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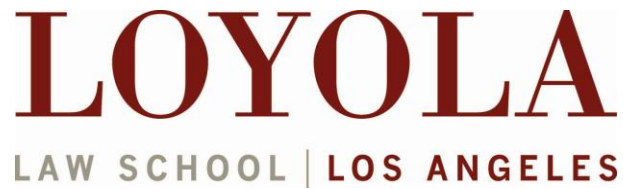
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Professor Ellen P. Aprill

Once and Future Gift Taxation of Transfers to Section 501(c)(4) Organizations:

Current Law, Constitutional Issues, and Policy Considerations

Ellen P. Aprill*

Section 501(c)(4) social welfare organizations, which are permitted to intervene in political campaigns to a significant extent while keeping their donors anonymous, played a key role in the 2010 elections and are expected to do so again in 2012. A September 2010 New York Times editorial declared: “For all the headlines about the Tea Party and blind voter anger, the most disturbing story of this year’s election is embodied in an odd combination of numbers and letters: 501(c)(4).”¹ Crossroads GPS, a section 501(c)(4) organization founded by a group of Republican insiders, is reported to have spent more than \$17.1 million on campaign activity in the 2010 elections.² It has pledged to remain active in the 2012 campaign.³ Reportedly, former

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¹ Editorial, *The Secret Election*, N.Y. TIMES, Sept. 19, at WK8. The editorial called for passage of the DISCLOSE ACT, which would have ended donor anonymity. See also Michael Luo & Stephanie Strom, *Donors’ Names Kept Secret As They Influence Midterms*, N.Y. TIMES, Sept. 21, 2010, at A1 (Crossroads Grassroots Policy Strategies set up by Karl Rove as 501(c)(4)).

² See <http://www.opensecrets.org/outsidespending/detail.php?cmte=Crossroads+Grassroots+Policy+Strategies&cycle=2010>.

³ D. Eggen, “Political groups, now free of limits, spending heavily ahead of 2012,” *The Washington Post* (May 21, 2011). See also Kenneth P. Vogel, *Both sides dash for anonymous cash*, POLITICO (Aug. 9, 2011), available at <http://www.politico.com/news/stories/0811/60731.html>

Obama White House officials and Democratic political operatives plan to establish section 501(c)(4) organizations of their own for the 2012 election.⁴

Congress has not ignored these developments. Senator Baucus, as Chairman of the Senate Finance Committee, sent a letter to Commissioner Shulman of the Internal Revenue Service (“IRS”) on September 28, 2010 calling upon the IRS to survey section 501(c)(4) organizations and other major noncharitable 501(c) organizations to ensure that they are obeying the rules regarding political activity, including applicable limits on campaign intervention.⁵ The letter asked whether the tax code is “being used to eliminate transparency in the funding of our elections.”⁶ As part of its work plan for next year, the IRS has indicated its intention to study of section 501(c)(4) organizations.⁷

Along with the level of permissible campaign intervention by section 501(c)(4) organizations, the applicability of the gift tax for transfers to them has long been a matter of uncertainty. Applicability of the gift tax to contributions to section 501(c)(4) organizations concerns these organizations because if the gift tax applies and were to be enforced, the amounts

⁴ M. Gold, “Former Obama aides launch independent fundraising groups,” *Los Angeles Times*, April 29, 2011; J. Rutenberg, “Democrats Form Fund-Raising Groups,” *The New York Times* (April 29, 2011).

⁵ As explained further below, section 501(c)(4) organizations can lobby without limit and engage in campaign intervention if such is not their primary activity. I will use “political activity” for both lobbying and campaign intervention. “Campaign intervention” will refer to direct or indirect political campaign activities on behalf of or in opposition to candidates for public office, that is, activity for or against particular individual candidates. “Lobbying” will rely on part of the definition in Treas. Reg. § 1.501(c)(3)-1(c)(3), namely, “to engage in attempts to influence legislation by contacting legislators or urging the public to contact them to propose, support, or oppose legislation, or advocating the adoption or rejection of legislation.”

⁶ Letter from Senator Baucus to Commissioner Shulman *available at* <http://finance.senate.gov/newsroom/chairman/release/?id=9bc04792-1ead-4668-a512-89443f342312>.

⁷ Exempt Organizations, FY 2010 Annual Report and 2011 Work Plan at 28, *available at* http://www.irs.gov/pub/irs-tege/fy2011_eo_workplan.pdf.

such organizations receive are likely to be significantly reduced. In many cases, donors would be expected to take such cost into account and reduce the amount of their contributions.⁸

This issue has gone without resolution because for decades the IRS has not enforced the gift tax in such situations. Recently, however, a furor arose about application of the gift tax to transfers to section 501(c)(4) that engage in campaign intervention, only to die down soon after it appeared. At the American Bar Association Tax Section meeting in May 2011, members of an Exempt Organization Subcommittee shared with others the fact that the IRS had sent several of their clients letters stating that their contributions to section 501(c)(4) organizations would be audited in connection with liability for the gift tax. According to a redacted version of one such letter circulated at the meeting, “[d]onations to 501(c)(4) organizations are taxable gifts.”⁹ When officials of the IRS Exempt Organizations divisions were asked about such audits at a later plenary session, they expressed ignorance of these efforts and suggested that the initiative came from the Estate and Gift Tax division.¹⁰

The revelation lit a firestorm. The IRS acknowledged that it had audits underway for five such donors and stated that the decisions were made by career civil servants without interference from anyone outside the IRS.¹¹ Six Senate Finance Committee Republicans then wrote a letter to IRS Commissioner Douglas Shulman questioning the action and asking “whether political

⁸ Another possible would be recasting the organization as a section 527 political organization, although in such a case donors would be disclosed. See Gregg Polsky, *A Tax Lawyer's Perspective on Section 527 Organizations*, 28 CARDOZO L. REV. 1773, 1782 (1982); Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations after Citizens United*, forthcoming 10 ELECTION L. J. However, donors to politically active section 501(c)(4) organizations currently have the option of contributing to a section 527 organization. That they have chosen not to do so, or at least not exclusively, suggests that, unless disclosure is also required for contributions to section 501(c)(4) organizations, they will continue to donate to section 501(c)(4) organizations, likely at a lower level, rather than contribute to section 527 organizations.

⁹ Letter on file with author

¹⁰ The author was present at both of these meetings.

¹¹ Stephanie Strom, *IRS Moves to Tax Gifts to Groups Active in Politics*, New York Times (May 12, 2011), available at <http://www.nytimes.com/2011/05/13/business/13gift.html>; *IRS Confirms Examinations of Donors to Social Welfare Groups*, 2011 TNT 94-2 (May 16, 2011).

appointees inside or outside the IRS were involved in any way in the decision.”¹² Shulman answered with a firm no, explaining that the action “resulted from a single matter where an IRS employee followed up on an internal referral” as part of “ongoing work that focuses broadly on gift tax noncompliance.”¹³ Despite Commissioner Shulman’s response to the Senate Finance Republicans, Dave Camp, the Chairman of the House Ways and Means Committee, further questioned the audits. In releasing his letter, Camp announced, “Every aspect of this tax investigation, from the timing to the sudden reversal of nearly thirty years of IRS practice, strongly suggests that the IRS is targeting constitutionally-protected political speech.”¹⁴

At that point, the IRS threw in the towel. On July 7, Steven T. Miller, Deputy Commissioner for Services and Enforcement, wrote a memo stating that his office would be coordinating with the Office of Chief Counsel as to whether there is a need for further guidance in the area, closing any outstanding efforts and stating that no examination resources would be expended on the issue until further notice. According to the memo, application of the gift tax to transfers to section 501(c)(4) organizations is a “difficult area with significant legal, administrative, and policy implications” with respect to which the IRS has “little enforcement history.” The memo stated, “It is anticipated that any further examination activity would be after the coordination described above and would be prospective only after notice to the public.”¹⁵ Moreover, a statement on the IRS webpage plaintively suggested, “It is possible that Congress

¹² *Senate Republicans Question IRS on Gift Tax Enforcement*, 2011 TNT 97-31 (May 19, 2011).

¹³ *Shulman Says IRS 501(c)(4) Enforcement Is Apolitical*, 2011 TNT 109-36 (June 7, 2011).

¹⁴ *Camp Says IRS Tax Investigation May Be Targeting Protected Political Speech*, 2011 TNT 116-39 (June 16, 2011).

¹⁵ *IRS Suspends Exams on Application of Gift Tax To Contributions Made to Some Exempt Orgs*, 2011 TNT 131-18 (July 18, 2011). The memo also indicated that the audits had in fact been suspended as of March 23, 2011. *Id.*

may choose to clearly articulate through legislation the applicability of the gift tax to contributions to 501(c)(4) organizations.”¹⁶

The purpose of this piece is to scrutinize the issues raised in connection with applying the gift tax to contributions to section 501(c)(4) organizations. It examines the status of such taxation under current law, the constitutionality of such taxation, and policy considerations.¹⁷ It concludes that, despite precedents that might be interpreted to the contrary, the better view is that such gifts are taxable under current law and that, despite Supreme Court campaign finance reform precedents, such taxation is constitutional under Supreme Court tax law precedents. Nonetheless, important constitutional values are at stake, and Congress should enact a provision explicitly exempting such contributions from the gift tax, as well as a provision taxing donations of appreciated property and a provision requiring donor disclosure. Failure by the IRS to enforce the law is not a satisfactory solution.

Part I explains the structure, history and purpose of the gift tax. Part II describes section 501(c)(4) organizations. Part III presents administrative and judicial precedents. Part IV sets forth constitutional arguments both against and in favor of applying the gift tax to section 501(c)(4) organizations. Part V adds the policy calculus that calls for Congress to enact a provision adding an exemption from the gift tax for section 501(c)(4) organizations. Part VI concludes.

¹⁶ <http://www.irs.gov/newsroom/article/0,,id=241592,00.html>; see *IRS Halts Gift Tax Exams of 501(c)(4) Donors, Won't Start More*, 2011 TNT 131-2 (July 8, 2011).

¹⁷ The accusation that the IRS responded to political pressure in initiating the gift tax audits on contributions to section 501(c)(4) organizations is not relevant to these arguments and will not be discussed.

I. The Gift Tax

The gift tax was first enacted in 1924. It was seen as a backstop to the estate tax, needed to prevent taxpayers from evading the estate tax by making *inter vivos* gifts.¹⁸ In 1926, however, the gift tax was repealed and not reenacted until 1932.¹⁹ Today we see the gift tax as protecting the integrity of not only the estate tax, but also the progressive rate structure of the income tax.²⁰ Without a gift tax, wealthy taxpayers would be much more likely to transfer income-producing property to family members in a lower income tax bracket. More generally, the transfer taxes, which include the generation skipping tax as well as the estate and gift tax, ensure against enormous concentrations of wealth. They also serve as a surrogate tax for the unrealized appreciation that goes untaxed under section 1014, which gives a fair market basis to property acquired from a decedent.

Under section 2501,²¹ tax is due on the transfer by an individual of property by gift. It is thus a form of excise tax. The tax is a tax on *inter vivos* transfers to the extent property “is transferred for less than an adequate and full consideration in money or money’s worth.”²² However, a transfer of up to \$13,000 per donor per donee per year, known as the annual exclusion, is not subject to the gift tax and thus is not a taxable gift.²³ In addition to the annual exclusion, the law provides a unified credit so that no tax is due out of pocket until gifts exceed a specified amount.²⁴ Through 2012, no tax will be due out of pocket until the total amount of

¹⁸ See Jeffrey A. Cooper, *Ghosts of 1932: The Lost History of Estate and Gift Taxation*, 9 FLA. TAX REV. 875, 883 (2010).

¹⁹ Cooper, *supra* at 884.

²⁰ See Mitchell M. Gans and Jay A. Soled, *Reforming the Gift Tax and Making It Enforceable*, 87 B.U. L. REV. 759, 761-64 (2007). The gift tax constrains transfers not only to those in a lower tax bracket for purposes of the federal income tax but also to those living in states with lower income tax rates or no income tax at all.

²¹ All references are to the Internal Revenue Code of 1986, as amended, unless otherwise noted.

²² Sec. 2512(b).

²³ Sec. 2503(b). Transfers for educational or medical expenses are also not subject to the gift tax. Sec. 2503(e).

²⁴ Sec. 2505.

lifetime taxable gifts by a donor exceeds \$5,000,000.²⁵ At other times in our history, the exclusion amount before tax was due out of pocket was considerably lower; in 2009, tax out of pocket was due for taxable gifts totaling more than \$1,000,000 at progressive rates with a maximum of 45 percent; in 2010 the amount remained at \$1,000,000 but the maximum tax rate was 35 percent.²⁶ The structure of the gift tax after 2012 is uncertain. It is possible that, if the exclusion amount for years after 2012 is reduced, amounts exempted from gift tax when the amount was \$5,000,000 will be clawed back and subject to tax.

Under the regulations a gift from an individual to a corporation generally represents gifts to the other shareholders of the corporation in proportion to their interests. This regulation also provides, “However, there may be an exception to this rule, such as a transfer made by an individual to a charitable, public, political or similar organization, which may constitute a gift to the organization as a single entity, depending upon the facts and circumstances in the particular case.”²⁷ Thus, the regulations anticipate that transfers to nonprofit organizations can be gifts and subject to gift tax.

The gift tax generally applies regardless of donative intent. Long-standing regulations explain, “Transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales,

²⁵Tax Relief, Unemployment Insurance Reauthorization , and Job Creation Act of 2010, sec. 301 (H.R. 4853). If Congress does not pass new legislation applicable after 2012, gift taxes will revert to the 2000 structure, with a \$1,000,000 exclusion amount and a maximum tax rate of 55%. *Id.*

²⁶ See sections 2505 (2009 and 2010); 2502 (2009 and 2010), Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16). In 2009, there was a unified credit for purposes of the estate tax for transfers up to \$3,500,000. For 2010, executors may choose between no estate tax with carryover basis or applying the 2011 and 2012 rules, which include fair market basis for property acquired from a decedent. See Bridget J. Crawford, *Fixing the Federal Wealth Transfer Tax System*, 2011 TNT 120-7 (June 22, 2011). Note that for purposes of the income tax, gifts, no matter how large, are not income. See sec. 102. The income tax, however, has a different definition of gift. See *Commissioner v. Duberstein*, 363 U.S. 278 (1960) (detached and disinterested generosity as test for gift for purposes of the income tax).

²⁷ Treas. Reg. § 25.2511-1(h)(1).

exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor.”²⁸ Moreover, “consideration not reducible to money or money's worth, as love and affection, promise of marriage, etc., is to be wholly disregarded.”²⁹ An early Supreme Court case interpreted the gift tax broadly. It emphasized that in enacting the gift tax, Congress, in order “to hit all the protean arrangements which the wit of man can devise . . . , dispensed with the test of ‘donative intent’” and applied the gift tax to other than genuine business transactions for less than “adequate and full consideration in money or money's worth.”³⁰ The case endorsed the gift tax regulations as fulfilling Congressional intent.

The gift tax regulations provide that “a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration.”³¹ This regulation was used, for example, in one oft-cited case to exempt from the gift tax a profit sharing plan in which executives bought stock at below fair market value. The case, cautioning against an assertion by the government that such transfers were not made in the ordinary course of business, wrote that “[t]he pertinent inquiry for gift tax purposes is whether the transaction is a *genuine business* transaction, as distinguished from the marital or family type of transaction.”³² Although another regulation states that the gift tax does not apply “to ordinary business transactions, described in § 25.2512-8,”³³ there has been controversy as to whether “bona fide,

²⁸ Treas. Reg. § 25.2512-8. Treas. Reg. § 25.2511-(g)(1) provides, “Donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer. The application of the tax is based on the objective facts of the transfer, rather than the subjective motives of the donor.”

²⁹ Treas. Reg. § 25.2512-8.

³⁰ *Commissioner v. Wemyss*, 324 U.S. 303, 306 (1945).

³¹ Treas. Reg. § 25.2512-8.

³² *Anderson's Estate v. Commission*, 8 T.C. 706, 720 (1947).

³³ Treas. Reg. § 25.2511-1(g)(1).

at arm's length, and free from any donative intent" defines an ordinary business transaction or whether being such a transaction is an additional requirement. Using the former approach, the regulation has been applied to exclude from gift tax transactions that are bona fide, at arm's length, and free from donative intent, without showing of any business motive.³⁴

The provisions of the gift tax include two additional provisions that bear upon its application to transfers to section 501(c)(4) organizations. Section 2522(a) permits a charitable contribution deduction in calculating taxable gifts for contributions to organizations like those for which charitable contributions deductions are permitted under section 170(c) for the income tax and section 2055 for the estate tax – governments, charities, the charitable activities of fraternal orders and posts or organizations of war veterans.³⁵ (While amounts for which a deduction is allowed are technically subject to a tax, the effect of the deduction is to make such transfers tax-free.) Although there are some differences in language among the charitable contribution provisions for the income tax, gift tax, and estate tax, all permit a deduction for transfer to any such organization only if it is “not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and . . . does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”³⁶

³⁴ See, e.g., *Galluzzo v. Commissioner*, 43 T.C.M. 199 (1981) (transfer during criminal investigation to reduce transferor's association with business not subject to gift tax).

³⁵ A charitable contribution deduction was provided by section 321(a)(2) of the Revenue Act of 1924, section 505(a)(2) of the Revenue Act of 1932 and section 1004(a)(2) of the Internal Revenue Code of 1939. See *Carson v. Commissioner*, 71 T.C. 252, 269-70 (1978) (Chabot, dissenting).

³⁶ Sec. 170(c)(2)(D); sec. 2055(a)(2); sec. 2522(a)(2). The language in all three of these sections regarding intervention in political campaigns was added in the Tax Reform Act of 1969, P.L. 91-72, §§ 201(a)(1), 201(d)(4)(A) and (C), while the campaign intervention prohibition had been added to section 501(c)(3) in 1954. See Roger Colinvaux, *Citizens United and the Political Speech of Charities*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1726407.

Further, section 2501(a)(4) exempts from the gift tax “the transfer of money or other property to a political organization (within the meaning of section 527(e)(1)) for the use of such an organization.” A political organization within the meaning of section 527(e)(1) is an organization with the primary purpose of campaign intervention.³⁷ In enacting this provision in 1974, Congress stated that it was “inappropriate to apply the gift tax to political contributions because the tax system should not be used to reduce or restrict political contributions.”³⁸ At the same time, Congress enacted a provision, codified as section 84, requiring that the transfer of appreciated property to a political organization be treated as a sale so that any appreciation would be subject to income tax.³⁹ It also stated in the legislative history that “if a decedent includes a political organization as a beneficiary of his estate, the amount so transferred is to be included in his estate.”⁴⁰ As a result of these provisions, contributions to political organizations have protection from gift tax, but do not enjoy the same kind of shelter from tax liability as that granted to charitable contributions.⁴¹

These statutory amendments followed an IRS announcement in 1973 anticipating Congressional action regarding both income and gift tax treatment of political organizations. The announcement called attention to the House Ways and Means Committee listing of the tax status of political organizations as a major subject for consideration and to the Secretary of

³⁷ Section 527 governs taxation of all political organizations. It also governs disclosure and registration for section 527 organizations regulated by the IRS rather than the Federal Election Commission (“FEC”) or the states. See § 527(i). The IRS defines campaign intervention far more broadly than does the FEC. See Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations after Citizens United*, *supra* note 8. The exclusion from the gift tax applies to all categories of political organizations.

³⁸ S. Rep. No. 93-1357 at 30 (1974). One wonders if self-interest played any role in this conclusion.

³⁹ P.L. 93-625, § 13(a) (codified as section 84).

⁴⁰ S. Rep. No. 93-1357 at 30 (1974). Eric G. Reis, *Mr. Soros Goes to Washington: The Case for Reform of the Estate and Gift Tax Treatment of Political Contributions*, 41 REAL. PROP., PROB. & TR. J. 299 (2007), argues that contributions to political organizations should be exempt from estate tax as well since “a bequest at death is less likely to have a corrupting influence on public officials than a gift made during lifetime.” *Id.* at 301

⁴¹ In contrast, section 170(e)(1) explicitly permits in many situations a deduction for the full fair market value of property for which gain would have been capital gain. As a result, the donor escapes income tax on the property’s appreciation.

Treasury calling for Congressional action in the area.⁴² In 1972, the IRS had published Revenue Ruling 72-355, which stated that it had been the position of the IRS since the enactment of the present gift tax in 1932 that contributions to a political campaign were taxable. The revenue ruling also gave a series of examples.⁴³ It thus seems that Congress was aware that its action in 1974 did not simply clarify but changed current law and practice.⁴⁴

In sum, the gift tax does not apply to contributions to charities or political organizations, but the provisions of the gift tax do not explicitly permit a deduction or exclusion for transfers to section 501(c)(4) organizations. Yet, as discussed in the next section, such organizations display similarities to both charitable organizations and to political organizations.

II. The Nature of Section 501(c)(4) Organizations

Treasury regulations describe a section 501(c)(4) organization as an organization “operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.”⁴⁵ As described below, some section

⁴² Ann. Rev. Proc. 73-84, 1973-2 C.B. 461.

⁴³ 1972-2 C.B. 532. The IRS also took action during this period regarding income taxation of political organizations. After opportunity for public comments and a public hearing, the IRS announced in 1973 that political parties and committees would be required to file “appropriate” tax returns for the years 1972 and following, as associations taxable as corporations or as trust, depending on specific facts and circumstances. Ann. Rev. Proc. 73-84, 1973-2 C.B. 461. The announcement it issued described a particular focus on the treatment of contributions of appreciated property that were subsequently sold by the recipient political organization. IRS News Release, Oct. 3, 1972.

⁴⁴ Congress in 1974 also enacted section 527 to govern income tax treatment of political organizations. See Aprill, *supra* note 8. The focus of section 527 was on how to tax political organizations for both the purposes of the income and gift tax and not on how the gift tax should treat different categories of tax-exempt organizations.

⁴⁵ Treas. Reg. § 1.501(c)(4)-1 (1995). Section 501(c)(4) also encompasses local associations of employees but such entities are not relevant here. For a history of section 501(c)(4), see *IRS EO CPE Text for Fiscal 2003: IRC 501(c)(4)*, 2002 TNT 2003-35 (October 21, 2002).

501(c)(4) organizations exhibit significant parallels to section 501(c)(3) organizations and others to political organizations.

A 2002 IRS Continuing Professional Education text acknowledges, “There is considerable overlap between IRC 501(c)(4) and IRC 501(c)(3). Many organizations could qualify for exempt status under either code section.”⁴⁶ Indeed, the regulations describing section 501(c)(3) organizations also include “promotion of social welfare” as a permitted tax- exempt purpose for charities.⁴⁷ Status as a section 501(c)(3) organization, however, allows donors who itemize to take a charitable contribution deduction for gifts to the organization. No charitable contribution deduction is available for gifts to section 501(c)(4) organizations.

The distinction between organizations eligible for status as a section 501(c)(3) organization and those only eligible for section 501(c)(4) status often turns on the breadth of the class of beneficiaries served.⁴⁸ Section 501(c)(3) organizations must serve a charitable class,⁴⁹ and not a smaller group in particular. Thus, Revenue Ruling 75-286⁵⁰ explains that a nonprofit organization with membership limited to the residents and business operators within a city block that was formed to preserve and beautify the public areas in the block not only benefits the community, but also enhances the value of individual members’ property rights. As a result, it will not qualify for exemption under section 501(c)(3), but may qualify under section 501(c)(4).

⁴⁶ *IRS EO CPE Text for Fiscal 2003: IRC 501(c)(4)*, *supra* note 45. The chapter also admits, “Although the Service has been making an effort to refine and clarify this area, IRC 501(c)(4) remains in some degree a catch-all for presumptively beneficial non-profit organizations that resist classification under the other exempting provisions of the Code. Unfortunately, this condition exists because “social welfare” is inherently an abstruse concept that continues to defy precise definition.” *Id.*

⁴⁷ See Treas. Reg. § 1.501(c)(3)-1(d)(2) (1995).

⁴⁸ HMOs are frequently section 501(c)(4) organizations because their enrollment requirements prevent the community benefit required for a health organization to qualify as a section 501(c)(3) organization. In some cases, low-income housing developments do not meet the IRS safe harbors for section 501(c)(3) status. See, e.g., *Two Utah-Based HMOs Get Tax Exempt Status*, 2005 TNT 218-7 (Nov. 14, 2005); *IRS Issues Guidance for Organizations Involved in Low-Income Housing*, 2006 TNT 112-101 (June 12, 2006).

⁴⁹ A charitable class must be large or indefinite enough that providing aid to the members of the class benefits the community as a whole. See *IRS CPE Text for 2003: Disaster Relief Current Developments*, 2002 TNT 200-25 (Oct. 16, 2002).

⁵⁰ 1975-2 C.B. 210.

In contrast, under Rev. Rul. 68-14,⁵¹ an organization formed to beautify an entire city is operated exclusively for charitable purposes and eligible for tax-exempt status under section 501(c)(3).

Like section 501(c)(3) organizations, section 501(c)(4) organizations can lobby. Unlike section 501(c)(3) organizations, which must limit their lobbying so that it is not substantial or so that it is within a sliding scale dollar amount under section 501(h), section 501(c)(4) organizations can lobby without limit if the lobbying is related to their exempt purpose. Thus, the distinction between a section 501(c)(3) and a section 501(c)(4) organization also often turns on the amount of lobbying it intends to do. In fact, lobbying can be the sole activity of a section 501(c)(4) organization.⁵² Revenue Ruling 71-350, for example, described an organization formed to improve the tax system.⁵³ The organization identified experts to testify at legislative and administrative hearing on tax matters, aided them in preparing and publicizing testimony, and used contributions from the public to cover the costs of transporting these witnesses, preparing and reproducing their statements, publicizing recommendations on proposed tax changes, and paying salaries and other expenses. As the ruling sets forth, the statute requires that a section 501(c)(4) organization be operated “exclusively for the promotion of social welfare,” but the applicable regulation states that the “exclusively requirement is satisfied if the organization is “primarily engaged in promoting in some way the common good and general welfare of the people of the community.”⁵⁴

⁵¹ 1968-1 C.B.243

⁵² Fishman and Schwarz, in the leading textbook, observe of the conclusion under the regulations that efforts by section 501(c)(4) organizations to influence legislation do promote social welfare but are not charitable: “This distinction is rather odd in view of the fact that promotion of social welfare is an example of charitable purpose.” JAMES J. FISHMAN & STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* (FOUNDATION PRESS: 3RD ED.) 990.

⁵³ Rev. Rul. 71-350, 1971-2 C.B. 237.

⁵⁴ Treas. Reg. § 1.501(c)(4)-1(a)(2) (1995).

The ruling characterized the organization as promoting the common good by helping policymakers “form better judgments” about tax legislation. It concluded, “[t]he fact that the organization’s only activities may involve advocating changes in law does not preclude the organization from qualifying under section 501(c)(4) of the Code.” That is, an organization can qualify for exemption under section 501(c)(4) even though it would fail to qualify for exemption under section 501(c)(3) as an “action organization,” an organization with primary objectives that can only be obtained through legislation and that advocates for those objectives.⁵⁵ Similarly, committees formed to support ballot initiatives or referenda are generally section 501(c)(4) organizations because their activity is lobbying.

Section 501(c)(4) organizations, unlike section 501(c)(3) organizations but like section 527 political organizations, can engage in campaign intervention.⁵⁶ Unlike section 527 organizations, for which campaign intervention activity must be their primary purpose, however, section 501(c)(4) organizations can do so only if campaign intervention does not constitute the organization’s primary activity; an organization must be primarily engaged in its exempt purpose.⁵⁷ The regulations are explicit: “The promotion of social welfare does not include direct

⁵⁵ Treas. Reg. § 1.501(c)(3)-1(c)(3)(iv) (1995). See Rev. Rul. 67-293, 1972-2 C.B. 185 (organization that attempts to influence legislation for the welfare of animals denied exemption under section 501(c)(3) as action organization but could qualify under section 501(c)(4)). It is common for there to be paired section 501(c)(3) and section 501(c)(4) organizations so that one can accept deductible contributions and the other can engage in substantial lobbying and some campaign intervention. Examples include the Sierra Club and the Sierra Club Foundation, the National Rifle Association and the National Rifle Association Foundation, and the American Civil Liberties Union and the American Civil Liberties Union Association. The Supreme Court blessed this affiliate structure in *Regan v. Taxation with Representation*, 461 U.S. 540 (1983).

⁵⁶ Section 501(c)(3) organizations are prohibited in section 501(c)(3) itself from any campaign intervention.

⁵⁷ Moreover, if political organizations are subject to FEC or IRS regulation, donors must be disclosed. Donors to political organizations regulated by states may or may not be subject to disclosure.

or indirect participation or intervention in political campaigns on behalf or in opposition to any candidate for public office.”⁵⁸

The IRS has not provided guidance as to what constitutes primary activity, and advisors differ widely in how much campaign intervention they believe section 501(c)(4) organizations can undertake without endangering their exempt status. Some are comfortable so long as campaign intervention is less than 50 percent of an organization’s total activities.⁵⁹ Members of the ABA Tax Section have suggested that the IRS adopt a 40 percent safe harbor for nonexempt activities.⁶⁰ Gregory Colvin has recently urged a 50% test.⁶¹ Professor Miriam Galston has recommended that the IRS undertake a regulations project on the question and perhaps look to the sliding scale of section 501(h) as a model.⁶² Democracy 21 and the Campaign Legal Center have petitioned the IRS for regulations that limit campaign intervention to an insignificant amount of the organization’s activity.⁶³ Although section 501(c)(4) organizations, unlike section 527 organizations, cannot engage primarily in campaign intervention, they have attracted politically-minded donors, because, unlike the case of political organizations, there is no public disclosure of contributors to them.⁶⁴

⁵⁸ Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (1959). The regulation echoes the prohibition in section 501(c)(3). A revenue ruling has explained that “all facts and circumstances are taken into account in determining a § 501(c)(4) organization’s primary activity.” Rev. Rul. 68-45, 1968-1 C.B. 259.

⁵⁹ FISHMAN AND SCHWARZ, *supra* note 52 at 570.

⁶⁰ See Renato Beghe, *Comments of the Individual Members of the Exempt Organizations Committee’s Task Force on Section 501(c)(4) and Politics*, 2004 TNT 101-16 (May 25, 2004), available on LEXIS, TNT file.

⁶¹ See Gregory L. Colvin, *Political Tax Law After Citizens United: A Time for Reform*, 66 EXEMPT ORG. TAX REV. 71 (2010). I personally would recommend a much lower test – 15 to 20%.

⁶² Miriam Galston, *Vision Service Plan v. U.S.: Implications for Campaign Activities of 501(c)(4)’s*, 53 EXEMPT ORG. TAX REV. 165 (2006). Section 501(h) permits 501(c)(3) organization to elect dollar limits for their lobbying activities. The limits depend on the size of the organization, but at a maximum \$1,000,000 of lobbying is permitted under section 501(h).

⁶³ http://democracy21.org/vertical/Sites/%7B3D66FAFE-2697-446F-BB39-85FBBBA57812%7D/uploads/IRS_PETITION_JULY_27_2011.pdf

⁶⁴ See sec. 6104(d)(3) (nondisclosure of contributors on annual information return except for contributors to private foundations and organizations exempt from taxation under section 527). During the last election, one lobbyist asserted that the “501cs are the keys to political kingdom” precisely “because they allow anonymity” and former

In certain situations, engaging in lobbying or campaign intervention will lead to tax liability for a section 501(c)(4) organization itself. To the extent an organization exempt under section 501(c)(4) intervenes in a political campaign using monies from its general funds, the organization is subject to tax on the lesser of its net investment income or the amount spent on politicking.⁶⁵ Because section 162(e) denies a business deduction for lobbying, if a section 501(c)(4) organization engaged in lobbying has members that deduct dues to the organization as a business expense, the organization must pay a “proxy tax” on behalf of its members for the lobbying or notify its members of the percentage of dues that are not deductible.⁶⁶ Under current law, however, no provision of the Internal Revenue Code taxes the gain inherent in contributions of appreciated property to section 501(c)(4) organizations. That is, there is no provision parallel to section 84 applicable to section 501(c)(4) contributions.

In sum, section 501(c)(4) organizations can lobby far more than section 501(c)(3) organizations or section 527 organizations⁶⁷ and engage in campaign intervention far less than section 527 political organizations. As the next section discusses, in the absence of statutory guidance, the IRS and courts have struggled with whether the gift tax applies to transfers to social welfare organizations and, prior to the adoption of section 2501(a)(4), to political organizations.

FEC counsel Larry Noble concluded that the major impact of *Citizens United* “is that more money is going to 501(c)(4) groups, trade groups and others that don’t disclose their donors.” See Peter Stone, *Campaign Cash: The Independent Fundraising Gold Rush Since ‘Citizens United’ Ruling*, Center for Public Integrity, October 4, 2010, available at <http://www.publicintegrity.org/articles/entry/2462/>.

⁶⁵ Section 527(f). In many cases, however, section 501(c)(4) organizations have little or no investment income and thus little or no tax liability under this provision. Moreover, they can engage in campaign intervention through a section 527 organization, rather than directly, simply by setting up a bank account as a “separate segregated fund.” See § 527(f). The separate segregated fund will be taxed only on investment income, if any.

⁶⁶ Section 6033(e)(1)(A)(ii). Section 162(e) also forbids deductions for campaign intervention, but the proxy tax does not apply to amounts subject to tax under section 527(f). Sec. 6033(e)(1)(A)(iii).

⁶⁷ Lobbying is not a permitted exempt purpose for section 527 organizations. See section 527(e)(2).

III. Administrative and Judicial Precedents

The IRS has consistently taken the position that transfers to section 501(c)(4) organizations and, until enactment of section 2501(a)(4), to political organizations are subject to the gift tax. Courts have been less consistent.⁶⁸ While there is authority that transfers to political organizations before the enactment of section 2501(a)(4) are not subject to the gift tax, I do not find these cases well-reasoned. Moreover, transfers to political organizations offer only a partial analogy for transfers to section 501(c)(4) organizations.

Cases from the 1940's and 1950's denied a gift tax deduction for transfers to organizations that today would be classified as section 501(c)(4) organizations. *Faulkner v. Commissioner* held that a transfer to the Birth Control League of Massachusetts was subject to the gift tax.⁶⁹ Its legislative activities for the years at issue prevented it from being a charitable organization for which a deduction from the gift tax was allowed. In *DuPont v. United States*,⁷⁰ the taxpayer made a transfer to the National Economic Council, which had as its purpose, "to preserve private enterprise, private property and private initiative and American independence."⁷¹ Its activities included appearances before committees of Congress and efforts to influence legislation. The taxpayer had asserted on his gift tax return that the transfer was deductible as a charitable, public, or similar gift. Upon audit, he asserted that the amount was not a gift but a payment for services. According to the court, the taxpayer felt that the

⁶⁸ Throughout this section, I owe particular thanks to Barbara K. Rhomberg, *The Law Remains Unsettled on Gift Taxation of Section 501(c)(4) Contributions*, TAXATION OF EXEMPTS (SEPTEMBER/OCTOBER 2002) 62 and Donald B. Tobin, *The Application of the Gift Tax Provisions in the Internal Revenue Code to § 501(c)(4) Organizations*, available at [HTTP://MORITZLAW.OSU.EDU/ELECTIONLAW/COMMENTS/INDEX.PHP?ID=8335](http://moritzlaw.osu.edu/electionlaw/comments/index.php?id=8335).

⁶⁹ 41 B.T.A. 875 (1940),

⁷⁰ 97 F. Supp 944 (D. Del. 1951).

⁷¹ *Id.* at 946

organization's objectives "would further the general welfare, including his own."⁷² The court concluded that the gift tax applied: "[T]he plaintiff received no direct and personal consideration for the transfer which may be accurately reduced to a money value. . . . Any consideration or benefit by the plaintiff was not a benefit accruing to him alone, but one enjoyed by every citizen of the country."⁷³ In dicta, the court stated that the taxpayer's transfer was "somewhat analogous" to a transfer of the same amount to a political party or a newspaper having the same views as he.

*Blaine v. Commissioner*⁷⁴ involved large transfers in 1948, 1949 and 1950 to the Foundation for World Government, an organization that the Commissioner had determined to be a social welfare organization rather than an educational organization. The estate of Mrs. Blaine filed for refund of gift taxes that she had paid. The issue was whether the Foundation qualified as a charitable organization to which contributions were deductible for purposes of the gift tax. The Foundation sought to form a world government and its early grants to "groups that were actively advocating and seeking the establishment of world government, were largely to organizations or groups that were vigorously supporting many of the world government movement" that is, "a political objective."⁷⁵ Thus, the organization did not qualify as an educational organization for which a deduction from the gift tax would be permitted. Because it was a social welfare organization, transfers to it were not deductible under either the income tax or the gift tax.⁷⁶ The court denied the taxpayer's refund request.

⁷² *Id.*

⁷³ *Id.* at 947.

⁷⁴ 22 T.C. 1195 (1954).

⁷⁵ *Id.* at 1212

⁷⁶ The opinion is explicit: "no income tax deductions are provided for gifts to 'social welfare' organization, nor are such gifts declared to be deductible in the computation of the gift tax." *Id.*

The next precedent involved political organizations and political campaigns rather than section 501(c)(4) organizations. In 1959, the IRS weighed in on transfers to a political party or a candidate for public office. A short revenue ruling without analysis or explanation held that such transfers above the annual exclusion would be subject to the gift tax.⁷⁷

After the 1959 revenue ruling, the applicability of the gift tax to transfers in 1959, 1960, and 1961 to a group supporting a reform slate of candidates in Louisiana underwent judicial scrutiny. Mrs. Edith Stern transferred funds to a group organized as an informal finance committee by herself and others who shared her views. She did not pay gift tax on these transfers, but attached a statement to a gift tax return explaining that her transfers to a group supporting a reform slate of candidates were made to protect her property and personal interests by promoting efficiency in government and that the funds were used on her behalf for handbills, posters, television and radio publicity, and other campaign expenses. That is, she and the others on the committee designated the use of the funds.

According to findings of the District Court, this informal finance committee controlled the funds. It also made a finding of fact that “[p]laintiff was not motivated by affection, respect, admiration, charity, or like impulses but her political expenditures were motivated by a desire to promote efficiency in government and to protect her property and personal interests, which purposes constituted full and adequate consideration for the expenditures.”⁷⁸ Such a finding would suggest that if the plaintiff’s political beliefs had instead been motivated by more altruistic concerns, such as helping the poor and needy, there would have been a taxable gift. However, the District Court further found that the goods and services purchased partly with her funds by

⁷⁷ 1959-1 C.B. 626.

⁷⁸ *Stern v. United States*, 304 F. Supp 376, 379 (E.D. LA. 1969).

the committee in which she participated constituted full and adequate consideration. The transfers, it found as a matter of fact, were bona fide, at arm's length, and free from donative intent. Thus, as a matter of law, the transfers did not constitute gifts to which the gift tax applied. The Fifth Circuit affirmed by looking primarily to Treasury Regulation section 25.2512-8, the regulation addressing transfers in the ordinary course of business. To the Fifth Circuit, "[t]he transactions in controversy were permeated with commercial and economic factors."⁷⁹

The IRS announced it would not follow *Stern*, except in the Fifth Circuit.⁸⁰ After the decision in the *Stern* case, the IRS issued Revenue Ruling 72-355, in which it gave examples of the principles under which political organizations will be recognized as one organization or separate donees for the purposes of the gift tax. It also took the occasion to state that "[s]ince the enactment of the present gift tax in 1932, it has been the position of the Internal Revenue Service that contributions to a political campaign are taxable transfers for purposes of the gift tax imposed by section 2503(b) of the Code."⁸¹ It cited to the Testimony of Assistant Commissioner Justin Winkle before the Subcommittee on Privileges and Elections of the Senate Committee on Rules and Administration in 1956, which asserted that only one annual exclusion was permitted for a contribution to a political organization, even if several individuals benefit from the contribution. This statement presupposes that the gift tax applies to transfers to political organizations.

A few years after Revenue Ruling 72-355, the Tax Court considered the application of the gift tax to transfers in 1967, 1968 and 1970 and 1971 by David Carson and his wife to various election campaigns. Judge Wilbur's opinion avoided an inconsistency inherent in the

⁷⁹ *Stern v. United States*, 436 F.2d 1327, 1330 (5th Cir. 1971).

⁸⁰ Rev. Rul. 72-583, 1972-2 C.B. 534.

⁸¹ 1972-2 C.B. 255. A later revenue ruling explained that the transfer had to be to a bona fide political organization. Rev. Rul. 74-199, 1974 C.B. 285.

Stern case, which had seemed to imply that only those whose contributions to political organizations were based on self-interest could be exempt from the gift tax. Judge Wilbur took the position that any transfer to a candidate who will “promote the social framework petitioner considered most auspicious to the attainment of his objectives in life,” whether “most conducive to his economic aspirations” or “a social structure advancing their own notions of social justice”⁸² would be exempt from tax. He concluded that such transfers “when considered in light of the history and purpose of the gift tax, are simply not ‘gifts’ within the meaning of the gift tax law,” rejecting the full and adequate consideration reasoning of *Stern*.⁸³

Judge Tannenwald wrote a concurring opinion, which two judges joined, in which he said he would stay the court’s hand because of the sensitive nature of politics.⁸⁴ Judge Hall’s concurrence, which two other judges joined, reasoned that the transfer is not to benefit the donee in his personal capacity and, because given “to facilitate the taxpayer’s own views” is not more a gift than “is an expenditure for a newspaper advertisement a gift to the paper.”⁸⁵

Judge Chabot was one of three judges dissenting. As Judge Chabot demonstrated, the arguments of the majority in the Tax Court and of the Fifth Circuit “repeal (or at least make into surplusage)” the provision for the charitable contribution deduction under the gift tax since all such transfers “also would qualify under the majority opinion in the instant case as not being a gift.”⁸⁶ He noted that in particular the majority’s approach repealed the amendment to the gift tax charitable contribution deduction that denied any deduction to charitable organizations that

⁸² *Carson v. Commissioner*, 71 T.C. 252, 258 (1978).

⁸³ *Id.* at 263-64.

⁸⁴ *Id.* at 264.

⁸⁵ *Id.* at 265.

⁸⁶ *Id.* at 268, 270.

engage in campaign interventions.⁸⁷ He further observed that no statutory provision justified the exemption from the gift tax and that the gift tax case law and regulations did not require personal benefit to the donee. He pointed to the similarity between the motives of the taxpayers in *Carson* and in *DuPont*, a case that concluded that the gift tax did apply to the transfer. He questioned the failure to examine the majority's factual basis for *Stern*.

The Tenth Circuit affirmed the Tax Court on the grounds that campaign contributions are not gifts within the meaning of the gift tax law.⁸⁸ The Tenth Circuit, however, did not answer the arguments made by Judge Chabot in dissent in the Tax Court.

Like Judge Chabot, the IRS was concerned about possible implications of the *Carson* decision, although it acquiesced in the result.⁸⁹ It issued Revenue Ruling 82-216,⁹⁰ in which it conceded that in light of *Stern* and *Carson* and the enactment of section 2501(a)(4) exempting contributions to political organizations from the gift tax, the IRS would no longer contend that contributions to political organizations would be subject to the gift tax “irrespective of when the contributions were made.” It noted, however, that the IRS did not accept the rationale of either decisions and continued to maintain that “gratuitous transfers to persons other than organizations described in section 527(e) are subject to the gift tax absent any specific statute to the contrary, even though the transfers may be motivated by a desire to advance the donor's own social, political or charitable goals.” It gave section 2522(a), which limits the charitable gift tax deduction to those organizations that have not been disqualified for exemption under section

⁸⁷ See *supra* note 36.

⁸⁸ *Carson v. Commissioner*, 641 F.2d 864, 866 (10th Cir. 1981). The court also noted that the exemption from the gift tax for transfers to political organizations applied only after May 7, 1974 and thus did not apply to the transactions at issue in the case. *Id.* at 866. The court stated that the new provision could either indicate a change in the law or a clarification of the law. As I discussed earlier, I believe that the events leading to the exemption from the gift tax for political organizations indicates that Congress is likely to have known it was changing the law.

⁸⁹ 1982-2 C.B. 1.

⁹⁰ 1982-2 C.B. 220.

501(c)(3) for attempting to influence legislation or participate in political campaigns, as an example of a specific statute to the contrary.⁹¹

After issuing this revenue ruling, however, IRS activity become dormant. No further rulings were issued. There appeared to be no enforcement against donors to section 501(c)(4) organizations. In 2004, a Task Force of the members of the ABA Tax Section Exempt Organizations Committee called upon the IRS to take the matter of the application of the gift tax under advisement and announce that the IRS would not assert that such gifts are taxable while review of the issue is pending.⁹² Only now has the IRS done so.

Thus, courts in the *Stern* and *Carson* cases held that the gift tax did not apply to transfers to political organizations. *Stern* depended, at least in part, on a factual finding of adequate consideration for transfers to an organization the taxpayer had helped to organize and control, *Carson* on a court making a policy decision.⁹³ Nonetheless, a court faced with the issue of whether the gift tax applies to transfers to section 501(c)(4) organizations could rely on these cases to say that it does not. The Joint Committee on Taxation, for example, has written, “The rationale reflected in the *Carson* and *Stern* cases – i.e., that the recipient organization or candidate may be viewed for gift tax purposes as the means to the end of the contributor—arguably could be applied to contributions made to fund advocacy activities (‘express advocacy’ or ‘issue advocacy’) of section 501(c)(4) organizations.”⁹⁴

⁹¹ It is worth noting that a section 501(c)(3) organization that loses its status for too much lobbying or for campaign intervention may not thereafter be treated as a section 501(c)(4) organization. Section 504(a).

⁹² *ABA Comments on Political Activity Policies*, 2004 TNT 102-16 (May 26, 2004).

⁹³ Donald Tobin writes, “*Stern* is a very fact-intensive case that relied on a type of contribution that does not exist in the current context. Moreover, the Service in *Stern* stipulated that the gifts were made without donative intent. . . . The *Carson* holding completely ignores the relevant law”

“<http://moritzlaw.osu.edu/electionlaw/comments/index.php?ID=8335>

⁹⁴ Joint Comm. On Taxation, *Overview of Present-Law Rules and Description of Certain Proposals Relating to Disclosure of Information by Tax-Exempt Organizations with Respect to Political Activities*, JCX-59-00, at 45 n.

I do not subscribe to the Joint Committee's view. To the extent that arguments supporting inapplicability of the gift tax to section 501(c)(4) organizations rely on the full and adequate consideration rationale accepted in *Stern*, I agree with the court in *DuPont* that the taxpayer did not receive full and adequate consideration in money or money's worth: "[T]he plaintiff received no direct and personal consideration for the transfer which may be accurately reduced to a money value. . . . Any consideration or benefit by the plaintiff was not a benefit accruing to him alone, but one enjoyed by every citizen of the country."⁹⁵

While less important, I also see structural differences between contributions to purely political organizations to section 501(c)(4) organizations when it comes to the issue of full and adequate consideration. A transfer to a section 501(c)(4) organization will, I believe, generally be treated as a transfer to the organization as a whole under the regulations.⁹⁶ A section 501(c)(4) organization cannot have campaign intervention as its primary purpose. It must have as its primary purpose promoting the "common good and general welfare of the people of the community."⁹⁷ That is, it cannot have as its goal the promotion of the donor's personal interests. Transferees to section 501(c)(4) organizations generally thus should not be able to rely on the reasoning of *Stern* that a transfer to a political organization involves full and adequate consideration because political interests are identical to personal goals.⁹⁸ Under the gift tax, a

129) (June 19, 2000). Such was not in fact the basis for the decision in *Carson*. It explicitly declined to adopt the reasoning of *Stern* that these were transfers for full and adequate consideration.

⁹⁵ 97 F. Supp. at 947.

⁹⁶ As noted earlier, under Treas. Reg. § 25.2511-1(h), "a transfer made by an individual to a charitable, public, political or similar organization . . . may constitute a gift to the organization as a single entity, depending upon the facts and circumstances in the particular case." See also Ellen P. Aprill, *Section 501(c)(4) Organizations, the Gift Tax, and Election Law Disclosure*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1706975, for discussion of transfers to section 501(c)(4) organizations being transfers to the organization as a whole unless otherwise explicitly specified.

⁹⁷ Treas. Reg. § 1.501(c)(4)-1 (1995).

⁹⁸ The consequences under this line of reasoning for a gift earmarked for campaign intervention are less clear. I note that unless the donor earmarks a gift for a particular campaign activity, not campaign activity in general, the Federal Election Commission will not require disclosure of the donor. Aprill, *supra* note 96. Nothing in the

transfer to a section 501(c)(4) organization generally should be deemed to be made for all the exempt purposes of the organization.⁹⁹

As for the *Carson* case, I would reject it for all the reasons that Judge Chabot set forth in his dissent, in particular the fact that the majority's view of the case repeals the disallowance of the gift tax charitable contribution deduction to organizations that do not engage in substantial lobbying or participate to any extent in campaign intervention. Most importantly, deciding whether to apply the gift tax as a matter of policy is a decision for Congress, not a court, to make, unless application of the tax would be unconstitutional, as some assert and as the next section discusses.

In addition, Revenue Ruling 82-216, in which the IRS asserted that the gift tax applied to transfers to organizations absent a specific statute to the contrary, could be expected to receive some deference from a court. The current consensus is that revenue rulings get so-called “*Skidmore* deference,” under which a court considers various factors in deciding how weight to give to the administrative pronouncement, rather than the strong deference known as *Chevron* deference.¹⁰⁰ Under *Skidmore*, according to a recent Supreme Court case, a court considers “the degree of the agency’s care, its consistency, formality, and relative expertness, and . . . the

regulation speaks to whether the gift should be deemed made to those that benefit from the section 501(c)(4) organization’s activities. The regulation could be read as implying that, in situations when the entity, such as a section 501(c)(4), has members with rights analogous to shareholder’s rights, such as the right to vote for board members, gifts are deemed made to the members. In any case, this argument is subsidiary to that rejecting the reasoning of *Stern* as to receipt of full and adequate consideration for the transfer to the political organizations.

⁹⁹ I note that the situation would be different if the section 501(c)(4) organization acts as a contributor’s agent rather than as a donee. If the section 501(c)(4) organization agrees to act as a contributor’s agent, no gift will be made to the organization; instead, a contribution will be made at the time that the section 501(c)(4) organization selects an expenditure, such as candidate-related advertisements, to which the contributor’s funds are then dedicated, and the expenditure will be treated as made directly by the contributor at that time for that expenditure. However, such a structure may require disclosure under FEC regulations. See Aprill, *supra* note 96. I thank Harvey Dale for pointing out this structure.

¹⁰⁰ See Kristin E. Hickman, *IRB Guidance: The No Man’s Land of Tax Code Interpretation*, 2009 MICH. ST. L. REV. 239, 258-60. The Justice Department, for example, has recently stated that it will no longer argue for *Chevron* deference for revenue rulings. *DOJ Won’t Argue for Chevron Deference for Revenue Rulings and Procedures, Official Says*, 2011 TNT 90-7 (May 10, 2011).

persuasiveness of the agency's position.”¹⁰¹ In the case of Revenue Ruling 82-216, the IRS has expertise and the persuasiveness of the statutory language in its favor. The lack of enforcement of the gift tax for contributions to section 501(c)(4) organizations, however, seems to demonstrate lack of consistency, and Revenue Ruling 82-216 lacks extensive reasoning in reaching its conclusion. The degree of deference a court would give to the revenue ruling is therefore uncertain.

In sum, I believe that under current law transfers to section 501(c)(4) organizations are subject to the gift tax. In other words, the IRS has legal authority to apply the gift tax to such organizations, although if it did so and the taxpayer challenged the tax in court, it would need to be prepared to defend its decision with a critical reading and distinguishing of *Stern* and *Carson* as well as to expand on the basis for the conclusion in Revenue Ruling 82-216 .

IV. Constitutional Issues

The IRS has acknowledged that gift taxation of transfers to section 501(c)(4) organizations could implicate the constitution. Before releasing Revenue Ruling 82-216, the Individual Tax Division sent a draft and asked for guidance from the Office of Chief Counsel and received an answer in the form of a General Counsel Memorandum (“GCM”).¹⁰² The drafters of the ruling asked whether imposition of the gift tax on certain political contributions violates the First Amendment. The GCM responded that it believed that Taxation with Representation of Washington v. Regan, pending at the time before the Supreme Court, would answer the constitutional question indirectly if not directly, since gift taxation of political

¹⁰¹ United States v. Mead Corp., 533 U.S. 218, 228 (2001) (summarizing *Skidmore* factors)..

¹⁰² Various functions that were in separate offices are now combined in Office of Chief Counsel, and GCMs are no longer issued. See Jasper L. Cummings, *Legal Research in Federal Taxation*, 2005 TNT 200-30 (October 18, 2005).

contributions and limitations on lobbying by section 501(c)(3) organizations are both “arguably unconstitutional restraints upon the right to freedom of expression and right to engage in legislative activity.”¹⁰³ As discussed further below, I believe that both *Taxation with Representation (TWR)* and a series of Supreme Court cases upholding broad-based taxes answer arguments that campaign finance precedents make application of the gift tax to transfers for purposes of campaign intervention unconstitutional.

Language in campaign finance cases might suggest at first reading that gift taxation of section 501(c)(4) organizations engaged in lobbying or campaign intervention violates the First Amendment because the tax chills free speech and discourages freedom of association in the fundamental arena of political speech.¹⁰⁴ The seminal campaign finance case, *Buckley v. Valeo*,¹⁰⁵ acknowledged that freedom of association is diluted “if it does not include the right to pool money through contributions, for funds are often essential if advocacy is to be truly optimal or effective.”¹⁰⁶ Nonetheless, the Court upheld limits on an individual’s campaign contributions under an “exacting scrutiny” standard of review because “in contrast with a limitation upon expenditures for political expression, a limitation upon the amount that any one person or group may contribute to a candidate or political committee entails only a marginal restriction upon the contributor’s ability to engage in free communication.”¹⁰⁷ The Court weighed the contributor’s interest against the government’s “weighty” interest in preventing the reality or appearance of corruption and found the balance favored the limitations. Moreover, contributors remained “free to engage in independent political expression, to associate actively through volunteering their

¹⁰³ GCM 38930 (December 3, 1981).

¹⁰⁴ For these arguments, I am indebted to Barbara K. Rhomberg, *Constitutional Issues Cloud the Gift Taxation of Section 501(c)(4) Organizations*, TAXATION OF EXEMPTS (JANUARY/FEBRUARY 2004) and an email sent by Barnaby Zall to the Election Law Listserv (on file with author).

¹⁰⁵ 424 U.S. 1 (1976).

¹⁰⁶ *Id.* at 66.

¹⁰⁷ *Id.* at 20-21.

services, and to assist to a limited but nonetheless substantial extent in supporting candidates and committees with financial resources.”¹⁰⁸ The same is true if contributors to section 501(c)(4) organizations are subject to the gift tax. Moreover, the income tax substantially reduces the amount available for contributions. Yet, as discussed below, broad-based taxes are constitutional unless aimed at First Amendment activity.

In *Citizens Against Rent Control v. Berkeley*, however, the Supreme Court held unconstitutional a city ordinance that limited the size of contributions to committees supporting or opposing ballot measures. Under the ordinance, “an affluent person” could, “acting alone, spend without limit to advocate individual views on a ballot measure.”¹⁰⁹ For the Court, “[t]o place a Spartan limit - or indeed any limit - on individuals wishing to band together to advance their views on a ballot measure, while placing none of individuals acting alone, is clearly a restraint on the right of association.”¹¹⁰ The Court also acknowledged the right of individuals to speak through groups:

Apart from the impermissible restraint on freedom of association, but virtually inseparable from it in this context, [the ordinance] imposes a significant restraint on the freedom of expression of groups and those individuals who wish to express their view through committees.¹¹¹

The Court rejected as insufficient the city’s justification of a risk of corruption because “[t]he risk of corruption perceived in cases involving candidate elections simply is not present in a

¹⁰⁸ *Id.* at 27.

¹⁰⁹ 454 U.S. 290, 296 (1981).

¹¹⁰ *Id.* at 298.

¹¹¹ *Id.*

popular vote on a public issue.”¹¹² One commentator finds the reasoning of *Citizens Against Rent Control* “directly on point” for transfers to section 501(c)(4) organizations, because the gift tax imposes its tax burden when taxpayers act in concert with others by contributing to an organization. Thus, when applied to contributions for expressive activities, it burdens the donor’s exercise of First Amendment rights without adequate government justification.¹¹³

Further, courts have expanded the principles announced in *Citizens against Rent Control*. In *Federal Election Commission v. Massachusetts Citizens for Life*,¹¹⁴ the Supreme Court held it was unconstitutional to apply federal election law limits on organizations, which are virtually always section 501(c)(4) organizations, “formed to disseminate political ideas, not to amass capital” and which do not accept corporate or union contributions.¹¹⁵ In *Citizens United v. F.E.C.*,¹¹⁶ the Supreme Court went further. It rejected the campaign finance law prohibition on corporations of any kind, for-profit or nonprofit, making independent expenditures – that is, expenditures not coordinated with a candidate, the candidate’s authorized committee, or a political party. It dismissed the government’s anticorruption rationale because, according to the opinion, independent expenditures “do not give rise to corruption or the appearance of corruption.”¹¹⁷ It identified only quid pro quo corruption, not “[i]ngratiation and access,” as a government interest that outweighs the burden of any prohibition or limit on the exercise of First Amendment rights.¹¹⁸

¹¹² *Id.* at 298, citing *First Nat’l Bank of Boston v. Bellotti*, 435 U.S. 765 (1978).

¹¹³ Rhomberg, *Constitutional Issues*, *supra* note at 167. Yet, as Donald Tobin has pointed out to me, in the gift tax context, unlike the case in *Citizens against Rent Control*, individuals contributions are not treated differently from group contributions. If I give money directly to an individual to help that person conduct activities I believe promote social welfare, my transfer will be subject to the gift tax.

¹¹⁴ 479 U.S. 328 (1986).

¹¹⁵ *Id.* at 259.

¹¹⁶ 130 S.Ct. 876 (2010).

¹¹⁷ *Id.* at 909.

¹¹⁸ *Id.* at 909-910.

In *Speech Now v. F.E.C.*,¹¹⁹ the D.C. Circuit, relying on *Citizens United*, held that contribution limits are unconstitutional when applied to individual contributions to an organization formed by individuals to make independent expenditures advocating the defeat or election of candidates because such contributions do not pose a threat of corruption. Since 501(c)(4) organizations, which can engage in First Amendment activities of both lobbying and campaign intervention, make independent expenditures that do not pose a threat of corruption under these tests, and the gift tax reduces the amount transferred to them, those who believe that applying the gift tax to such contributions is unconstitutional argue that the gift tax acts as a limit on contributions under these precedents.

I reject application of the reasoning of these cases to gift taxation of transfers to section 501(c)(4) organizations. Campaign finance regulation by its very nature is aimed directly at political speech. The limits are absolute. In *Citizens United*, Justice Kennedy described the campaign finance provision at issue as an “outright ban, backed by criminal sanctions”¹²⁰ and as “prohibition on corporate independent expenditures . . . a ban on speech.”¹²¹ The gift tax, in contrast, is not aimed only at section 501(c)(4)s that engage in political speech or even at all section 501(c)(4)’s, but more generally at all transfers for less than full and adequate consideration, with the exemptions discussed earlier. Moreover, the gift tax does not limit the amount transferred to the organization¹²²

¹¹⁹ 599 F.3d 686 (D.C. Cir 2010).

¹²⁰ 130 S. Ct. at 897. The Court offered a hypothetical involving a number of well-known 501(c)(4) organizations – the Sierra Club, the National Rifle Association, and the American Civil Liberties Union, although it did not identify them as such.

¹²¹ Id. at 898.

¹²² The donor has primary liability for the gift tax. This liability, admittedly, may affect the amount a donor is willing to give, although any tax due out of pocket is paid out of other of the donor’s funds. If the donor does not pay tax due, the donee becomes liable for it. Section 6324(b). There is, however, no limit on the amount the donor can give.

The gift tax is a broad based tax, and the Supreme Court has upheld a number of broad-based taxes in the face of First Amendment challenges and without any type of heightened scrutiny. In *Jimmy Swaggart Ministries v. Board of Equalization*,¹²³ the appellant challenged the failure of California's tax code to provide an exception in its sales and use tax provisions for sales of religious material. Appellant argued that a tax on religious material, such as Bibles, Bible study manuals, printed sermons, religious books and pamphlets, violated the First Amendment's Free Exercise clause. Distinguishing cases that had struck down as unconstitutional ordinances that required all persons canvassing or soliciting within a city to procure a license by paying a flat fee on the grounds that such licenses operated as a prior restraint on constitutionally protected conduct,¹²⁴ the Court rejected the argument. "California's generally applicable sales and use tax . . . applies neutrally to all retail sales of tangible personal property made in California."¹²⁵ The Court also rejected the argument that the tax burden interfered with appellant's religious activities. It looked to the decision in *Hernandez v. Commissioner*,¹²⁶ holding that the government's disallowance of a tax deduction for religious auditing and training did not violate the Free Exercise Clause. It quoted from *Hernandez v. Commissioner*:¹²⁷

¹²³ 493 U.S. 378 (1990).

¹²⁴ The cases the Court distinguished were *Murdock v. Pennsylvania*, 319 U.S. 105 (1943) and *Follett v. McCormack*, 321 U.S. 573 (1944).

¹²⁵ *Id.* at 389.

¹²⁶ 490 U.S. 680 (1989).

¹²⁷ *Id.* at 699. Similarly, when the Branch Ministries church asserted at trial that revocation of its exemption under section 501(c)(3) for campaign intervention violated its rights under the Free Exercise clause, the court wrote, "In fact, the only way in which the revocation of Section 501(c)(3) status has had any effect on plaintiffs' exercise of religion is that the Church may now have less operating money to spend on religious activities because it is a taxable entity. The fact that plaintiffs may now have less money to spend on their religious activities as a result of their participation in partisan political activity, however, is insufficient to establish a substantial burden on their free exercise of religion." *Branch Ministries v. Rossotti*, 40 F. Supp. 15, 25 (D.D.C.), *aff'd* 211 F.3d 137 (D.C. Cir 2000) (citing *Jimmy Swaggart Ministries*). The same would be true of application of the gift tax to transfers to section 501(c)(4) organizations engaged in political speech and freedom of association protected by the First Amendment if donors reduce donations because of application of the gift tax.

Any burden imposed on auditing or training . . . derives solely from the fact that, as a result of the deduction denial, adherents have less money to gain access to such session. This burden is not different from that imposed by any public tax or fee; indeed, the burden imposed by the denial of the ‘contribution or tax’ deduction would seem to pale by comparison to the overall income tax burden on an adherent.

Such reasoning would apply as well to a lack of a deduction or exemption from the gift tax for contributions to section 501(c)(4) organizations. That a sales tax generally applies to only a small percentage of the sale, while the gift tax is currently a 35% tax after a \$5,000,000 exclusion amount is not a constitutionally significant difference.¹²⁸

In *Leathers v. Medlock*¹²⁹ the Court upheld a generally applicable sales tax when it was extended to cable television even though it exempted receipts from subscription and over-the-counter newspaper sales and subscription magazine sales. The Court acknowledged that cable television engaged in speech under the First Amendment and can be part of the press. It upheld the tax as one of general applicability. There was no indication that it had targeted cable television,¹³⁰ and it was not content based, a consideration that could have raised the level of scrutiny.

¹²⁸ *Swaggert* did note that California’s generally applicable sales and use tax “represented only a small fraction of any retail sale,” 439 U.S. at 695, but did so in order to distinguish the tax from flat license fees that operated as a prior restraint. The gift tax does not operate as a prior restraint.

¹²⁹ 499 U.S. 439 (1991).

¹³⁰ Even when the Supreme Court has struck down a tax on First Amendment grounds for having an effect on too small a group or for being discriminatory, it has noted that broadly based regulation or taxation is permissible. In *Minneapolis Star & Tribune Co. v. Minnesota Commissioner of Revenue*, 460 U.S. 574 (1983), the court struck down a tax on ink and paper with a \$100,000 exemption because it singled out the press and targeted a small group of publishers. The Court, however, observed, “It is beyond dispute that the States and the Federal Government can subject newspapers to generally applicable economic regulation without creating constitutional problems.” *Id.* at 581. In *Arkansas Writers’ Project v. Ragland*, 481 U.S. 221 (1987), the Court struck down a sales tax that discriminated on the basis of a publication’s content, but reiterated that “owners of newspapers are not immune from any of the ‘ordinary forms of taxation’ for support of the government.” *Id.* at 226, *quoting* *Grosjean v. American Press Co.*, 297 U.S. 233, 250 (1936).

Rhomberg argues that these cases are distinguishable “because the gift tax is not assessed against income earned from the conduct of First Amendment activities, but rather on the exercise of the right itself.”¹³¹ Yet, the taxpayers in both *Jimmy Swaggart* and *Leathers* argued that the tax was assessed on the right itself; in neither case did income earned from the conduct of First Amendment rights play any role. Further, I do not understand the argument or the distinction. To me, the arguments that she and others advance to show that application of the gift tax to section 501(c)(4) organizations involved in political activity violates the First Amendment prove too much; they imply that application of the income tax to newspapers and other members of the press is also unconstitutional.

Leathers relied heavily on *Regan v. Taxation with Representation (TWR)*.¹³² This case also supports the conclusion that applying the gift tax to section 501(c)(4) organizations is constitutional. As *Leathers* explains *TWR*, “Inherent in the power to tax is the power to discriminate in taxation.”¹³³ In *TWR*, the Court had explained, “Both tax exemptions and tax-deductibility are a form of subsidy that is administered through the tax system.”¹³⁴ That *Leathers* extends the *TWR* analysis beyond the income tax to taxes imposed on transfers such as a sale tax is significant for the constitutionality of applying the gift tax, which is a generally applicable tax on transfers, to contributions to section 501(c)(4) organizations as one among many transfers to which the gift tax applies, albeit one imbued with First Amendment considerations.

In *TWR* itself, the organization Taxation with Representation objected under the First Amendment to provisions in the Internal Revenue Code that limited lobbying by section 501(c)(3) organizations, which can receive tax-deductible contributions, and under the equal

¹³¹ Rhomberg, *Constitutional Issue*, *supra* note at 168.

¹³² 461 U.S. 540 (1983).

¹³³ 499 U.S. at 451.

¹³⁴ See *TWR*, 461 U.S. at 553.

protection clause to provisions that permitted veterans' organizations to both receive tax-deductible contributions and lobby without limit. The Supreme Court rejected the claims without applying any heightened scrutiny. As to the first claim, it concluded that a legislature is not required to subsidize First Amendment rights through a tax exemption or a deduction.¹³⁵ Only if a regulation or tax was aimed at the suppression of dangerous ideas would more than a rational relation standard be required. Such was not the case in either *Leathers* or *TWR*.

Special treatment of veterans' associations did not require a different conclusion. In *TWR* the Court explained that not only are statutory classifications generally "valid if they bear a rational relation to a legitimate governmental purpose,"¹³⁶ but also that legislatures are given particular discretion in creating tax classifications. While statutes may be subject to greater scrutiny if they interfere with a fundamental right, such as speech, a decision to subsidize some, but not other, speech does not infringe that right, so long as the distinction is not based on content of the speech. It is not irrational, the Court explained, for Congress to limit the public subsidy for lobbying by section 501(c)(3) organizations or subsidize lobbying by veterans' associations, in recognition of their service to the nation. In short, Congress was not required to provide *TWR* with public money with which to lobby.

Thus, under these cases, application of a gift tax to section 501(c)(4) organizations would be constitutional. The gift tax is a generally applicable tax. It does not aim at the content of speech. It is tested under the rational relation test and given a presumption of constitutionality.

¹³⁵ In so holding, it relied on *Cammarano v. United States*, 358 U.S. 498 (1959), which upheld a regulation denying a business deduction for lobbying expenses. Such denial is now statutory and applies to campaign intervention as well as lobbying. See § 162(e). That amounts spent in the exercise of the First Amendment rights or lobbying and campaign intervention can be subject to the income tax, which currently has rates as high as 39.6 percent for individuals, see § 1(h), and 34% for corporations, see § 11, supports the argument that a tax of 35% imposed on lifetime transfers to section 501(c)(4) organizations when total taxable transfers exceed \$5,000,000 is constitutionally permissible.

¹³⁶ *Id.* at 546.

That it might indirectly affect First Amendment rights involving core political speech and freedom of association by discouraging or reducing contributions to section 501(c)(4) organizations does not require that contributions to section 501(c)(4) organizations be deductible or exempted from the gift tax, to provide public money for the activities of section 501(c)(4) organizations. To do so would be to subsidize these organizations because of their First Amendment activities, and such subsidy is not constitutionally required.

There is one caution to this conclusion. While the result in *TWR* was unanimous, Justice Blackmun, joined by Justice Brennan and Justice Marshall, issued an important caveat. According to Justice Blackmun's concurrence, if the provisions of section 501(c)(3) were viewed in isolation, excessive lobbying would deny an organization not only the ability to receive tax-deductible contributions for its lobbying activities, but also the ability to achieve tax-exempt status and to receive tax-deductible contributions for any of its activities. Such a consequence would deny a significant benefit to organizations choosing to exercise their First Amendment right to lobby and, in his view, would be unconstitutional. For Justice Blackmun, avoiding constitutional defect required that a tax-exempt organization be able to set up a section 501(c)(4) organization subject to fewer restraints on constitutionally protected speech.

A number of subsequent cases have emphasized Justice Blackmun's alternative channel approach, in some situations treating it as the holding of the *TWR*.¹³⁷ Under the alternative channel, whether there is an avenue for engaging in political activity free of the gift tax becomes an important consideration. In the case of campaign intervention, such is clearly the case. A

¹³⁷See, e.g., *American Soc'y of Ass'n Executives*, 195 F.3d 47 (D.C. Cir. 1999), *cert. denied* 529 U.S. 1108 (2000); *Branch Ministries v. Rossotti*, 211 F.3d 137 (D.C. Cir. 2000); *FCC v. League of Women Voters of Cal.*, 468 U.S. 364 (1984). Other cases have not relied on Justice Blackmun's dissent. See *Rust v. Sullivan*, 500 U.S. 173 (1991); *Mobile Republican Assembly v. United States*, 353 F.3d 1357 (11th Cir. 2003); *Ysursa v. Pocatello Educ. Ass'n*, 129 S. Ct. 1093 (2009).

section 501(c)(4) organization can establish a section 527 organization by setting up a separate segregated fund, i.e. a bank account, and contributions to it would be exempt from the gift tax under section 2501(a)(4), although donors to the section 527 organization would be subject to disclosure. For organizations that wish to engage in substantial lobbying, however, there is currently no vehicle that under the Internal Revenue Code is explicitly free of the gift tax; section 501(c)(3) organizations are eligible for the gift tax charitable contribution deduction only if they do not engage in such lobbying activity and lobbying is not an exempt function for a section 527 organization.

If Justice Blackmun's concurrence is considered crucial to the decision in *TWR*,¹³⁸ the lack of a gift tax exemption for section 501(c)(4) organizations which are free to lobby is problematic. That is, the primary constitutional concern is not with transfers to section 501(c)(4) organizations for campaign intervention, which has attracted so much attention, but with transfers to section 501(c)(4) organizations engaged in lobbying.¹³⁹ On the other hand, because

¹³⁸ *Ysura*, the most recent invocation of *TWR* by the Supreme Court, suggests that the Court would not do so. *Ysura* did not rely on or look to Blackmun's dissent, but repeatedly cited the Court's opinion in *TWR*, thus suggesting that this Court would not look to the Blackmun dissent in other cases. *Ysura* involved the decision by the State of Idaho not to permit payroll deductions for political activities of local government employees unions, although it did permit payroll deductions for union dues and for charitable contributions. A group of unions argued that this limitation violated their First Amendment rights. The Supreme Court disagreed. Chief Justice Roberts observed that government is "not required to assist others in funding the expression of particular ideas, including political ones." 129 S. Ct. at 1098. He then, by quoting *TWR*, equated the decision not to supply such assistance, however little the burden or cost, with a decision not to subsidize. Next, he reasoned that because a decision not to subsidize a right does not infringe it under the Court's opinion in *TWR*, the State need demonstrate only a rationale basis for its decision. Justice Roberts found the State's asserted rationale, "avoiding in reality or appearance of government favoritism or entanglement with partisan politics," *id.* at 1099, sufficient to pass the rationale basis test. There was no need to compare benefit and burden, as the Blackmun concurrence in *TWR* would have required. Under the reasoning of *Ysura*, there is no constitutional requirement to subsidize a section 501(c)(4) organization's lobbying and campaign intervention activities by exempting them from the gift tax even though such activities are protected by the First Amendment.

¹³⁹ For an argument as to why *TWR* remains good law after recent campaign finance cases, including *Citizens United*, and despite statements in *Citizens United* that "[n]o sufficient governmental interest justifies limits on the political speech of nonprofit or for-profit corporation," 130 S.Ct. at 897, or that a PAC does not speak on behalf of its affiliated corporation because a "PAC is a separate association from the corporation," and enormously burdensome, see Aprill, *supra* note 8; Lloyd Mayer, *Charities and Lobbying: Institutional Rights in Light of Citizens United*, forthcoming, 10 ELECTION L.J.; Miriam Galston, *When Statutory Regimes Collide: Will Wisconsin Right to Life and Citizens United Invalidate Federal Tax Regulation of Campaign Activity?*, 12 U. PA. J. OF CON. LAW 867 (2011).

the gift tax is not a direct limit on speech as were the section 501(c)(3) limits on lobbying, but a generally applicable tax, Justice Blackmun's First Amendment concerns are unlikely to apply.

Thus, the constitution does not require a gift tax exemption for transfers to section 501(c)(4) organizations. Campaign finance precedents are not applicable. The Supreme Court applies a very different jurisprudence when deciding campaign finance and tax cases. As Miriam Galston has written, it would be "inappropriate to import the campaign finance First Amendment standards . . . into tax law First Amendment jurisprudence because the constitutional principles underlying the two spheres of constitutional law are fundamentally different, permitting more intrusive regulation by the tax code than by FECA [Federal Election Campaign Act]."¹⁴⁰ Tax precedents that uphold broad based taxes and those establishing that there is no duty to subsidize First Amendment rights support gift taxation of transfers to section 501(c)(4) organizations engaged in lobbying and campaign intervention. The tax law precedents permit even direct restrictions on speech, such as the limit on lobbying and prohibition of campaign intervention for section 501(c)(3) organizations. Application of the gift tax, in contrast, is not a direct restriction of speech. For all these reasons, application of the gift tax to section 501(c)(4) organizations is constitutional.

¹⁴⁰ Galston, *supra* note 139, at 873-74. As she further explains:

To summarize, tax and campaign finance jurisprudence embody distinct and generally inconsistent principles regarding the appropriate form of judicial scrutiny to test the constitutionality of restrictions on speech. In the First Amendment tax cases, the courts gravitate toward the rational relation test because of the presumption of constitutionality, and heightened scrutiny is the exception. In the tax cases, it is permissible to discriminate on the basis of the speaker, whereas in campaign finance law it is not. In tax cases, the courts place the burden of proof on the party challenging a government restriction on speech, whereas in campaign finance law it is exactly the reverse. Finally, underlying the tax restriction is the government's interest in equalizing access to government funding, whereas the campaign finance cases categorically reject equalizing speakers' resources as a valid government purposed for burdening speech in any way.

Id. at 902.

The constitutionality of such taxation, however, does not answer the issue of whether such transfers should be subject to gift tax, discussed below. Since both lobbying and campaign intervention are activities at the core of the First Amendment, a tax that affects such important national values calls for careful consideration.

V. Policy Issues

Even if we do not take Justice Blackmun's concurrence as crucial to *TWR*, applying the gift tax to section 501(c)(4) organizations but not to section 501(c)(3) organizations or section 527 organization gives pause. Section 501(c)(4) organizations implicate important First Amendment values even if gift taxation of them is constitutionally permissible.

As discussed earlier, section 501(c)(4) organizations share traits with both section 501(c)(3) and section 527 organizations, neither of which are subject to gift taxation. That is, there is a discontinuity in not providing a gift tax deduction for transfers to section 501(c)(4) organizations. On a continuum, section 501(c)(4) organizations fall in the middle between section 501(c)(3) organizations and section 527 organizations. For the gift tax not to apply to the organizations that flank section 501(c)(4) organizations but not to section 501(c)(4) organizations themselves is inconsistent and troubling.

To the extent that section 501(c)(4) organizations are social welfare organizations unable to qualify for section 501(c)(3) status because of too small a charitable class, the requirement that they provide community benefit justifies a gift tax exemption. For those that engage in substantial campaign intervention, the similarity to section 527 organizations calls for a gift tax exemption.

Many organizations, however, are exempt as section 501(c)(4) organizations instead of section 501(c)(3) organizations or section 527 organizations because they wish to engage in substantial lobbying, and in such cases the comparison of section 501(c)(4) organizations to political organizations strikes me as particularly important. We allow a gift tax exclusion for contributions to political organizations which, in campaigning for or against a candidate, endorse particular positions of the candidate or the positions of the candidate generally. It would seem that such should be the case as well for section 501(c)(4) organizations that lobby on particular issues, whether or not they engage in campaign intervention.¹⁴¹

The case of ballot committees is particularly instructive. Getting a measure on a ballot, an exercise in direct democracy, is expensive. Ballot committees are generally section 501(c)(4) organizations because their activity is deemed to be lobbying. To apply the gift tax to individual donors to ballot committees when corporate donors have no such exposure raises one set of concerns. If, in enacting the gift tax exception for transfers to political organizations, Congress believed that it was “inappropriate to apply the gift tax to political contributions because the tax system should not be used to reduce or restrict political contributions,”¹⁴² the same would seem to be true for contributions to section 501(c)(4) social welfare organizations whether their activities are exclusively those that benefit the community, whether their beneficial activities include lobbying, or whether they engage in campaign intervention.

¹⁴¹ As to the role of interest groups and their lobbying, Lloyd Mayer writes:

Some commentators paint interest groups as ultimately destructive to our democratic form of government, but the more widely accepted and long-standing view of both scholars and lawmakers is that interest groups provide significant benefits. These benefits include supplying valuable information and advice for government decision makers, informing citizens of proposed and current government action and thus increasing the transparency of government, and creating a mechanism through which citizens can both participate in politics generally and influence specific government actions . . .

Lloyd Mayer, *What Is This ‘Lobbying’ That We are So Worried About*, 26 YALE L. & POL’Y REV. 485, 539 (2007).

¹⁴² S. Rep. No. 93-1357 at 30 (1974).

Moreover, the policy that underlies the transfer taxes calls for an exception from the gift tax for contributions to section 501(c)(4) organizations. Contributions to section 501(c)(4) organizations do not present the danger of large accumulations of family wealth or avoidance of the income tax. They deplete the contributor's wealth to the same extent as contributions to section 501(c)(3) organizations or section 527 organizations.¹⁴³

Silence from the IRS or announcement of an IRS decision not to apply the gift tax to transfers to section 501(c)(4) organizations, followed by a revenue ruling or regulations, does not adequately resolve the situation. Such a response is inconsistent with the statutory structure and with the long-standing IRS position on this issue. Marcus Owens, former head of the IRS Exempt Organizations Division, has written to the IRS on behalf of four anonymous clients that suspension of enforcement activity without a change in the existing precedential guidance on the application of the gift tax leaves both taxpayers and their advisors in a difficult position. He asked for immediate guidance.¹⁴⁴ Silence from the IRS leaves the issue unresolved, with donors to section 501(c)(4) organizations always wondering if the gift tax would apply at some future time. While the IRS, like other agencies, is entitled to prosecutorial discretion as to particular enforcement actions, it should not ignore an obligation to enforce a statutory duty. Ignoring this obligation would undermine respect for the tax law, on one hand, while suggesting that the IRS has enormous discretion in picking and choosing which provisions of the Code to enforce, on the other. Even if there were a constitutional issue regarding such transfers, and I believe there is

¹⁴³ See Polsky, *supra* note 8, at 1782-83. Thus, I do not object to the analysis of *Carson* regarding the gift tax but only whether the decision regarding exceptions from the gift tax for transfers to section 501(c)(4) organizations are for the courts or for Congress to make.

¹⁴⁴ *Attorney Questions IRS Decision to Halt Gift Tax Exams*, 2011 TNT 153-224 (August 9, 2011). Owens also suggested that the IRS may well have succumbed to political pressure in ending the audits. For a similar argument, see Donald B. Tobin, *Is Congress Politicizing the IRS and Its Enforcement Process*, 132 TAX NOTES 853 (Aug. 22, 2011). As noted earlier, I am not considering questions of political pressure, whether in connection with the initiation or the suspension of the audits.

not, the IRS has no obligation to determine the constitutional question. Administrative agencies are not required to make decisions as to the constitutionality of the statutory scheme they are to enforce.¹⁴⁵ Thus, the IRS should issue precedential guidance, preferably in the form of regulations entitled to the strong deference of *Chevron*, that it continues to adhere to its position that the gift tax applies to transfers to section 501(c)(4) organizations and will begin enforcing this position.

Most importantly, a decision that the gift tax does not apply to transfers to section 501(c)(4) organizations should not be a matter of failure by an administrative agency to enforce the law. It should be a policy decision made by Congress, not the IRS. To resolve uncertainty, to remove pressure from the IRS, and to make treatment of section 501(c)(4) organizations consistent with the treatment of section 501(c)(3) and section 527 organizations, Congress should provide a deduction or exemption from the gift tax for transfers to section 501(c)(4) organizations.¹⁴⁶ Silence from the IRS will not prompt Congressional action. An announcement that the IRS intends to apply the gift tax to transfers to section 501(c)(4) organizations, however, could do so. Such an announcement would be more effective in motivating Congressional action than a hope expressed on the IRS webpage.¹⁴⁷

If Congress acts, it needs to enact other provisions as well. As discussed earlier, one purpose of the gift tax is to back up the income tax. Currently, if a taxpayer makes a gift of

¹⁴⁵ “[A]djudication of the constitutionality of congressional enactments has generally been thought beyond the jurisdiction of administrative agencies.” *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 215 (1994), *quoting Johnson v. Robison*, 415 U.S. at 368, *quoting Oestereich v. Selective Serv. System Local Bd. No. 11*, 393 U.S. at 242 (Harlan, J., concurring in result). The Court goes on to observe, “This rule is not mandatory, however.” *Id.* See also Harold J. Bruff, *Specialized Courts in Administrative Law*, 43 ADMIN. L. REV. 329, 361-62 (1991); Student Author, *The Authority of Administrative Agencies to Consider the Constitutionality of Statutes*, 90 HARV. L. REV. 1682, nn. 1-3 (1977).

¹⁴⁶ Since the IRS has already announced that it will not impose the gift tax retroactively or until further notice, Congress can and should make any change prospective only. See text at note 15 *supra*.

¹⁴⁷ Or this article, I must admit.

appreciated property to a section 501(c)(4) organization, there is no provision that taxes the gain,¹⁴⁸ and thus the gift tax can be seen as a surrogate for this foregone income tax. If Congress enacts an exclusion from the gift tax for transfers to section 501(c)(4) organizations, Congress should also enact a provision parallel to section 84, which provides that transfers of appreciated property to political organizations are treated as sales.¹⁴⁹ Taxation of appreciated property donated to a section 501(c)(4) organization is not an issue that the IRS can address or resolve.¹⁵⁰ Only Congress can do so, and thus only Congress can address all the issues raised by contributions to section 501(c)(4) organizations.

Policy considerations call for exempting transfers to section 501(c)(4) organizations from the gift tax, but it is up to Congress to resolve this issue. Congress can and should do so. At the same time, however, allowing section 501(c)(4) organizations exemption from the gift tax while continuing to allow anonymity for their donors is disturbing. Section 527 political organizations regulated by either the IRS or the FEC must disclose their donors.¹⁵¹ Although the fact that disclosure of donors to section 501(c)(4) organizations is not currently required has encouraged contributions to such entities, as press reports attest, the possibility that the gift tax would apply

¹⁴⁸ I thank Gregg Polsky for discussion on this issue. See Gregg D. Polsky & Guy-Uriel E. Charles, *Regulating Section 527 Organizations*, 73 GW L. REV. 1000, 1013-14 n. 81 (2005). Professor Daniel Halperin has also recently noted that “the exemption for gain on appreciated property transferred by a donor” seems “inappropriate” for section 501(c)(4) organizations. Daniel Halperin, *Is Income Tax Exemption for Charities a Subsidy*, 64 TAX L. REV. 283, 310 (2011).

¹⁴⁹ In contrast, we do permit a charitable contribution deductions for the full fair market value of appreciated property to the extent any gain if the property had been sold would have been capital gain without requiring realization of gain. Sec. 170(e)(1). This is a special rule limited to charities and certain other organizations. It has been the subject of much criticism. See, e.g., Calvin Johnson, *Ain't Charity: Disallowing Deduction for Kept Resources*, 2010 TNT 150-10 (August 5, 2010); Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-In Gain*, 56 TAX L. REV. 1 (2002). As noted earlier, charitable contribution deductions are permitted only for organizations that do not engage substantially in lobbying. Since so many section 501(c)(4) organizations engage in lobbying or campaign intervention, particularly those likely to attract contributions, the special rule permitting contributions without recognition of gain should not apply to contributions to section 501(c)(4) organizations.

¹⁵⁰ Although section 527(f) would tax the lesser of the investment income or the amounts expended by the 501(c)(4) in any given year, a section 501(c)(4) could avoid that tax by selling appreciated property in the year received and engaging in campaign activity only in the following year. I thank Gregg Polsky for this example.

¹⁵¹ See April, *Regulating the Political Speech of Noncharitable Exempt Organizations*, *supra* note 8.

to these contributions may nonetheless have constrained contributions. The announcement by the IRS that they will not apply the gift tax to these transfers or any Congressional action exempting them from the gift tax eliminates this check and opens the possibility of even greater campaign intervention by section 501(c)(4) organizations through anonymous donations.

Thus, any Congressional action regarding section 501(c)(4) organizations and the gift tax should address disclosure of contributors as well. IRS cannot on its own require public disclosure of donors in connection with disclosure of a section 501(c)(4) organization's annual information return,¹⁵² and Congress in 2010 rejected legislation that would have required disclosure for section 501(c) organizations making contributions to organizations that engage in express advocacy.¹⁵³ Nonetheless, other more palatable approaches are possible. As I have suggested in another paper, for example, disclosure could be required only for section 501(c)(4) organization supported primarily by a small number of donors.¹⁵⁴

¹⁵² Congress has allowed public disclosure of contributors on the annual information return only for private foundations and political organizations. § 6104(b). Private foundations generally are section 501(c)(3) organizations that receive their support from a single individual or corporate source or close knit family group. More specifically, they are not traditional public charities, such as schools, churches, and hospitals; broadly supported section 501(c)(3) organizations; or section 501(c)(3) organizations with a close and defined relationship with traditional charities or publicly supported section 501(c)(3) organizations. See § 509(a)(1)-(3). In contrast to public charities, private foundations, as a result of the excise tax on taxable expenditures, which includes lobbying, are for all practical purposes prohibited from lobbying as well as campaign intervention. Section 4945(e).

¹⁵³ Congress rejected Democracy is Strengthened by Casting Light on Spending in Elections (DISCLOSE) Act, H.R. 5175, 111th Cong. §§ 201-214, 301 (2010); Democracy is Strengthened by Casting Light on Spending in Elections (DISCLOSE) Act, S. 3295, 111th Cong. §§ 201-214, 301 (2010).

¹⁵⁴ See Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations*, *supra* note 8. As discussed there, if this choice is enacted, Congress would be following the model of the private foundation disclosure. We require public disclosure of contributors to private foundations out of concern that this is subset of section 501(c)(3) organizations with their narrow base of contributors may serve only their contributors' narrow interests. We could do the same for noncharitable exempt organizations: develop a public support test applicable to each category and require public disclosure of contributors only for those organizations that do not meet the applicable public support test. Donald B. Tobin, *Campaign Disclosure and Tax-Exempt Entities: A Quick Repair to the Regulatory Plumbing*, *forthcoming* 10 ELECTION L. J., makes the subtle argument that the IRS is limited in disclosing donors only in connection with its own public disclosure of the annual information return, but could require section 501(c)(4) organizations themselves to disclose contributors. I am skeptical that the IRS would so interpret the statutory limitations on disclosure.

Disclosure of donors to section 501(c)(4) organizations should go hand in hand with exemption from the gift tax. Congress could consider as well specifying the amount of campaign intervention permissible for section 501(c)(4) organizations rather than waiting for the IRS to issue regulations on this issue. The lower the level of permitted campaign intervention, the less section 501(c)(4) organizations will displace political organizations and their regulatory regimes.

VI. Conclusion

By not addressing or enforcing the application of the gift tax on transfers to section 501(c)(4) organizations for many decades, the IRS has put itself in an awkward position regarding this issue. The IRS has now undertaken to study the issue. As it does so, I suggest that existing judicial precedents do not lead to the conclusion that an exception from the gift tax is required for such transfers. In particular, I do not see the *Stern* and *Carson* cases involving contributions to political organizations as well-reasoned or as sufficiently analogous. Neither do I see constitutional obstacles to application of the gift tax to these organizations because I believe Supreme Court precedents regarding taxes permit the tax and are more relevant than campaign finance precedents.

Nonetheless, I believe an exemption for such transfers, along with some disclosure requirements, is appropriate as a matter of policy. Implementing this policy is a matter for Congress, not the IRS. Congressional complaints about the short-lived attempt of the IRS to undertake enforcement ignored Congress's own ability to resolve the issue by statute. It should focus on the issue and do so. Indeed, since both Republicans and Democrats make large contributions to section 501(c)(4) organizations, this may be one of the few issues on which bipartisan support could be obtained.