

Gift Tax Enforcement on Payments to 501(c)(4) Exempt Organizations

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From information shared at the May 6, 2011, meeting of the ABA Exempt Organizations Committee, it appears that the IRS is now pursuing some individual donors for failure to report and pay gift tax on payments to Section 501(c)(4) social welfare organizations. We have one such audit pending in our office so far.

In 2004, Greg Colvin and Miriam Galston co-chaired a 2004 ABA task force that expressed concern about the IRS standards for enforcing tax laws affecting 501(c)(4) groups that engage in political activities. The task force report to the IRS recommended that the Service study the difficult questions, including constitutional and policy problems, surrounding application of the gift tax to payments made to (c)(4) entities, and NOT enforce the tax during the study. The report stated that any enforcement should be prospective only, based on a new revenue ruling proposed for public comment. The IRS has made no response as of this writing.

As the 2004 report predicted, there has been an increase in (c)(4) political activity, especially after the 2010 U.S. Supreme Court's *Citizens United* decision allowing unlimited, independent corporate spending to influence elections.

Many (c)(4) groups were active in the 2008 and 2010 election campaigns, years that are still open to audit for many taxpayers. In situations where the IRS does not succeed in collecting gift tax from donors, the recipient organization may be secondarily liable.

In 1982, the IRS, after losing in court, issued a ruling indicating that it still intended to apply the gift tax to non-charitable 501(c) groups. However, the strength of the IRS stance is uncertain. There has been no further official guidance and widespread lack of awareness, even disbelief, that the gift tax would be enforced (or enforceable) on such donations. We believe that very few donors voluntarily paid the gift tax, and instances of IRS enforcement have been extremely rare.

Our view is that this sudden, unannounced initiative to retroactively enforce gift tax on such payments—a position the IRS had virtually abandoned for almost 30 years—undermines the character of our federal tax system, which depends on people knowing and voluntarily meeting their tax obligations. Considering that donations to 501(c)(3) charities and

to 527 political organizations are not subject to the gift tax, there are serious questions of due process, equal protection, and First Amendment speech rights at issue.

It is worth noting that the Exempt Organizations Division of the IRS, in its FY 2011 Workplan, announced that it would increase its examinations of 501(c)(4), (5), and (6) organizations, looking at various aspects of their compliance including political activity. However, gift tax enforcement comes out of another part of the IRS called “SB/SE Estate & Gift Tax,” which seems to be lacking in coordination and transparency.

Donors wishing to support 501(c)(4) organizations and other non-charitable, non-political groups should consider their options, including (a) paying the gift tax, (b) selecting another recipient for which the gift tax does not apply, or (c) structuring and documenting the payment so that it is less likely to be treated as a taxable gift. For past transactions, if the gift tax was not paid, it is possible to mount a strong defense against an IRS audit depending on the understanding between the donor and the (c)(4) as to purpose at the time the payment was made.