FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

April 22, 2004

MEMORANDUM

TO: The Commission
General Counsel
Staff Director
Public Information
Press Office
Public Records

FROM: Mai T. Dinh
Acting Assistant General Counsel

SUBJECT: Supplemental Comment on Political Committee Status

Attached please find the supplemental information submitted by Don Simon. The information pertains to the application of the gift tax to donations to 501(c)(4) organizations and was sent in response to a question from Commissioner Mason during his testimony at the hearing on April 14.

Attachment

cc: Associate General Counsel for Policy
Congressional Affairs Officer
Executive Assistants

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*NOT ADMITTED IN D.C.

April 22, 2004

By Electronic Mail

Ms. Mai T. Dinh
Acting Assistant General Counsel
Federal Election Commission
999 E Street NW
Washington, DC 20463

Re: Supplemental Comments on Notice 2004-6: Political Committee Status

Dear Ms. Dinh:

During my testimony at the Commission's hearing in the above-captioned matter on April 14, 2004, Commissioner Mason posed a question to me regarding the applicability of federal gift tax to donations made to section 501(c)(4) social welfare organizations. I requested permission to file supplemental written comments in order to respond to the question, and Commissioner Mason indicated that he would welcome such a submission.

Accordingly, I attach a short memorandum which addresses this matter, and ask that it be made part of the record.

Respectfully submitted,

/s/ Donald J. Simon

Donald J. Simon

Copy to: Lawrence Norton, Esq.

Commissioner David Mason

Discussion of Federal Gift Tax
Applicability to 501(c)(4) Organizations

March 29, 2004

This memo begins with a general summary of the gift tax followed by a discussion of the current state of the law regarding whether the gift tax applies to contributions to social welfare organizations described in Internal Revenue Code ("IRC") section 501(c)(4).

The Gift Tax Generally

The federal gift tax applies to the transfer of property by gift, by any individual. IRC § 2501(a)(1). When property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the transferred property exceeds the value of the consideration is deemed to be a gift. IRC § 2512(b). Consideration such as love and affection, promise of marriage, etc. is not reducible to a value in money or money's worth and so is disregarded. Reg. § 25.2512-8. The gift tax is not applicable, however, to transfers for full and adequate consideration in money or money's worth, which transfers are deemed to include transfers of property made in the ordinary course of business, *i.e.*, transactions which are bona fide, at arm's length, and free from any donative intent. Reg. §§ 25.2511-1(g)(1), 25.2512-8.

There is an annual exclusion from the gift tax in the amount of $11,000 per person, per donee. IRC § 2503(b); Rev. Proc. 2002-7, § 3.24(1), 2002-46 I.R.B. 845. This figure is adjusted for inflation, but only in $1,000 increments. A "donee" for this purpose can be either an individual (such as a family member) or a nonprofit organization. See Reg. § 25.2511-1(h)(1); PLR 9818042 (Jan. 28, 1998). This annual exclusion is available only for gifts of present interests in property (such as cash or securities), as opposed to future interests. See IRC § 2503(b)(1).

If a person makes a gift to a donee in excess of the $11,000 annual exclusion, the donor must file a gift tax return reporting the gift. The gift tax return is filed annually on IRS Form 709, and is due by April 15 of the year following the year in which the donor made the taxable gift. The IRS also makes available a simplified Form 709-A, which can be used (among other things) where the sole purpose of filing the return is to elect gift-splitting by a married couple.

Although a gift in excess of the applicable annual exclusion triggers a return-filing obligation, the donor will not necessarily be required to pay any tax currently. There is a credit available against the gift tax; this credit allows a donor to transfer property worth up to $1 million, free of gift tax, over his or her lifetime. IRC § 2505(a)(1). In order to determine whether tax is due on a particular gift, the donor must add current year gifts (in excess of applicable annual exclusions) to all prior year gifts (again in excess of applicable annual exclusions). If the total of such "taxable gifts" is above $1 million — the lifetime exclusion amount — gift tax must be paid on the excess at the applicable marginal rate. A donor who

use some or all of the this credit by making gifts in excess of the annual exclusion during his or her lifetime will effectively reduce his or her estate tax credit by the same amount, however, so the estate tax bill will be proportionally higher upon his or her death. See IRC §§ 2001(b), 2010.

The marginal gift tax rate in 2003 begins at 41% (for gifts beyond the $1 million lifetime exclusion) and rises by increments to 49% (for gifts beyond $2.5 million). IRC §§ 2502(a) & 2001(c). The top rate, which is also the top rate for the estate tax, is scheduled to decline over the next several years until it reaches 45% in 2007. IRC § 2001(c)(2)(B). For 2010, the year for which the estate tax is repealed, the marginal gift tax rates change to 18% for the first $10,000 above the $1 million lifetime exclusion amount, with the marginal rates then increasing to 35% (for gifts beyond $500,000). IRC § 2502(a).

The donor is liable for the gift tax. IRC § 2502(c). If the donor fails to pay the tax, however, the recipient of the gift can be held liable for the tax. See IRC § 6324(b).

The Gift Tax and 501(c)(4) Organizations

There are statutory exceptions from the gift tax for gifts to charitable organizations described in IRC § 501(c)(3) and political organizations described in IRC § 527. IRC §§ 2522(a)(2) & (b)(2), 2501(a)(5). There is no similar exception for gifts to social welfare organizations described in IRC § 501(c)(4).

The three court cases directly addressing whether the gift tax applies to contributions to social welfare organizations or their equivalent under previous versions of the federal income tax laws are *Estate of Blaine v. Commissioner*, 22 T.C. 1195 (1954), *Dupont v. United States*, 97 F. Supp. 944 (D. Del. 1951), and *Faulkner v. Commissioner*, 41 B.T.A. 875 (1940), *modified by* 42 B.T.A. 1019. In *Estate of Blaine* and *Faulkner*, the courts concluded that the gift tax applied to the contributions because they found that the donees did not fall within the statutory exception for charitable organizations; the donors did not argue and the courts did not consider any other grounds for not subjecting the contributions to gift tax. In *Dupont*, the court rejected the donor's argument that the contribution was not a gift but was in fact a payment for services, specifically services that would improve the monetary, business and political conditions in the United States and elsewhere, thereby economically benefiting the donor. The court found that the donor's lack of control over the donee, the lack of a direct economic benefit to the donor, and the impossibility of determining whether the donee's actions created an indirect economic benefit for the donor demonstrated that the contribution was in fact a gift for federal gift tax purposes and not a payment for services.

More recently, however, two appellate courts concluded that gifts to political organizations were not subject to gift tax even though the gifts preceded the enactment of the current statutory exception from the gift tax for such gifts. *Carson v. Commissioner*, 641 F.2d 864 (10th Cir. 1981), *acq. in result*, 1982-2 C.B. 5, *affirming* 71 T.C. 252 (1978); *Stern v. United States*, 436 F.2d 1327 (5th Cir. 1971), *affirming* 304 F. Supp. 376 (E.D. La. 1969). The *Stern* decision relied on the regulatory exception for transfers of property made in the ordinary course of business because the trial court found that the transfers at issue were bona

fide, at arm's length and free of any donative intent. See Reg. § 25.2512-8. This conclusion rested primarily on the fact that the transferor was motivated by a desire to promote a slate of candidates that would protect her economic interests and the fact that the group of which she was part retained control of the transferred funds to ensure that they were spent in a manner consistent with attaining that goal. The trial court also concluded that there had been no transfer because the group of which the donor was a part retained control of the funds and that the donor received full and adequate consideration for her transfer in the form of the political goods and services purchased with her funds, but the appellate court did not find it necessary to consider the merits of these conclusions.

The *Carson* decision rested on much broader grounds. The appellate court found that the legislative history of the gift tax demonstrated that it was designed as a backstop to the estate tax. As such, the court apparently determined, through its adoption of the reasoning of the trial court, that since it was unlikely that political organizations would become the beneficiaries of bequests given the vicissitudes of politics it could not have been Congress' intent to have the gift tax apply to gifts to such organizations. The trial court also relied on its view that given the lack of significant personal connections between the contributor and the candidates he supported and given the contributor's economic motivations for supporting these candidates:

> These facts do not suggest a gift to a candidate, but the use of petitioner's resources to promote the social framework petition consider most auspicious to the attainment of his objectives in life. Petitioner focused on the social structure most conducive to his economic aspirations; others may focus on a social structure advancing their own notions of social justice, or conditions they deem essential for world peace or public order. In either case, in the particular circumstances before us, the individual candidate may generally be viewed, for purposes of the gift tax, as the means to the ends of the contributor.

Carson, 71 T.C. at 258. It is not clear, however, that the appellate court relied on this reasoning.

In response to this second decision, the IRS accepted the position that contributions to political organizations are not transfers subject to the gift tax. Rev. Rul. 82-216, 1982-2 C.B. 220. The IRS refused, however, to accept the reasoning of either the trial court or the appellate court in *Carson*. **The IRS instead stated that transfers to organizations other than political organizations "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."** *Id.* This position has not been tested through litigation as of this date, or modified by the IRS subsequent to the Revenue Ruling..