

issuance of a share of FNMA stock during a taxable year beginning after December 31, 1959, such sale is to be treated in a manner consistent with the purpose for, and the legislative intent underlying the enactment of, the provisions of section 8, Act of September 14, 1960 (Pub. L. 86-779, 74 Stat. 1003). Thus, for the purpose of determining an initial holder's gain or loss from the sale to FNMA of mortgage paper, with respect to which a share of FNMA stock is issued in a taxable year beginning after December 31, 1959 (irrespective of when the sale is made), the amount realized by the initial holder from the sale of the mortgage paper is the amount of the "FNMA purchase price". The "FNMA purchase price" is the gross amount of the consideration agreed upon between FNMA and the initial holder for the purchase of the mortgage paper, without regard to any deduction therefrom as, for example, a deduction representing a capital contribution or a purchase or marketing fee. The date of issuance of the stock is the date which appears on the stock certificates of the initial holder as the date of issue. The initial holder is the original purchaser who is issued stock of the Federal National Mortgage Association pursuant to section 303(c) of the Act, and who appears on the books of FNMA as the initial holder. In determining the period for which the initial holder has held such stock, such period shall begin with the date of issuance.

(b) *Examples.* The provisions of paragraph (a) of this section may be illustrated by the following examples:

Example 1. A, a banking institution which reports its income on a calendar year basis, sold mortgage paper with an outstanding principal balance of \$12,500 to FNMA on October 17, 1960. The FNMA purchase price was \$11,500. A's basis for the mortgage paper was \$10,500. In accordance with the terms of the contract, FNMA deducted \$375 (\$250 representing capital contribution and \$125 representing purchase and marketing fee) from the amount of the purchase price. FNMA credited A's account with the amount of the capital contribution. A stock certificate evidencing two shares of FNMA common stock of \$100 par value was mailed to A and FNMA deducted \$200 from A's account, leaving a net balance of \$50 in such account. The stock certificate, bearing an issue date of November 1, 1960, was received by A on November 7, 1960. The fair market value of a share of

FNMA stock on October 17, 1960, was \$65, on November 1, 1960, was \$67, and on November 7, 1960, was \$68. A may deduct \$66 the difference between the issuance price (\$200) and the fair market value (\$134) of the two shares of stock on the date of issuance (November 1, 1960), as a business expense for the taxable year 1960. The basis of each share of stock issued as of November 1, 1960 will be \$67. See section 1054 and § 1.1054-1. A's gain from the sale of the mortgage paper is \$875 computed as follows:

Amount realized in FNMA purchase price	\$11,500
A's basis in mortgage paper	\$10,500
Purchase and marketing fee	125
	10,625
Gain on sale	875

Example 2. Assume the same facts as in Example (1), and, in addition, that A sold to FNMA on December 15, 1960, additional mortgage paper having an outstanding principal balance of \$12,500. FNMA deducted from the FNMA purchase price \$250 representing capital contribution and credited A's account with this amount. A then had a total credit of \$300 to his account consisting of the \$50 balance from the transaction described in Example (1) and \$250 from the December 15th transaction. A stock certificate evidencing three shares of FNMA common stock of \$100 par value was mailed to A and FNMA deducted \$300 from A's account. The stock certificate, bearing an issue date of January 1, 1961, was received by A on January 9, 1961. The fair market value of a share of FNMA stock on January 1, 1961, was \$69. A may deduct \$93, the difference between the issuance price (\$300) and the fair market value (\$207) of the three shares of stock on the date of issuance (January 1, 1961), as a business expense for the taxable year 1961. The gain or loss on the sale of mortgage paper on December 15, 1960, is reportable for the taxable year 1960.

[T.D. 6690, 28 FR 12253, Nov. 19, 1963]

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

(a) *In general*—(1) *Scope of section.* This section contains rules governing the deductibility or nondeductibility of expenditures for lobbying purposes, for the promotion or defeat of legislation, for political campaign purposes (including the support of or opposition to any candidate for public office) or for carrying on propaganda (including advertising) related to any of the foregoing purposes. For rules applicable to such expenditures in respect of taxable

years beginning before January 1, 1963, and for taxable years beginning after December 31, 1962, see paragraphs (b) and (c), respectively, of this section. This section also deals with expenditures for institutional or "good will" advertising.

(2) *Institutional or "good will" advertising.* Expenditures for institutional or "good will" advertising which keeps the taxpayer's name before the public are generally deductible as ordinary and necessary business expenses provided the expenditures are related to the patronage the taxpayer might reasonably expect in the future. For example, a deduction will ordinarily be allowed for the cost of advertising which keeps the taxpayer's name before the public in connection with encouraging contributions to such organizations as the Red Cross, the purchase of United States Savings Bonds, or participation in similar causes. In like fashion, expenditures for advertising which presents views on economic, financial, social, or other subjects of a general nature, but which does not involve any of the activities specified in paragraph (b) or (c) of this section for which a deduction is not allowable, are deductible if they otherwise meet the requirements of the regulations under section 162.

(b) *Taxable years beginning before January 1, 1963—(1) In general.* (i) For taxable years beginning before January 1, 1963, expenditures for lobbying purposes, for the promotion or defeat of legislation, for political campaign purposes (including the support of or opposition to any candidate for public office), or for carrying on propaganda (including advertising) related to any of the foregoing purposes are not deductible from gross income. For example, the cost of advertising to promote or defeat legislation or to influence the public with respect to the desirability or undesirability of proposed legislation is not deductible as a business expense, even though the legislation may directly affect the taxpayer's business.

(ii) If a substantial part of the activities of an organization, such as a labor union or a trade association, consists of one or more of the activities specified in the first sentence of this subparagraph, deduction will be allowed only for such portion of the dues or

other payments to the organization as the taxpayer can clearly establish is attributable to activities other than those so specified. The determination of whether such specified activities constitute a substantial part of an organization's activities shall be based on all the facts and circumstances. In no event shall special assessments or similar payments (including an increase in dues) made to any organization for any of such specified purposes be deductible. For other provisions relating to the deductibility of dues and other payments to an organization, such as a labor union or a trade association, see paragraph (c) of § 1.162-15.

(2) *Expenditures for promotion or defeat of legislation.* For purposes of this paragraph, expenditures for the promotion or the defeat of legislation include, but shall not be limited to, expenditures for the purpose of attempting to—

(i) Influence members of a legislative body directly, or indirectly by urging or encouraging the public to contact such members for the purpose of proposing, supporting, or opposing legislation, or

(ii) Influence the public to approve or reject a measure in a referendum, initiative, vote on a constitutional amendment, or similar procedure.

(c) *Taxable years beginning after December 31, 1962—(1) In general.* For taxable years beginning after December 31, 1962, certain types of expenses incurred with respect to legislative matters are deductible under section 162(a) if they otherwise meet the requirements of the regulations under section 162. These deductible expenses are described in subparagraph (2) of this paragraph. All other expenditures for lobbying purposes, for the promotion or defeat of legislation (see paragraph (b)(2) of this section), for political campaign purposes (including the support of or opposition to any candidate for public office), or for carrying on propaganda (including advertising) relating to any of the foregoing purposes are not deductible from gross income for such taxable years. For the disallowance of deductions for bad debts and worthless securities of a political party, see § 1.271-1. For the disallowance of deductions for

certain indirect political contributions, such as the cost of certain advertising and the cost of admission to certain dinners, programs, and inaugural events, see § 1.276-1.

(2) *Appearances, etc., with respect to legislation*—(i) *General rule.* Pursuant to the provisions of section 162(e), expenses incurred with respect to legislative matters which may be deductible are those ordinary and necessary expenses (including, but not limited to, traveling expenses described in section 162(a)(2) and the cost of preparing testimony) paid or incurred by the taxpayer during a taxable year beginning after December 31, 1962, in carrying on any trade or business which are in direct connection with—

(a) 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) 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.

For provisions relating to dues paid or incurred with respect to an organization of which the taxpayer is a member, see subparagraph (3) of this paragraph.

(ii) *Legislation or proposed legislation of direct interest to the taxpayer*—(a) *Legislation or proposed legislation.* The term “legislation or proposed legislation” includes bills and resolutions introduced by a member of Congress or other legislative body referred to in subdivision (i)(a) of this subparagraph for consideration by such body as well as oral or written proposals for legislative action submitted to the legislative body or to a committee or member of such body.

(b) *Direct interest*—(1) *In general.* (i) Legislation or proposed legislation is of direct interest to a taxpayer if the legislation or proposed legislation is of such a nature that it will, or may reasonably be expected to, affect the trade

or business of the taxpayer. It is immaterial whether the effect, or expected effect, on the trade or business will be beneficial or detrimental to the trade or business or whether it will be immediate. If legislation or proposed legislation has such a relationship to a trade or business that the expenses of any appearance or communication in connection with the legislation meets the ordinary and necessary test of section 162(a), then such legislation ordinarily meets the direct interest test of section 162(e). However, if the nature of the legislation or proposed legislation is such that the likelihood of its having an effect on the trade or business of the taxpayer is remote or speculative, the legislation or proposed legislation is not of direct interest to the taxpayer. Legislation or proposed legislation which will not affect the trade or business of the taxpayer is not of direct interest to the taxpayer even though such legislation will affect the personal, living, or family activities or expenses of the taxpayer. Legislation or proposed legislation is not of direct interest to a taxpayer merely because it may affect business in general; however, if the legislation or proposed legislation will, or may reasonably be expected to, affect the taxpayer’s trade or business it will be of direct interest to the taxpayer even though it also will affect the trade or business of other taxpayers or business in general. To meet the direct interest test, it is not necessary that all provisions of the legislation or proposed legislation have an effect, or expected effect, on the taxpayer’s trade or business. The test will be met if one of the provisions of the legislation has the specified effect. Legislation or proposed legislation will be considered to be of direct interest to a membership organization if it is of direct interest to the organization, as such, or if it is of direct interest to one or more of its members.

(ii) Legislation which would increase or decrease the taxes applicable to the trade or business, increase or decrease the operating costs or earnings of the trade or business, or increase or decrease the administrative burdens connected with the trade or business meets the direct interest test. Legislation which would increase the social

security benefits or liberalize the right to such benefits meets the direct interest test because such changes in the social security benefits may reasonably be expected to affect the retirement benefits which the employer will be asked to provide his employees or to increase his taxes. Legislation which would impose a retailer's sales tax is of direct interest to a retailer because, although the tax may be passed on to his customers, collection of the tax will impose additional burdens on the retailer, and because the increased cost of his products to the consumer may reduce the demand for them. Legislation which would provide an income tax credit or exclusion for shareholders is of direct interest to a corporation, because those tax benefits may increase the sources of capital available to the corporation. Legislation which would favorably or adversely affect the business of a competitor so as to affect the taxpayer's competitive position is of direct interest to the taxpayer. Legislation which would improve the school system of a community is of direct interest to a membership organization comprised of employers in the community because the improved school system is likely to make the community more attractive to prospective employees of such employers. On the other hand, proposed legislation relating to Presidential succession in the event of the death of the President has only a remote and speculative effect on any trade or business and therefore does not meet the direct interest test. Similarly, if a corporation is represented before a congressional committee to oppose an appropriation bill merely because of a desire to bring increased Government economy with the hope that such economy will eventually cause a reduction in the Federal income tax, the legislation does not meet the direct interest test because any effect it may have upon the corporation's trade or business is highly speculative.

(2) *Appearances, etc., by expert witnesses.* (i) An appearance or communication (of a type described in paragraph (c)(2)(i)(a) of this section) by an individual in connection with legislation or proposed legislation shall be considered to be with respect to legis-

lation of direct interest to such individual if the legislation is in a field in which he specializes as an employee, if the appearance or communication is not on behalf of his employer, and if it is customary for individuals in his type of employment to publicly express their views in respect of matters in their field of competence. Expenses incurred by such an individual in connection with such an appearance or communication, including traveling expenses properly allocable thereto, represent ordinary and necessary business expenses and are, therefore, deductible under section 162. For example, if a university professor who teaches in the field of money and banking appears, on his own behalf, before a legislative committee to testify on proposed legislation regarding the banking system, his expenses incurred in connection with such appearance are deductible under section 162 since university professors customarily take an active part in the development of the law in their field of competence and publicly communicate the results of their work.

(ii) An appearance or communication (of a type described in paragraph (c)(2)(i)(a) of this section) by an employee or self-employed individual in connection with legislation or proposed legislation shall be considered to be with respect to legislation of direct interest to such person if the legislation is in the field in which he specializes in his business (or as an employee) and if the appearance or communication is made pursuant to an invitation extended to him individually for the purpose of receiving his expert testimony. Expenses incurred by an employee or self-employed individual in connection with such an appearance or communication, including traveling expenses properly allocable thereto, represent ordinary and necessary business expenses and are, therefore, deductible under section 162. For example, if a self-employed individual is personally invited by a congressional committee to testify on proposed legislation in the

field in which he specializes in his business, his expenses incurred in connection with such appearance are deductible under section 162. If a self-employed individual makes an appearance, on his own behalf, before a legislative committee without having been extended an invitation his expenses will be deductible to the extent otherwise provided in this paragraph.

(3) *Nominations, etc.* A taxpayer does not have a direct interest in matters such as nominations, appointments, or the operation of the legislative body.

(iii) *Allowable expenses.* To be deductible under section 162(a), expenditures which meet the tests of deductibility under the provisions of this paragraph must also qualify as ordinary and necessary business expenses under section 162(a) and, in addition, be in direct connection with the carrying on of the activities specified in subdivision (i)(a) or (i)(b) of this subparagraph. For example, a taxpayer appearing before a committee of the Congress to present testimony concerning legislation or proposed legislation in which he has a direct interest may deduct the ordinary and necessary expenses directly connected with his appearance, such as traveling expenses described in section 162(a)(2), and the cost of preparing testimony.

(3) *Deductibility of dues and other payments to an organization.* If a substantial part of the activities of an organization, such as a labor union or a trade association, consists of one or more of the activities to which this paragraph relates (legislative matters, political campaigns, etc.), exclusive of any activity constituting an appearance or communication with respect to legislation or proposed legislation of direct interest to the organization (see subparagraph (c)(2)(ii)(b)(I)), a deduction will be allowed only for such portion of the dues or other payments to the organization as the taxpayer can clearly establish is attributable to activities to which this paragraph does not relate and to any activity constituting an appearance or communication with respect to legislation or proposed legislation of direct interest to the organization. The determination of whether a substantial part of an organization's activities consists of one or more of the

activities to which this paragraph relates (exclusive of appearances or communications with respect to legislation or proposed legislation of direct interest to the organization) shall be based on all the facts and circumstances. In no event shall a deduction be allowed for that portion of a special assessment or similar payment (including an increase in dues) made to any organization for any activity to which this paragraph relates if the activity does not constitute an appearance or communication with respect to legislation or proposed legislation of direct interest to the organization. If an organization pays or incurs expenses allocable to legislative activities which meet the tests of subdivisions (i) and (ii) of subparagraph (2) of this paragraph (appearances or communications with respect to legislation or proposed legislation of direct interest to the organization), on behalf of its members, the dues paid by a taxpayer are deductible to the extent used for such activities. Dues paid by a taxpayer will be considered to be used for such an activity, and thus deductible, although the legislation or proposed legislation involved is not of direct interest to the taxpayer, if, pursuant to the provisions of subparagraph (2)(ii)(b)(I) of this paragraph, the legislation or proposed legislation is of direct interest to the organization, as such, or is of direct interest to one or more members of the organization. For other provisions relating to the deductibility of dues and other payments to an organization, such as a labor union or a trade association, see paragraph (c) of § 1.162-15.

(4) *Limitations.* No deduction shall be allowed under section 162(a) for any amount paid or incurred (whether by way of contribution, gift, or otherwise) in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums. For example, no deduction shall be allowed for any expenses incurred in connection with "grassroot" campaigns or any other attempts to urge or encourage the public to contact members of a legislative body for the purpose of proposing, supporting, or opposing legislation.

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

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

[T.D. 6819, 30 FR 5581, Apr. 20, 1965, as amended by T.D. 6996, 34 FR 835, Jan. 18, 1969; T.D. 8602, 60 FR 37573, July 21, 1995]

§ 1.162-21 Fines and penalties.

(a) *In general.* No deduction shall be allowed under section 162(a) for any fine or similar penalty paid to—

(1) The government of the United States, a State, a territory or possession of the United States, the District of Columbia, or the Commonwealth of Puerto Rico;

(2) The government of a foreign country; or

(3) A political subdivision of, or corporation or other entity serving as an agency or instrumentality of, any of the above.

(b) *Definition.* (1) For purposes of this section a fine or similar penalty includes an amount—

(i) Paid pursuant to conviction or a plea of guilty or *nolo contendere* for a crime (felony or misdemeanor) in a criminal proceeding;

(ii) Paid as a civil penalty imposed by Federal, State, or local law, including additions to tax and additional amounts and assessable penalties im-

posed by chapter 68 of the Internal Revenue Code of 1954;

(iii) Paid in settlement of the taxpayer's actual or potential liability for a fine or penalty (civil or criminal); or

(iv) Forfeited as collateral posted in connection with a proceeding which could result in imposition of such a fine or penalty.

(2) The amount of a fine or penalty does not include legal fees and related expenses paid or incurred in the defense of a prosecution or civil action arising from a violation of the law imposing the fine or civil penalty, nor court costs assessed against the taxpayer, or stenographic and printing charges. Compensatory damages (including damages under section 4A of the Clayton Act (15 U.S.C. 15a), as amended) paid to a government do not constitute a fine or penalty.

(c) *Examples.* The application of this section may be illustrated by the following examples:

Example 1. M Corp. was indicted under section 1 of the Sherman Anti-Trust Act (15 U.S.C. 1) for fixing and maintaining prices of certain electrical products. M Corp. was convicted and was fined \$50,000. The United States sued M Corp. under section 4A of the Clayton Act (15 U.S.C. 15a) for \$100,000, the amount of the actual damages resulting from the price fixing of which M Corp. was convicted. Pursuant to a final judgment entered in the civil action, M Corp. paid the United States \$100,000 in damages. Section 162(f) precludes M Corp. from deducting the fine of \$50,000 as a trade or business expense. Section 162(f) does not preclude it from deducting the \$100,000 paid to the United States as actual damages.

Example 2. N Corp. was found to have violated 33 U.S.C. 1321(b)(3) when a vessel it operated discharged oil in harmful quantities into the navigable waters of the United States. A civil penalty under 33 U.S.C. 1321(b)(6) of \$5,000 was assessed against N Corp. with respect to the discharge. N Corp. paid \$5,000 to the Coast Guard in payment of the civil penalty. Section 162(f) precludes N Corp. from deducting the \$5,000 penalty.

Example 3. O Corp., a manufacturer of motor vehicles, was found to have violated 42 U.S.C. 1857f-2(a)(1) by selling a new motor vehicle which was not covered by the required certificate of conformity. Pursuant to 42 U.S.C. 1857f-4, O Corp. was required to pay, and did pay, a civil penalty of \$10,000. In addition, pursuant to 42 U.S.C. 1857f-5a(c)(1), O Corp. was required to expend, and did expend, \$500 in order to remedy the nonconformity of that motor vehicle. Section 162(f)