hen}

Once upon a time, there was a little red hen who scratched about the barnyard until she uncovered some grains of wheat. She called her neighbors and said, "If we plant this wheat, we shall have bread to eat. Who will help me plant it?"

"Not I," said the cow.
"Not I," said the duck.
"Not I," said the pig.
"Not I," said the goose.

"Then I will," said the little red hen. And she did. The wheat grew tall and ripened into golden grain. "Who will help me reap my wheat?" asked the little red hen.

"Not I," said the duck.
"Out of my classification," said the pig.
"I'd lose my seniority," said the cow.
"I'd lose my unemployment compensation," said the goose.

"Then I will," said the little red hen, and she did.

At last it came time to take the bread. "Who will help me bake the bread?" asked the little red hen.

"That would be overtime for me," said the cow.
"I'd lose my welfare benefits," said the duck.
"I'm a dropout and never learned how," said the pig.
"If I'm to be the only helper, that's discrimination," said the goose.

"Then I will," said the little red hen.

She baked five loaves and held them up for her neighbors to see.
The third ruling, Revenue Ruling 78-113, defines nondeductible trade association lobbying activities. In this ruling, the IRS sets forth the general rule that the employees and customers of members of the trade association constitute a “segment” of the general public for section 162(e)(2)(B) purposes. Thus, if a communication from a trade association is intended to go beyond its members and is either directly, or through the membership, aimed at employees or customers of members, it will constitute grassroots lobbying. This ruling, along with the abolition of the fifteen percent test for determining substantiality, will deter organization members from circumventing section 162(e)(2)(B) by prohibiting deductions for organization activities that would be disallowed were the members performing the activities directly. No problem is presented by the disallowance for communications to the members’ customers since the customer is clearly not part of the organization. Difficulty arises, however, in separating organization members from their employees.

Membership organizations specifi-
cally are allowed to deduct such communications to their members under section 162(e)(1)(B). Revenue Ruling 78-113's disallowance for indirect solicitation of the members' employees, however, seems in keeping with the congressional intent manifested by rejection of the proposed allowance for a corporation's communications to its employees and stockholders.

Revenue Ruling 78-114 addresses a similar issue, stating that although a tax-exempt trade association that contacts its members urging them to write to their congressmen in support of legislation of direct interest to the association is not engaged in grassroots lobbying, similar communication to prospective members is a nondeductible grassroots activity. The rationale for the different treatment is that communications to prospective members, who may or may not subsequently join the organization, must be considered directed at the general public.

These recent actions demonstrate that the IRS has recognized the subtle enforcement problems presented by the grassroots lobbying disallowance. Abolition of the fifteen percent test for substantial lobbying closes a loophole and allows trade association activities to be evaluated on a case-by-case basis. The revenue rulings close other loopholes by announcing the standards to be applied to the solicitation of shareholders, customers, and employees. In addition, the rulings make clear that IRS scrutiny will not be confined to the language of the message at issue. When considered together, these new rules indicate that future IRS policy will be to apply section 162(e)(2)(B) more strictly to a broader range of activities.

diture in connection with an election to any political office. Section 441b(b)(2) defines "contribution or expenditure" to include direct or indirect payments, loans, advances or gifts of money, or any services, or anything of value, but specifically excludes "communications by a corporation to its stockholders and executive or administrative personnel and their families on any subject. . . ." "Executive or administrative personnel" is defined as "individuals employed by a corporation who are paid on a salary, rather than hourly, basis and who have policymaking, managerial, professional, or supervisory responsibilities." 2 U.S.C. § 441b(7) (1976). This definition may reasonably be employed in applying Revenue Ruling 78-113 as a test for determining which personnel of a trade association member constitute the "member" and which constitute "employees." *Id.*

173. Section 162(e)(1)(B) states that a corporation may deduct as an ordinary and necessary business expense its expenditures paid or incurred:

(B) in direct connection with communication of information between the taxpayer and an organization of which he is a member with respect to legislation or proposed legislation of direct interest to the taxpayer and to such organization. . . ., I.R.C. § 162(e)(1)(B).

The House Report in connection with the enactment of this section stated that "[t]his communication may be either from the organization to the taxpayer or vice versa." H.R. REP. NO. 1147, 87th Cong., 2d Sess. (1962), reprinted in 1962-3 C.B. 405, 422.

III. THE NATIONAL ASSOCIATION OF MANUFACTURERS’ CHALLENGE TO THE REVENUE RULINGS

A. Grounds of the Complaint

On May 16, 1978, the National Association of Manufacturers (NAM), a trade association long known for its extensive lobbying activities, filed suit in the United States District Court for the District of Columbia to challenge the constitutionality of the four revenue rulings and of section 162(e)(2)(B) under the first and fifth amendments. The NAM also alleges that the revenue rulings contradict the terms of section 162(e)(2)(B) by expanding the category of nondeductible activities beyond those stated in the statute.

The NAM is a tax exempt trade association under section 501(c)(6), organized for the purpose of “the promotion of the industrial interests of the United States.” Treasury Regulation section 1.162-15(c) permits association members to deduct the dues they pay to the organization. The NAM is registered as a lobbying organization and files quarterly lobbying reports pursuant to the Federal Regulation of Lobbying Act. Since 162(e)(2)(B) became effective on January 1, 1963, no NAM member has been disallowed a deduction for any part of its annual dues payment on account of grassroots lobbying conducted by the NAM organization.

As the NAM is a voluntary association, the deductibility of its dues is important to businesses’ decisions to become and remain members. Thus, since the NAM engages in lobbying activities that are nondeductible under the new revenue rulings, the disallowance of dues deductions may curtail the organization’s membership.

The association either has engaged, or has proposed to engage in each of the various activities that would be nondeductible under the new rul-

---

175. See K. Crawford, The Pressure Boys 46-50 (1939), describing a history of intrigue, intimidation, bribery and solicitation by NAM’s high pressure lobbyists at the Capitol.
177. Id. at 10-11.
178. The criteria for exemption under section 501(c)(6) are discussed at note 160, supra.
179. Complaint, supra note 176, at 3.
181. According to this regulation, members may deduct all dues paid to organizations such as labor unions and trade associations subject to substantial grassroots lobbying limitations under Treas. Reg. 1.162-20(c) (1965).
183. Complaint, supra note 176, at 5.
184. Id. at 9.
It alleges that both section 162(e)(2)(B) and the rulings chill its exercise of first amendment rights, due to the adverse financial impact that would result if it were to continue grassroots lobbying activities. In order to maintain its membership, it will have to keep dues deductible, which therefore involves refraining from constitutionally protected political speech. The NAM further claims that the revenue rulings violate the due process clause of the fifth amendment by discriminating between the tax treatment accorded businesses and that accorded tax-exempt charitable organizations. With respect to the Code, the NAM alleges that section 162(e)(2)(B) violates the due process clause by creating a discriminatory distinction between direct and indirect lobbying, two forms of constitutionally-protected speech. Additionally, the NAM argues that the rulings misinterpret the Code by defining "the general public or segments thereof" to include narrowly defined audiences bearing special relationships to the lobbying party, such as shareholders and employees.

The last of these contentions is the most easily answered. As previously discussed, the Senate's rejection of the amendment allowing deduction of communications to shareholders and employees is persuasive evidence that Congress intended these communications to be considered addressed to "the general public or a segment thereof." Customers are clearly members of the general public because their alleged special relationship to the corporation is so tenuous as to be nonexistent. The revenue rulings' determination that grassroots lobbying communications to shareholders, employees, and customers are nondeductible is therefore consistent with the terms of section 162(e)(2)(B). The constitutionality of the rulings, as to

185. Id. at 8.
186. Id. at 9-10.
187. Id. at 10. New I.R.C. Section 4911 allows charitable organizations exempt from taxation under section 501(c)(3) to elect to engage in lobbying activities up to a prescribed percentage of their budgets, without losing exempt status. Up to 25% of the permissible lobbying expenditures may be spent on grassroots lobbying. If a charity does not so elect, it will be treated under the old rule, which provides that any charity engaging in "substantial" lobbying loses its exemption. These provisions are discussed in further detail at text accompanying notes 225-39, infra.
188. Complaint, supra note 176, at 10.
189. Id. at 10-11.
190. Senator Douglas' comments in debate on that amendment aptly summarize the rationale behind the rulings:
The effects of such subsidized efforts to influence legislation indirectly would not be confined to the recipient members, shareholders, and employees. The views expressed and their source would frequently come to the attention of families and friends of the recipients, thereby broadening the scope of the influence subsidized by the Federal Treasury.
191. See text accompanying notes 170-74 supra.
both the first amendment and due process claims, is thus inextricably entwined with the constitutionality of section 162(e)(2)(B).


The NAM's contention that section 162(e)(2)(B) and the revenue rulings chill its exercise of first amendment rights is based upon the Supreme Court's recent decision of First National Bank of Boston v. Bellotti, which extended first amendment protection to the political speech of corporations.

In Bellotti, two national banking associations and three business corporations challenged a Massachusetts statute prohibiting them from making contributions or expenditures to influence any referendum votes, except those materially affecting the property, business, or assets of the corporation. The case presented four possible views of Massachusetts' distinction between direct and indirect corporate lobbying—a distinction parallel to the provisions of section 162(e) regarding the deductibility of those activities.

Conceding that the right of corporations to claim fourteenth amendment protection for their business and property accorded them some rights of speech and expression under the first amendment, the Supreme Judicial Court of Massachusetts found these limited rights to be co-extensive with those allowed a corporation by section eight of the Massachusetts statute—the right to communicate to the general public its position on political issues materially affecting its business.

On appeal to the Supreme Court, three dissenters, Justice White, joined by Justices Brennan and Marshall, endorsed Massachusetts' holding that a state may impose a direct limitation on the first amendment rights of corporations in order to prevent corporations' inordinate resources from drowning out the competing first amendment interest of individuals' speech. Their view, however, was based on the premise that the principal function of the first amendment is to protect individual self-expression and

193. Mass. Gen. Laws Ann. ch. 55, § 8 (West Supp. 1978). The statute also specified that "no question submitted to the voters solely concerning the taxation of the income, property or transactions of individuals shall be deemed materially to affect the property, business or assets of the corporation." A maximum fine of $50,000 was imposed on a corporation violating section eight, and corporate officers, directors, and agents were subject to maximum fines of $10,000 and/or imprisonment up to one year. Id.
that this function could be furthered in no way by corporate speech.\textsuperscript{196} Thus, Justice White would have found no constitutional violation in Massachusetts' segregating direct lobbying activities from grassroots activities, and prohibiting only the latter.

Agreeing with Justice White that Massachusetts had reason to fear that corporations would use their economic power to unfair political advantage, Justice Rehnquist nevertheless wrote a separate dissent,\textsuperscript{197} stating that a corporation did not possess the right to political expression when such expression was not necessary for the corporation to carry out the commercial functions for which it was organized. In his opinion, corporations had no need to petition the legislature because their property rights were accorded adequate protection by the judicial branch. Therefore, Rehnquist would have extended section eight to prohibit corporate direct lobbying activities as well.

The majority of the Court analyzed the issue from a different perspective, focusing on the speech itself rather than its source. Whereas the Massachusetts Supreme Judicial Court and the four dissenters thought the principal question was the extent to which corporations possess first amendment rights, the majority focused upon whether the Massachusetts law abridged rights that the first amendment was intended to protect. The majority held that the state law did abridge those rights.\textsuperscript{198} Reviewing the history of the first amendment, the Court stated that one of its primary purposes has been to protect free discussion of matters of public concern.\textsuperscript{199} The Court found that appellants' expression of their opinion that enactment of a personal income tax would adversely affect the economy of the state clearly was guaranteed this protection.\textsuperscript{200} Had the speakers involved not been corporations, no one would have suggested that the State could silence their proposed speech. The fact that the speech came from a corporation, rather than an individual, made it no less indispensable to democratic decision-making. The Constitution has always protected the capacity of speech to inform the public.\textsuperscript{201}

\textsuperscript{196} 435 U.S. at 807 (White, J., dissenting). Justice White placed considerable emphasis on statistics demonstrating that corporate grassroots lobbying expenditures had influenced significantly the results of state referendums. \textit{Id.} at 811.

\textsuperscript{197} \textit{Id.} at 822 (Rehnquist, J., dissenting).

\textsuperscript{198} \textit{Id.} at 776.


\textsuperscript{200} 435 U.S. at 785-86.

\textsuperscript{201} \textit{Id.} For an exposition of the "public speech" theory of the First Amendment, see A. Meiklejohn, \textit{Political Freedom: The Constitutional Powers of the People} (1948); Meiklejohn, \textit{The First Amendment is an Absolute}, 1961 \textit{Sup. Ct. Rev.} 245, 255:

The First Amendment does not protect a "freedom to speak". It protects the free-
Accordingly, the Court held that by forcing a corporation to restrict its speech to business-related matters, section eight had effected a constitutionally impermissible limitation on the content of a message. Thus, the governmental interests asserted by Massachusetts to justify this limitation could not withstand the strict scrutiny required of state-imposed restrictions on free speech. The Court noted that there had been no showing that corporations exerted an inordinate influence in Massachusetts referendum votes. Additionally, it reasoned that the fact that corporate speech might have affected the outcome of a vote was irrelevant to the first amendment issue because the Constitution “protects expression which is eloquent no less than that which is unconvincing.” Since it is the responsibility of the citizens to make judgments concerning their government, the Constitution must properly place upon them the risk that information may be misinterpreted. To hold otherwise would be to endorse state paternalism, said the Court.

By thus adopting the view that both variations of corporate lobbying are accorded first amendment protection, the Court stated that no direct bans may be placed on either activity. It neither stated nor implied, however, that equivalent tax treatment necessarily follows.

C. The Constitutionality of the Tax Provisions in Light of Bellotti

Bellotti’s holding that no direct limitations may be imposed on corporate speech is constitutionally sound and in complete harmony with the Court’s prior decisions. Bellotti, however, is limited only to direct restraints on corporate expression and does not in any way upset the basic premise of Cammarano. Cammarano, in fact, seems to have anticipated the Bellotti holding by twenty years. In stating that corporate expenditures for grassroots lobbying are not deductible, Cammarano specifically assumed that such direct expenditures were constitutionally protected. The fact that

---

202. 435 U.S. at 789-90. This conclusion was criticized in White’s dissent, Id. at 810, and by commentators. See text accompanying notes 215-22 infra.

203. 435 U.S. at 790 (quoting Kingsley Int’l Pictures Corp. v. Regents of Univ. of the State of New York, 360 U.S. 684, 689 (1959)).

204. “Government is forbidden to assume the task of ultimate judgment, lest the people lose their ability to govern themselves.” 435 U.S. at 791, n.31. The Court also noted that Buckley v. Valeo, 424 U.S. 1 (1976), rejected the notion that government may restrict the speech of some citizens in order to enhance the relative voice of others. 435 U.S. at 790-91.

205. 358 U.S. 498, 513 (1959). Cammarano did not even suggest that corporate political
Bellotti explicitly declared such expenditures to be entitled to first amendment protection in no way augments their claim to deductibility status. The sixteenth amendment grants Congress the power to tax all income from whatever source derived, and the corollary discretion to create exemptions and deductions.\textsuperscript{206} The statutory determination that grassroots lobbying appeals are not deductible as ordinary and necessary business expenses was thus clearly within congressional authority.

Cammarano's statement that "[petitioners are not being denied a tax deduction because they engage in constitutionally protected activities, but are simply being required to pay for those activities entirely out of their own pockets . . . \textsuperscript{207} is therefore as valid today as it was when written. Now, as then, the constitutional protection accorded first amendment speech does not entitle that speech to government subsidization.\textsuperscript{208} It is only when the taxing power is employed in a discriminatory manner to create a prior restraint on speech on the basis of content, as in Speiser,\textsuperscript{209} or on the basis of the speaker's identity, as in Grosjean,\textsuperscript{210} that the taxing power collides with, and must yield to, the fundamental rights protected by the first amendment.

This conclusion is buttressed by the Fourth Circuit's recent opinion in Taxation with Representation v. United States.\textsuperscript{211} The plaintiff, a public interest group organized for the purpose of lobbying on federal tax legislation, had been denied section 501(c)(3) status as a tax-exempt charitable organization and the concomitant right to receive contributions deductible under section 170(c)(2)(D).\textsuperscript{212} The organization subsequently brought suit, charging that the lobbying proscription of section 501(c)(3) violates its rights of free speech and petition under the first amendment and denies it the equal protection of the law under the fifth amendment.\textsuperscript{213} On the first amendment issue, the Fourth Circuit noted the distinction between Speiser and Cammarano, holding the former inapposite and stating that the latter protects the nondiscriminatory deduction disallowance of sec-


\textsuperscript{207} 358 U.S. 498, 513 (1959).

\textsuperscript{208} See Justice Douglas' concurrence in Cammarano, discussed at text accompanying notes 79-81 supra.

\textsuperscript{209} 357 U.S. 513 (1958); see notes 50-55 and accompanying text, supra.

\textsuperscript{210} 297 U.S. 233 (1936); see notes 34-42 and accompanying text, supra.

\textsuperscript{211} Taxation with Representation v. United States, 586 F.2d 1219 (4th Cir. 1978).

\textsuperscript{212} These sections are discussed at note 229 infra.

\textsuperscript{213} The equal protection argument presented in Taxation with Representation is discussed at text accompanying note 238 infra.
tions 501(c)(3) and 170(c)(2)(D). It is thus clear that Cammarano's definition of the relationship between the first and sixteenth amendments has not been eroded by subsequent tax cases or by Bellotti.

Indeed, the Bellotti decision itself indicates a need to continue to treat these grassroots lobbying expenditures as nondeductible. Bellotti regarded the absence of corruption or undue influence resulting from corporate speech as an important factor in concluding that the speech was entitled to first amendment protection:

According to appellee, corporations are wealthy and powerful and their views may drown out other points of view. If appellee's arguments were supported by record or legislative findings that corporate advocacy threatened imminently to undermine democratic processes, thereby denigrating rather than serving First Amendment interests, these arguments would merit our consideration.214

Similarly, the key factor behind disallowing deductions for corporate grassroots expenditures has been to prevent corporations from acquiring such an unfair advantage. Denial of deductibility enhances the first amendment rights of all by preventing corporate purchasing power from impeding access to public forums by others. Thus, Internal Revenue Code section 162(e)(2)(B) represents a constitutionally permissible government action that addresses Justice White's concern with balancing the competing first amendment rights of corporations and individuals: the government may not deny corporations their right to speak but may refuse to subsidize the exercise of that right.

This balancing function performed by section 162(e)(2)(B) is particularly significant in light of criticism that regards Bellotti's conclusion that the relative voice of corporations has not overwhelmed or even significantly influenced referendums as naive.215 Although the majority in Bellotti dismissed as incomplete White's figures purportedly showing that corporate wealth dominates the electoral process,216 at least one study has shown that corporate grassroots lobbying activities have had a significant influence on the outcome of state-wide referendum votes.217 This study, focusing on voter initiatives during 1976, found that measures favored in public opinion polls early in the initiative campaigns frequently were re-

---

214. 435 U.S. at 789.
215. Hearings, supra note 4, at 77-78 (statement of Harvey J. Shulman, Executive Director, Media Access Project, criticizing Bellotti's conclusion that the influence of corporate political speech has been insignificant, 435 U.S. at 789-90).
216. 435 U.S. at 789 n.28.
217. Hearings, supra note 4, at 256-73 (statement of John S. Shockley, Associate Professor, Western Illinois University).
soundingly defeated on election day.\textsuperscript{218} In the cases studied, corporate efforts typically began not long before the election and presented a new definition of the issue designed to change the voters' opinions,\textsuperscript{219} at a cost of up to two-hundred times the amounts expended by public interest groups sponsoring the referendums.\textsuperscript{220} Since the initiatives were not always defeated, even when opponents outspent proponents, the study did not conclude that money in and of itself was decisive, but found that when the corporate viewpoint prevailed, money was clearly a significant factor.\textsuperscript{221} The study's findings indicate that any subsidization provided corporate grassroots lobbying campaigns by tax deductions might subject corporations to charges of undue influence, which in turn would jeopardize the first amendment protection accorded these activities under \textit{Bellotti}.\textsuperscript{222} Thus, \textit{Bellotti} does not aid the NAM's argument that section 162(e)(2)(B) and the revenue rulings thereunder are unconstitutional under the first amendment, but in fact supports the policy behind those tax provisions.

\section*{D. The NAM's Equal Protection Argument}

The NAM alleges that section 162(e)(2)(B) violates its right to the equal protection of the laws as guaranteed under the due process clause of the fifth amendment because it discriminates between different types of constitutionally-protected speech and between different types of speakers.\textsuperscript{223} These arguments address the fact that Cammarano's tax neutrality policy—that all parties should stand on the same footing regarding the purchase of grassroots publicity—\textsuperscript{224} is no longer the law.

The argument that section 162(e)(2)(B) discriminates between different

\textsuperscript{218} \textit{Id.} at 256.

\textsuperscript{219} Shockley's study focused on initiatives concerning mandatory bottle deposits and nuclear energy. Regarding nuclear energy safety initiatives, he stated that the energy corporations consistently charged that the true intent was to ban nuclear power, rather than to make it safe. Because early polls showed that the public did not want to foreclose nuclear energy as an option, but merely wished to ensure its safe use, this redefinition became critical to the outcome of the vote. Similarly, on mandatory deposit initiatives, the opposition charged that the measure would eliminate the choice of "convenience containers" (not "throwaways"!), would result in a loss of jobs, and would not alleviate the litter problem. \textit{Id.} at 261-62.

\textsuperscript{220} \textit{Id.} at 258.

\textsuperscript{221} \textit{Id.} at 261. "To overcome money, proponents needed unusual counter resources, such as unusually broad-based coalitions, or the luck of having an opposition which used its impressive resources poorly, or an issue which could not be easily redefined by the opposition." \textit{Id.} at 264.

\textsuperscript{222} See \textit{Bellotti}'s discussion of the integrity of the electoral process at 435 U.S. 765, 788-92, and text accompanying note 214 \textit{supra}.

\textsuperscript{223} Complaint, \textit{supra} note 176, at 10.

\textsuperscript{224} 358 U.S. 498, 513 (1959).
types of speakers is directed at new IRC section 4911 which allows tax exempt charitable organizations under section 501(c)(3) to retain their tax exempt status if they engage in limited amounts of lobbying activities, including grassroots lobbying.  

Previously, 501(c)(3) organizations would lose their tax exemptions if they engaged in a “substantial” amount of lobbying activities. However, neither the IRS nor the courts ever adequately defined “substantial”, so that organizations would know how much lobbying they could engage in without endangering their status. Under the old rule, if a charity were found to have violated the “substantial” rule, it would be allowed to retain its exemption by switching to section 501(c)(4) status, but would lose the privilege of having its contributions deductible to contributors. Now charities may choose to continue to be evaluated under the substantial test or elect under section 501(h) to be covered by the new provisions that restrict their legislative activities to a percentage of the organization’s expenditures for exemption purposes. As these expenditures increase, the percentage allowed for legislative activities declines, but in no event may more than one-fourth of this allowable lobbying percentage be spent on grassroots activities.

Under section 4911, grassroots expenditures are defined as any attempt to influence any legislation through an attempt to affect the opinions of the

---


227. For an analysis of the history and interpretation of the “substantial” test, see Caplin and Timbie, Legislative Activities of Public Charities, 39 LAW AND CONTEMP. PROB. No. 4, 183 (1975).

228. I.R.C. § 501(c)(4)—“Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.” These organizations are not subject to the substantial lobbying limitation.

229. Section 501(c)(3) status is important to maintain because only contributions to 501(c)(3) organizations are deductible to contributors under section 170. I.R.C. § 170(c)(2)(D).

230. I.R.C. § 501(h)(3). Subsection (h) was added to section 501 by the 1976 Tax Reform Act to implement the provisions of § 4911.

231. Two penalties are imposed on electing charities whose expenditures exceed these guidelines: expenditures beyond either the general or grassroots limit are taxed at 25% of the excess (§ 4911(a)(1)); when a charity has expended 150% of the limits on a four year average, loss of section 501(c)(3) status is imposed (§ 501(h)(2)(B) and (D)). Neither electing nor nonelecting charities are allowed to transfer to section 501(c)(4) status upon losing a 501(c)(3) exemption. I.R.C. § 4911(c). See H.R. REP. No. 1210, 94th Cong., 2d Sess. (1976); Washburn, New Tax Act Defines “Substantial” Lobbying - But Charities Must Elect to be Covered, 35 TAXES 291 (1977), and Weithorn, Practitioner’s Planning Guide to the New Lobbying Rules for Public Charities, 46 J. TAX. 294 (1977).
general public or any segment thereof.\textsuperscript{232} As a result, this section disturbs the "equilibrium" of the Code with respect to grassroots activities. Several factors, however, mitigate the resultant imbalance. Section 4911 only applies to public charities (other than churches) and not to private foundations.\textsuperscript{233} In addition, this section does not affect the nonbusiness grassroots lobbying expenses of individuals and other entities that remain nondeductible. One commentator discounts the possibility of section 4911 encouraging significant grassroots activities because of the minimal percentages it allows in the face of the high advertising and direct mailing costs that lobbying entails.\textsuperscript{234} Furthermore, section 4911 creates tax neutrality toward direct lobbying by eliminating penalties for charities engaging in direct lobbying activities that businesses may deduct under section 162(e)(1)(A).

The NAM bases its equal protection argument on the contention that there is "no justification" for the discriminatory treatment accorded businesses and charitable organizations.\textsuperscript{235} Clearly such justification exists in the disparate resources and the concomitant potential for abuse presented by these different entities. This justification is borne out by Bellotti's caveat that the first amendment rights of corporations are guaranteed only so long as the exercise of those rights does not jeopardize the integrity of the electoral process.\textsuperscript{236} Moreover, long before the enactment of section 4911, the Cammarano holding was interpreted as evidence of a fear of the disequilibrium resulting from excessive business power, rather than an endorsement of equilibrium in the abstract.\textsuperscript{237} It is reasonable to assume that the subsequent growth of business power has been sufficient to persuade Congress that this partial subsidy of other parties' first amendment rights is essential to maintain a proper balance. In this respect, the Fourth Circuit's recent decision in \textit{Taxation with Representation}\textsuperscript{238} again undermines the NAM's position. In that case, the plaintiff had argued that the provisions of sections 170(c)(3) and (4) permitting veterans' organizations and fraternal societies to lobby while retaining the right to receive tax-deductible contributions violated its equal protection rights under the fifth amendment. The court, however, agreed with the government that the compelling societal goals served by these organizations provide ample justification for the special tax treatment accorded them by Congress.

\begin{itemize}
\item \textsuperscript{232} I.R.C. §§ 4911(c)(3) and 4911(d)(1)(A).
\item \textsuperscript{233} I.R.C. §§ 501(h)(4) and (5). Lobbying expenditures of private foundations are governed by section 4945.
\item \textsuperscript{234} \textit{Hearings}, supra note 4, at 199 (Statement of Lester G. Fant, III, Attorney, Cohen & Uretz, Washington, D.C.).
\item \textsuperscript{235} Complaint, supra note 176 at 10.
\item \textsuperscript{236} See text accompanying notes 214 & 222 supra.
\item \textsuperscript{237} Cooper, supra note 22, at 815.
\item \textsuperscript{238} \textit{Taxation with Representation} v. United States, 586 F.2d 1219 (4th Cir. 1978).
\end{itemize}
More importantly, section 4911 may properly be viewed not as a new tax exemption but as an elective statutory definition of the previous substantial lobbying limitation. No equal protection violation exists with respect to trade associations and other 501(c)(6) organizations, because they too are allowed to engage only in insubstantial grassroots lobbying.\textsuperscript{239} Similarly, section 4911 does not disturb the tax neutrality between corporations and individuals—i.e., neutrality at the membership level—because grassroots lobbying expenditures remain nondeductible to both under sections 162(e)(2)(B) and 212.

Turning to the NAM's argument that there is no justification for allowing businesses to deduct direct lobbying expenses but not grassroots expenditures, it is important to remember that the primary congressional objective in allowing businesses to deduct direct lobbying costs was to achieve neutrality in the tax treatment accorded businesses' communications to each of the three branches of government.\textsuperscript{240} Furthermore, achievement of parity with the tax-subsidized lobbying conducted by the government and the fact that such expenses might be necessary to maintain a business' existence were significant considerations.\textsuperscript{241} These reasons, combined with the Bellotti rationale that no political expression may be denied first amendment protection as long as that expression has not attained a position of undue influence in the governing process, are sufficient justification for the discriminatory tax treatment that Congress, consistent with its discretion under the sixteenth amendment, has accorded direct and indirect lobbying. Therefore, section 162(e)(2)(B) and revenue rulings 78-111 through 78-114 must be found constitutional under both the first and fifth amendments.

IV. The Need for Improved Enforcement

While a favorable holding in \textit{National Association of Manufacturers v. Blumenthal} undoubtedly will encourage the IRS to prosecute the violations of section 162(e)(2)(B) more vigorously, it will not alter the fact that the law, as the regulations, rulings, and audit manuals presently define it, does not lend itself to strenuous enforcement. The rules are vague in defining a nondeductible advertisement and disturbingly ineffective in denying a deduction of trade associations' grassroots lobbying expenditures to their members.

While Revenue Ruling 78-112 makes clear that an advertisement that

\textsuperscript{239} Treas. Reg. § 1.162-20(c)(3), discussed at text accompanying note 131, \textit{supra} as defined by I.R.M. Supp. 7(10)G-26/4(11)G-57 § 6.05 (Feb. 3, 1978), discussed in text accompanying notes 159 & 161 \textit{supra}.

\textsuperscript{240} See \textit{H.R. REP. No. 1447, 87th Cong., 2d Sess. 17 (1962)}.

\textsuperscript{241} See text accompanying note 96 \textit{supra}.
Influencing the Public

does not specifically ask readers to contact their congressmen may be considered a grassroots lobbying solicitation, it does not enumerate those factors that determine if the message as a whole is an attempt to develop a grassroots point of view. Some guidelines that might resolve this factual problem include whether the advertisement makes explicit or implicit reference to currently pending legislation, whether the issue addressed by the advertisement is suitable for legislative action, and whether the general tone of the advertisement is polemical. Other pertinent considerations are whether the advertisement engages in “direct advocacy” by suggesting solutions to a legislative problem, or engages in subtly biased “non-advocacy” by presenting “both” sides of a complex issue in an over-simplified and nonobjective manner. In addition, it would be desirable to determine if the advertisement were part of a larger campaign that would come within the overall ambit of section 162(e)(2)(B), or if the advertiser were pursuing the same issue before the legislature, agencies, or courts, or through opinion polls or public meetings. Further litigation will be necessary before any of these guidelines become incorporated in revenue rulings, but corporations probably would be wise to heed them in the interim in order to insure that their tax returns withstand challenge.

Taxpayer compliance with section 162(e)(2)(B) would be improved significantly by requiring corporations to list their grassroots lobbying expenses on a separate line of the corporate tax return. At present, only the word “advertising” appears on the return, as an allowable deduction, and the instructions provide no guidance for the application of section 162(e)(2)(B). Similarly, voluntary compliance would be improved by requiring corporations to label their advertisements “deductible” or “non-deductible”. This procedure both would alert the public to the political nature of certain advertisements and facilitate audits by the IRS.

244. Id. at 422-23 (statement of S. Prakash Sethi, Professor of International Business & Social Policy, University of Texas).
245. Id. at 110 (statement of Harvey J. Shulman, Executive Director, Media Access Project).
246. Id. at 153.
248. Id. at 424-26 (statement of S. Prakash Sethi, Professor of International Business & Social Policy, University of Texas). Those advertisements classified as deductible would then be subject to the FTC's substantiation requirements. See Statement of Proposed Enforcement Policy by the Staff of the Federal Trade Commission Regarding Corporate Image Advertising at 21 (December 4, 1974). Nondeductible advertisements would remain outside the FTC's purview in order to avoid undue interference with corporations' first amendment rights.
As far as nondeductible trade association dues are concerned, section 162(e)(2)(B) seems hopelessly unenforceable. Although the IRS has abolished the fifteen percent test for determining the substantiality of an association's grassroots activities, and Revenue Rulings 78-113 and 78-114 limit the scope of associations' deductible expenses, this aspect of section 162(e)(2)(B) will remain ineffective until associations are required to inform their members of the extent of their nondeductible expenditures. To facilitate the audit procedure, annual reports to member companies should be made mandatory and trade associations, like individual corporations, should be required to label their advertisements.

Obviously, a thorough audit of a member corporation would require an audit of the association. The IRS would thus expedite enforcement by subjecting trade associations to frequent audits. Alternatively, the IRS might eliminate the "substantiality" loophole by taxing the trade associations on their dues income to the extent of their expenditures for grassroots lobbying. This would facilitate enforcement by allowing the Service to make tax adjustments at the entity rather than the membership level and would duplicate the economic effects of section 162(e)(2)(B)'s deduction disallowance. Legislation to this effect could be drafted so as to be constitutional under Bellotti and Cammarano.

V. CONCLUSION

Although section 162(e)(2)(B)'s disallowance of deductions for grassroots lobbying expenditures as an ordinary and necessary business expense had its origins in IRS regulations that lacked statutory authority, it represents sound policy and should be strictly enforced. While businesses unquestionably have the right to spend money to express their views on any political issue, there is no constitutional reason for requiring these sums to be deductible. To the contrary, there is considerable evidence showing that corporate "war chests" inordinately influence public opinion on controversial legislative issues.

Indeed, the overwhelming success of corporate grassroots lobbying com-
Influencing the Public

The language of section 162(e)(2)(B) prohibits only the deduction of expenditures incurred "in connection with any attempt to influence the general public, or segments thereof," it is clear that Congress intended a business' communications to parties in the special relationships of employee or shareholder status to come within the ambit of this prohibition. Revenue Rulings 78-111 through 78-114, which make such communications by a trade association to which a business belongs explicitly nondeductible, are thus clearly authorized by the Code.

These rulings, and section 162(e)(2)(B) are also consistent with Bellotti, which prohibited only direct restraints on corporate speech and implied that denial of a deduction for businesses' grassroots lobbying expenditures is a permissible means to balance the competing first amendment rights of individuals and corporations.

Nor does the fact that the Internal Revenue Code subsidizes the direct lobbying expenses of corporations render section 162(e)(2)(B) unconstitutional. Although this provision undermines the tax neutrality premise, it does not impair the basic principle that businesses are not denied a tax deduction because they engage in first amendment speech. Rather, section 162(e)(2)(B) merely requires businesses to pay for their grassroots activities entirely out of their own pockets. The fact that Congress in its discretion may choose to subsidize some first amendment rights does not imply that all free speech rights may not be fully realized absent equivalent subsidization.

Most importantly, although the present laws are essential to protect the integrity of the legislative process, they are not amenable to rigorous enforcement. Substantial structural revision, including imposition of the tax on the trade associations rather than their members and more detailed definitional guidance, is necessary to make the rules effective.

Anne M. Krauskopf

ADDENDUM

On March 7, 1979, the United States District Court for the District of Columbia granted the defendant's motion to dismiss in National Association of Manufacturers v. Blumenthal, No. 78-0874 (D.D.C. March 7, 1979), for lack of subject matter jurisdiction. Judge John Lewis Smith, Jr. found the action to be barred by the Anti-Injunction Act, 26 U.S.C. § 7421(a) (1976). The court specifically noted that "the governmental interests found [to exist by the Supreme Court in Cammarano] arguably provide a reasonable basis for the prohibition against deducting these expenses in satisfaction of the equal protection requirements of the Fifth Amendment." Slip op. at 2. The NAM indicated its intent to appeal.