rules in the second sentence of each of paragraphs (e)(3)(i)(A), (e)(3)(ii)(B), and (e)(3)(ii)(C) of this section for determining the date or dates on which remuneration is considered paid to a director are effective for taxable years beginning on or after January 1, 1995. Prior to those taxable years, taxpayers must follow the rules in paragraphs (e)(3)(i)(A), (e)(3)(ii)(B), and (e)(3)(ii)(C) of this section or another reasonable, good faith interpretation of section 162(m) with respect to the date or dates on which remuneration is considered paid to a director.

(ii) Separate treatment of publicly held subsidiaries. Notwithstanding paragraph (j)(1) of this section, the rule in paragraph (e)(1)(ii) of this section that treats publicly held subsidiaries as separately subject to section 162(m) is effective as of the first regularly scheduled meeting of the shareholders of the publicly held subsidiary that occurs more than 12 months after December 2, 1994. The rules for stock-based compensation set forth in paragraph (f)(3) of this section will apply for this purpose, except that the grant must occur before the shareholder meeting specified in this paragraph (j)(2)(ii). Taxpayers may choose to rely on the rules referred to in the first sentence of this paragraph (j)(2)(ii) for the period prior to the effective date of the rule.

(iii) Subsidiaries that become separate publicly held corporations. Notwithstanding paragraph (j)(1) of this section, if a subsidiary of a publicly held corporation becomes a separate publicly held corporation as described in paragraph (f)(4)(i) of this section, then, for the duration of the reliance period described in paragraph (f)(2) of this section, the rules of paragraph (f)(4)(i) of this section are treated as applying (and the rules of paragraph (f)(4) of this section do not apply) to remuneration paid to covered employees of that new publicly held corporation pursuant to a plan or agreement that existed prior to December 2, 1994, but that remuneration is not performance-based under a reasonable, good faith interpretation of section 162(m), the rules of paragraph (f)(1) of this section will be treated as applying only until the first regularly scheduled meeting of shareholders that occurs more than 12 months after December 2, 1994. The rules of paragraph (f)(4) of this section will apply as of that first regularly scheduled meeting. The rule for stock-based compensation set forth in paragraph (f)(3) of this section will apply for purposes of this paragraph (j)(2)(iii), except that the grant must occur before the shareholder meeting specified in the preceding sentence if the remuneration is not performance-based under a reasonable, good faith interpretation of section 162(m). Taxpayers may choose to rely on the rules of paragraph (j)(2)(iii) for the period prior to the applicable effective date referred to in the first or second sentence of this paragraph (j)(2)(iii).

(iv) Bonus pools. Notwithstanding paragraph (j)(1) of this section, the rules in paragraph (e)(2)(iii)(A) that limit the sum of individual percentages of a bonus pool to 100 percent will not apply to remuneration paid before January 1, 2001, based on performance in any performance period that began prior to December 20, 1995.

(v) Compensation based on a percentage of salary or base pay. Notwithstanding paragraph (j)(1) of this section, the requirement in paragraph (e)(4)(i) of this section that, in the case of certain formulas based on a percentage of salary or base pay, a corporation disclose to shareholders the maximum dollar amount of compensation that could be paid to the employee, will apply only to plans approved by shareholders after April 30, 1995.

§ 1.162–28 Allocation of costs to lobbying activities.

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

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

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

(i) The ratio method described in paragraph (d) of this section;
(ii) The gross-up method described in paragraph (e) of this section; and
(iii) A method that applies the principles of section 263A and the regulations thereunder (see paragraph (f) of this section).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

\[
\text{Allocable third-party costs} = \frac{\text{Lobbying labor hours}}{\text{Total labor hours}} \times \text{Total costs of operations} - \text{Allocable third-party costs for travel and entertainment}.
\]

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

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

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

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

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

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

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

(iii) For purposes of the gross-up method, X determines that its basic labor costs are $20 per hour for A, $30 per hour for B, and $25 per hour for C. Thus, its basic lobbying labor costs are ($20\times300)+($30\times1,700)+($25\times1,000), or
(f) Section 263A cost allocation methods—(1) In general. A taxpayer may allocate its costs to lobbying activities under the principles set forth in section 263A and the regulations thereunder, except to the extent inconsistent with paragraph (g) of this section. For this purpose, lobbying activities are considered a service department or function. Therefore, a taxpayer may allocate costs to lobbying activities by applying the methods provided in §1.263A–1 through 1.263A–3. See §1.263A–1(e)(4), which describes service costs generally; §1.263A–1(f), which sets forth cost allocation methods available under section 263A; and §1.263A–1(g)(4), which provides methods of allocating service costs.

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

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

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

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

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

<table>
<thead>
<tr>
<th>Employee</th>
<th>Lobbying hours</th>
<th>Overall management hours</th>
<th>Total hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>0</td>
<td>2,000</td>
<td>2,000</td>
</tr>
<tr>
<td>B</td>
<td>1,750</td>
<td>250</td>
<td>2,000</td>
</tr>
<tr>
<td>C</td>
<td>2,000</td>
<td>0</td>
<td>2,000</td>
</tr>
<tr>
<td>Totals</td>
<td>3,750</td>
<td>2,250</td>
<td>6,000</td>
</tr>
</tbody>
</table>

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

\[
\begin{align*}
175\% \times \text{Basic lobbying labor costs of all personnel} + \text{Allocable third-party costs} & = \text{Costs allocable to lobbying activities} \\
[175\% \times 82,000] + [0] & = 143,500.
\end{align*}
\]
§ 1.162–29 Influencing legislation.

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

(b) Definitions. For purposes of this section—

(1) Influencing legislation. Influencing legislation means—

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

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

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

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

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

[T.D. 8602, 60 FR 37573, July 21, 1995]