



potential gift tax liability for election year contributions to 501(c)(4) social welfare (political?) organizations

MSK Client Alert

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Contributors to 501(c)(4) "social welfare organizations" may maintain their anonymity with respect to the public, but disclosure is still owed to the IRS, and contributions by individuals may be subject to gift taxes.

Individual contributors to 501(c)(4)s may wish to consider carefully the possible gift tax implications of their contributions and to include documentation of related tax reporting positions (including any advice of counsel) with their tax records for the applicable year.

Numerous 501(c)(4)s have been in the news lately. Their tax-exempt status (under section 501(c)(4) of the Internal Revenue Code (the "Code")) is being questioned as a result of substantial political activities relating to the upcoming elections. In addition, there has been concern expressed about large donors eluding normal IRS and Federal Election Commission disclosure rules by contributing money to those 501(c)(4)s. Citing media reports that question whether the tax code is being used to eliminate campaign finance transparency, Senator Max Baucus, as Chairman of the Senate Finance Committee, sent a September 28, 2010 letter to the IRS Commissioner demanding an examination of major tax-exempt organizations involved in political campaign activity.

Tax-exempt organizations are permitted varying levels of political campaign activity and have different disclosure obligations. Organizations exempt from federal income tax under the more well-known section 501(c)(3) of the Code may not participate or intervene in any political campaign on behalf of, or in opposition to, any candidate for public office. The names and addresses of contributors to 501(c)(3)s, other than "private foundations," are not available for public inspection. At the other end of the spectrum, Code section 527 "political organizations" generally are required to be organized and operated primarily for the purpose of accepting contributions and/or making expenditures to try to influence political elections. 527s are subject to periodic reporting, which

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generally must include the names and addresses of all contributors of \$200 or more during the calendar year.

501(c)(4)s fall somewhere in the middle. They may participate or intervene in political campaigns on behalf of, or in opposition to, any candidate for public office, so long as they are not "primarily engaged" in those activities. Unlike 527s, they need not publicly disclose their contributors. As a result, it seems, 501(c)(4)s have become the vehicle of choice for campaign spending from anonymous sources, and vast sums have been flowing into them in anticipation of the upcoming elections.

There have been reports that the IRS Exempt Organizations division lacks the appetite and/or the capacity to pursue what arguably amount to campaign finance issues. Critics have pointed out that the IRS is set up to collect taxes, not to actively monitor political campaigns. Apparently, there is little revenue to be raised by tightly overseeing whether 501(c)(4)s have been "primarily engaged" in campaign activities in violation of their tax-exempt status. However, it is possible that the gift tax is applicable to their individual donors.

Gift tax generally is imposed annually on the "transfer of property by gift" by any individual (it is not applicable to corporations). It is unclear whether a particular contribution to a 501(c)(4) may be such a transfer under the applicable regulations. However, the IRS has indicated that "gratuitous transfers to persons other than [527 organizations] are subject to the gift tax absent any specific statute to the contrary..." Transfers to 527s have a "specific statute to the contrary," excluding them from gift tax treatment. Charitable contributions to 501(c)(3)s are eligible for a deduction from income taxes, but they also generally provide a deduction for gift tax purposes, effectively excluding them from the gift tax. Qualifying contributions to fraternal societies and veterans' organizations carry similar gift tax deductions.

On the other hand, there is no comparable statutory exclusion for contributions to 501(c)(4)s, and courts have upheld gift taxation of such contributions. Nonetheless, the IRS does not appear to be actively attempting to enforce the gift tax on contributions to 501(c)(4)s. The IRS perhaps is rightfully wary of the First Amendment and other constitutional challenges it would be sure to face, especially in light of the broadened freedom of speech positions taken by the Supreme Court earlier this year in the Citizens United case.

However, the IRS may soon find itself in receipt of a treasure trove of Form 990s, the annual information return for tax-exempt organizations, reporting large election season contributions by individuals to 501(c)(4)s. The names and addresses of contributors to a tax-exempt organization, other than a private foundation or a 527, generally are not available for public inspection, unlike the rest of the Form 990. Perhaps for that reason, seemingly little has been made of the requirement that 501(c)(4)s disclose to the IRS, on Schedule B of Form 990, the names of contributors of \$5,000 or more and the aggregate amount of such contributions.

With these reports in hand, the IRS may well find irresistible the potential revenue to be raised from assessing gift taxes on 501(c)(4) contributors. In that regard, while the gift tax rate for 2010 is 35%, it is scheduled to increase to 55% beginning in 2011, in time for the 2012 presidential election season and likely an attendant vast increase in contributions to 501(c)(4)s.



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Donors wishing to remain anonymous may feel the need to pay these sizable and perhaps unconstitutional gift tax assessments rather than challenge the tax in open court, and on the public record.

As indicated above, individual contributors to 501(c)(4)s may wish to consider carefully the possible gift tax implications of their contributions and to include documentation of related tax-reporting positions (including any advice of counsel) with their tax records for the applicable year. This concern generally may be applicable only to large contributors. Currently, the annual exclusion from gift tax generally applies to gifts of \$13,000 or less to each recipient. The lifetime exclusion beyond that is \$1,000,000. Note that the annual exclusion effectively is \$26,000 per recipient for married couples.

If you have any questions about this Alert, please contact the author or any member of the MSK Tax Department.