

Federal, state and local lobbying costs can be significant, considering the increase in government legislation, rules, and regulations. These costs are typically nondeductible for federal tax purposes. However, taxpayers may not perform a complete analysis and identify deductions that might otherwise be allowable. This unintended permanent disallowance can adversely affect the taxpayer's effective tax rate percentage and tax liability.



KPMG can help

KPMG LLP's (KPMG) Accounting Methods and Credit Services (AMCS) professionals are well-versed in the rules under Internal Revenue Code (IRC) section 162(e). These rules address what costs are disallowed for federal income tax purposes. The proper treatment for these costs can help you potentially realize significant, permanent tax savings, as well as decreasing the effective tax rate percentage. KPMG can assist you in gathering, analyzing, reviewing, and preparing documentation to help properly classify internal lobbyist, external lobbyist, and lobbying association costs incurred. Since this is not an accounting method, adjustments to disallowed lobbying expenses can be made on any unfiled tax return as well as by amending any previously filed tax returns in which the statute of limitations has not closed.

Why aren't more taxpayers doing this?

Under the Lobbying Disclosure Act (LDA), persons engaged in lobbying activities are required to report amounts incurred internally and externally, in connection with federal lobbying, to certain governmental authorities. Reporting under the LDA is usually the responsibility of the taxpayer's government

affairs or similar department. In some cases, tax departments may not be experienced with the rules of reporting under the LDA, and it may also be true in some cases that the government affairs department is relatively unfamiliar with the rules pertaining to nondeductible lobbying costs under the IRC. The definitions of reportable lobbying amounts under the LDA versus nondeductible lobbying amounts under the IRC are different, with more costs potentially included under the LDA reporting requirement. Without the awareness and capability to bridge the gap between the LDA and IRC rules, taxpayers may have a mismatch between what is reportable under the LDA and what expenses are non-deductible under the IRC rules.

Besides the reporting of federal lobbying activities under the LDA, taxpayers may also incur a significant amount of state and local lobbying expenses. The rules for deducting amounts for state purposes are generally the same as for federal purposes, while local lobbying expenses are generally deductible.

What costs are not allowed to be deducted (lobbying activities)?

Generally, for federal tax purposes, no deduction is allowed for amounts paid in connection with: (1) activities influencing legislation, (2) activities related to political campaigns, (3) activities to influence the general public with respect to elections, legislative matters, or referendums, or (4) any direct communication with a covered executive branch official in an attempt to influence the official actions or positions of such official.

Note that these activities can be through the taxpayer's internal resources or through third-party lobbyists. Further, overhead and direct expenses related to internal wages that meet the definition of lobbying are disallowed as well.

What costs qualify for deduction (non lobbying activities)?

Certain costs that do not relate to legislation activities, but rather to activities for purposes of complying with the requirements of any law, rule, or regulation, or communications with government officials on how to implement the law, may be deductible. Several other activities often thought of as lobbying activities, or considered a lobbying activity under the Lobbying Disclosure Act, may be deductible as well.

Generate cash flow by identifying permanent tax deductions

KPMG has been successful in helping clients identify and reduce expenditures that would have otherwise been permanently disallowed. We can perform a quick assessment test to help you estimate the amount of possible deductions.

KPMG has several customizable proprietary tools (i.e., questionnaires, time allocation tools, training tools, calculations, etc.) that can help manage the time and commitment required from your tax department and government affairs department, allowing them to remain focused on their priority work. KPMG's previous project involvement has ranged from general consultation, to full review and assistance with process implementation.

Contact KPMG to learn more about this subject and how KPMG can help review your analysis methodology to identify allowed and disallowed lobbying costs. This could potentially produce substantial tax savings in both your tax provision and in cash taxes.

A manufacturer with a \$7 million lobbying budget was planning to report, based on its current analysis methodologies, approximately \$5 million in nondeductible lobbying expenses. This would have resulted in a permanent disallowance of these expenses. KPMG reviewed the taxpayer's methodology, and produced a report resulting in the taxpayer revising its review and analysis of these costs. As a result, the taxpayer only had approximately \$3 million of costs that qualified as nondeductible lobbying expenses. This enabled the taxpayer to deduct an additional \$2 million of costs that would have otherwise been permanently disallowed, thereby generating approximately \$700,000 in both cash and financial statement tax reduction.

The client will continue to generate savings going forward based on the improved methodology.

Please note that it is not the purpose of this publication to advise on the application of lobbying laws, or other lobbying matters, including decisions on whether to engage or not to engage with lobbyists.

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