

Aprill: Section 501(c)(4) Organizations, the Gift Tax, and the Disclosure Rules

Election Law Blog Guest Commentary by Professor [Ellen P. Aprill](#)

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Recent discussions of whether gifts to section 501(c)(4) organizations that engage in candidate-related activity are subject to the federal gift tax have failed to make clear an important distinction. This important distinction is whether the contributor is making the gift to the organization as a whole or making the gift for its candidate-related activities and, in particular, for its candidate-related advertisements. The distinction can matter not only for gift tax liability, but also for disclosure obligations under campaign finance laws.

Contributors of large sums close to an election are caught between the proverbially rock and hard place: the more that they position themselves to avoid gift tax liability, the more likely that they may become obliged to disclose their contributions under the campaign finance laws, and vice versa. As explained in detail below for those who are interested, if donors take the position that their gifts are for particular candidate-related activities rather than to the organization in support of its activities generally, they have a good argument that the gift tax does not apply, but a weaker argument for avoiding disclosure obligations under campaign finance laws. It is possible to have the best of both worlds, however, and a determination from the FEC this past spring makes it clear how best to achieve that outcome.

Tax Rules

Section 501(c)(4) organizations may engage in candidate-related activity, but such activity cannot be the purpose or the primary activity of the organization. Under the tax code, a section 501(c)(4) organization is a tax exempt entity that is operated primarily for the promotion of social welfare, which tax regulations define as “promoting in some way the common good and general welfare of the people of the community,” including “bringing about civic betterments and social improvements.” An organization can qualify as tax-exempt under section 501(c)(4) even if the organization’s only activity is lobbying, so long as the lobbying is related to its exempt purpose.

Applicable tax regulations specifically state that candidate-related activity is not promotion of social welfare. Thus, candidate-related activity cannot be a section 501(c)(4)’s primary activity. The IRS has never provided guidance as to what “primary” means, and advisors differ as to how much candidate-related activity a section 501(c)(4) organization can undertake. Many are comfortable if the candidate-related activity is less than 50% of the organization’s total activities. How to judge activities is also a difficult task, since guidance is also lacking on that issue. Does the organization look to dollars spent, time spent by staff, contractors and volunteers, or some combination of the two?

Whatever test is applied, what constitutes an organization's primary activity is judged at the end of the organization's tax year. Section 501(c)(4) organizations are not required to be on a calendar year; they are free to choose a fiscal year for their operations.

The gift tax statutes provide that the gift tax is imposed on transfers "for less than full and adequate consideration in money or money's worth," above the annual exclusion. The annual exclusion is currently \$13,000 per year for a gift from one individual to any particular donee. In addition, no gift tax is owed out of pocket until an individual's total taxable gift exceeds \$1,000,000. For the first \$1,000,000 of gifts during life, an individual will can use a credit provided under the tax code; the gift tax on gifts above this \$1,000,000 lifetime exclusion is 35% for 2010.

Gift tax generally applies regardless of donative intent. However, transfers in the ordinary course of business, such as, for example, a bargain sale, are not subject to gift tax. The tax regulations specify that transfers in the ordinary course of business are those that are bona fide, at arm's length and free from donative intent. To identify a business transaction, the IRS often looks to see if there has been bargaining or negotiations between the parties.

Under the tax code, gift tax generally does not apply to transfers to organizations exempt under section 501(c)(3), the organizations that we often refer to as charities. Similarly, the gift tax does not apply to transfers to political organizations, and the tax code cross-references to section 527 for the definition of political organizations. Under 527, an organization must be operated primarily for candidate-related activities to qualify as a political organization. When Congress in 1975 enacted the provision making the gift tax inapplicable to transfers to political organizations, legislative history explained 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."

The IRS has lost two important cases in which it had asserted that contributions to political campaigns were subject to the gift tax. One of these cases was decided before Congress enacted the provision specifically addressing gifts to political organizations, and one was decided after the Congressional action, although the years at issue in the case involved years before the provision was in effect.

In the first case, *Stern v. United States*, 436 F.2d 1327 (5th Cir. 1971), Mrs. Stern 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. The appellate court concluded that these transfers were made in the ordinary course of business as transfers for consideration that were bona fide, at arm's length and free from donative intent. Thus, they were not subject to the gift tax.

The second case, *Carson v. Commissioner*, 641 F.2d 864 (F.2d 10th Cir. 1981), involved contributions by the taxpayer to general campaign funds of three candidates and direct payment of campaign expenses for other candidates, all of which took place prior to the enactment of provision specifically providing that the gift tax is inapplicable to transfers to political organizations. The appellate court affirmed the decision of the Tax Court that these campaign contributions were not gifts within the meaning of the gift tax law. It declined to adopt the position of the *Stern* court that they were transfers for consideration.

The IRS, concerned about the implications of the *Carson* case for contributions to noncharitable section 501(c) organizations, acquiesced in the result, but not the reasoning, of the case. The IRS takes the position in official rulings that gifts to section 501(c)(4) organizations, which must be primarily engaged in social welfare activities, are subject to the gift tax.

The leading cases, *Stern* and *Carson*, involved contributions made to political organizations or directly to candidates, and the money at issue was specifically directed to candidate-related activities. Moreover, the legislative history of the provision providing that the gift tax is inapplicable to transfer to political organizations refers to “political contributions.” Thus, I believe that in order to argue to a court that these authorities are relevant and that the gift tax does not apply to contributions to a section 501(c)(4) organization that engages in candidate-related activity, a donor needs to demonstrate that the gift had been made specifically for the organization’s candidate-related activities and not to the organization generally or for its organization’s primary, social welfare activities. (Certain kind of section 501(c)(4) organizations, such as ballot measure committees, may present special considerations.)

I note that contributors may also seek to avoid the gift tax risk by having the section 501(c)(4) organization act as their agent rather than as their 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 gift will be made at the time that the section 501(c)(4) organization selects an expenditure, such as candidate-related advertisements, to which the contributors funds are then dedicated, and the expenditure will be treated as made directly by the contributor at that time for that expenditure.

Although *Stern* and *Carson* provide the basis for an argument that the gift tax does not apply to any transfer to the candidate-related activities of section 501(c)(4) organizations, it is far from certain that a taxpayer making such an argument would succeed. Neither *Stern* nor *Carson* involved an entity that conducted both activities unrelated to a candidate and activities related to a candidate, much less an entity required to have a primary purpose that is not candidate-related. Both cases predated the statute specifying that the gift tax would be inapplicable to donations to political organizations. The provision as enacted applies only to organizations that have a primary purpose of accepting contributions or making expenditures for candidate-related activities. Neither the provision as enacted nor any other statutory provision exempts donations to section 501(c)(4) organization from the gift tax.

Election Law

Under the federal campaign finance law, any person who in a calendar year spends more than \$10,000 on an electioneering communication, which is any broadcast, cable or satellite communication that refers to a clearly identified candidate for public office and is made within 30 days of a primary or 60 days of a general election, must file a report with the FEC within 24 hours. The report, among other information, includes the names and addresses of all persons “who contributed an aggregate amount of \$1000 or more to the person making the disbursement” since the beginning of the preceding calendar year. The Supreme Court upheld application of this provision to a section 501(c)(4) organization in *Citizens United*; Citizens United is itself a section 501(c)(4) entity.

An FEC regulation specifies that disclosure of donations is required only for those made by donors “for the purpose of furthering electioneering communications.” Thus, if the donation is made to a section 501(c)(4) organization for an unspecified use, to further the activities of the organization generally, or to further its exempt social welfare purpose, no disclosure of any donor will be required for federal campaign finance purposes.

In the spring of this year, by a 3-2 vote, the FEC interpreted this regulation narrowly in a case involving Freedom’s Watch, a section 501(c)(4) organization, and \$126,000 in expenditures on electioneering communication ads for a special Congressional election in 2008. As the three Republican commissioners later explained, they determined that disclosure of a donor will be required only if the donation is made “for the purpose of further the electioneering communication *that is the subject of the report*” (emphasis added). The three Republican commissioners wrote that they found “no specific evidence to contradict the assertion of Freedom’s Watch that all funds contributed in 2008 were for general purposes (the general purpose of Freedom’s Watch was to engage in activities furthering its core issue agenda).” Thus, the complaint against Freedom’s Watch was dismissed.

Although in the Freedom’s Watch case, the section 501(c)(4) organization asserted that donations were made for the organization’s general purposes, the language quoted above takes the position that donations to a section 501(c)(4) organization for electioneering communications in general, but not for a specific electioneering communication, need not be disclosed in reports related to a specific electioneering communication.

The Republican commissioner based their conclusion in the Freedom’s Watch specifically on the requirements for reporting of independent expenditures in excess of \$200. There the applicable regulations require “[t]he identification of each person who made a contribution in excess of \$200 to the person filing such report, which contribution was made for the purpose of furthering the reported independent expenditure.” That is, unless donations are made to a section 501(c)(4) organization for the specific independent expenditure that is the subject of the report, no disclosure of the donor is required on Form 5. The instructions to Form 5 specify that

identification by name, address and employer of donors of over \$200 is required only if the donation was made “for the purpose of furthering the independent expenditures.”

Furthermore, many candidate-related activities do not involve any FEC disclosure because they neither involve express advocacy nor come within the definition of an electioneering communication. Examples include advertisements without express advocacy that name the candidate but occur more than 60 days prior to an election or communications without express advocacy close to an election that involve phone banks or print advertisements rather than broadcast media.

Conclusion

Gifts made to a section 501(c)(4) organization generally or for its social welfare purposes are likely in most cases to be subject to the gift tax. Gifts made to a section 501(c)(4) generally or for its social welfare purposes will not be subject to disclosure of donation under the federal campaign finance laws.

Gifts made to a section 501(c)(4) organization acting as the contributor’s agent rather than its donee will be treated as being made by the contributor when the organization selects an expenditure to which the contributor’s funds are dedicated, and treatment of the gift for both gift tax and disclosure under campaign finance law will depend on the nature of the expenditure.

There is an argument based on the *Stern* and *Carson* cases that gifts made to a section 501(c)(4) organization to fund a specific electioneering communication or a specific communication containing express advocacy are not be subject to the gift tax. Donations directed to specific electioneering communications or specific communications containing express advocacy will be subject to disclosure under federal campaign finance laws.

The *Stern* and *Carson* cases support an argument that donations to section 501(c)(4) organization to fund electioneering communications generally or express advocacy generally are not subject to the gift tax, and the dismissal of the complaint involving Freedom’s Watch by the FEC seems to make clear that such donations also will not be subject to disclosure under the federal campaign finance laws.

Contributions can also be made to activities sufficiently candidate-related to support an argument that the gift tax does not apply without triggering disclosure obligations under campaign finance laws.