CONSTITUTIONAL ISSUES CLOUD THE GIFT TAXATION OF SECTION 501(c)(4) CONTRIBUTIONS

Were the imposition of tax challenged on constitutional grounds, the result would probably depend on the nature and purpose of the contribution.

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While practitioners often view gift tax as an estate planning issue, there is authority indicating that gift tax also applies to some contributions to nonprofit organizations, including contributions to social welfare organizations exempt under Section 501(c)(4). The applicability of the tax is uncertain, however, and the IRS does not appear to enforce the gift tax on Section 501(c)(4) contributions. Nevertheless, the issue concerns exempt organization practitioners because the potential gift tax liability discourages some potential donors from making large gifts to advocacy and lobbying organizations, while other major donors to Section 501(c)(4) entities never even consider declaring their contributions on gift tax returns. The uncertainty and lack of enforcement therefore results in an unfortunate disparity in tax treatment between those who are cautious and those who are ignorant or tolerant of the risk.

This article is the second of two on the application of gift tax to Section 501(c)(4) contributions. The earlier article examined federal gift taxation generally, and whether and in what circumstances contributions to social welfare organizations could be taxable gifts.[1] This article assumes that Section 501(c)(4) contributions would be treated as gifts subject to gift tax, and examines constitutional arguments against the application of gift tax to Section 501(c)(4) contributions.

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Constitutional issues

No court appears to have considered whether the gift tax may be constitutionally applied to contributions made to Section 501(c)(4) organizations in order to fund lobbying or other expressive activities supported by the donor. The taxability of contributions could be attacked under both the Free Speech and Equal Protection Clauses. This does not mean that the gift tax is unconstitutional in general or that it would be struck down as facially invalid; rather, a court may find that an otherwise valid law, like the gift tax, cannot be applied in certain circumstances without violating the Constitution.[2]

First Amendment freedom of expressive association

The First Amendment guarantees the right to free speech, which includes the ancillary right to free

association for expressive purposes.[3] The Supreme Court has found that "'implicit in the right to engage in activities protected by the First Amendment' is 'a corresponding right to associate with others in pursuit of a wide variety of political, social, economic, educational, religious, and cultural ends.'"[4] In *Buckley v. Valeo*, 424 U.S. 1 (1976), the Court reiterated that the First Amendment protects the "freedom to associate with others for the common advancement of political beliefs and ideas."[5]

In *Buckley*, the Supreme Court recognized 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."[6] Hence, contributing to organizations which express the contributor's views is an aspect of the freedom of association protected under the First Amendment.

The constitutional right to associate for expressive purposes is not absolute; in *Buckley* and subsequent cases, the Court upheld laws that limit the size of contributions to political candidates, notwithstanding its recognition that contribution limits implicate First Amendment rights.[7] Whether application of the gift tax to Section 501(c)(4) contributions would be held to violate the First Amendment depends on a constitutional balancing test.

Contributions and the right to association. In *Buckley*, the Supreme Court upheld campaign contribution limits imposed by the Federal Elections Campaign Act (FECA). The Court acknowledged that limiting an individual's campaign contributions restricted "one aspect of the contributor's freedom of political association," but upheld the limitation under a "rigorous" standard of review. On one side of the balancing test, the Court found that FECA contribution limits did not severely impinge on contributors' First Amendment rights. The Court stressed that contributors were still able to affiliate themselves with and express symbolic support for the candidate by making contributions. Further, they remained "free to engage in independent political expression, to associate actively through volunteering their services, and to assist to a limited but nonetheless substantial extent in supporting candidates and committees with financial resources." On the other side of the balancing test, the Court found that the government had a "weighty interest" in preventing the reality or appearance of corruption caused by unlimited campaign contributions, and that the contribution limit was narrowly focused on preventing large contributions that created the appearance of corruption. The Court thus held that "under the rigorous standard of review established by our prior decisions, the weighty interests served by restricting the size of financial contributions to political candidates are sufficient to justify the limited effect upon First Amendment freedoms caused by the $1,000 contribution ceiling."[8]

The Court again applied a balancing test to contribution limits in *Citizens Against Rent Control v. Berkeley*, 454 U.S. 290 (1981), which concerned a Berkeley, California, ordinance that capped the size of contributions to committees supporting or opposing local ballot measures. The Court struck down the law because it violated the rights of expression and association. It reasoned that "[u]nder the Berkeley ordinance an affluent person can, acting alone, spend without limit to advocate individual views on a ballot measure." It was only when the individuals acted in concert through an organization that their contributions were limited. The law thus directly implicated the right of association:

> There are, of course, some activities, legal if engaged in by one, yet illegal if performed in concert with others, but political expression is not one of them. To 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 on individuals acting alone, is clearly a restraint on the right of association.[9]

The Court went on to hold that the Berkeley ordinance also impinged on the right to free expression of groups and individuals who wished to express their views through committees, because the contribution limit automatically affected expenditures. "The two rights overlap and blend; to limit the right of association places an impressible restraint on the right of expression." The Court found that the asserted state interests were not sufficient to justify this intrusion into First Amendment rights,

'[F]REEDOM OF ASSOCIATION IS DILUTED IF IT DOES NOT INCLUDE THE RIGHT TO POOL MONEY....'

[1] Rhomberg, "The Law Remains Unsettled on Gift Taxation of Section 501(c)(4) Contributions," 15 Exempts 62 (Jul/Aug 2003).

[2] See, e.g., Brown et al v. Socialist Workers '74 Campaign Committee, 459 U.S. 87 (1982).

[3] See NAACP v. Alabama, 375 U.S. 449 (1958).

[4] See Boy Scouts of America v. Dale, 530 U.S. 640 (2000), citing Roberts v. United States Jaycees, 468 U.S. 609 (1984).

[5] Buckley v. Valeo, 424 U.S. 1, 14 (1976).

[6] *Id.* at 65 (internal quotations omitted).

[7] See *id.* at 29.

[8] Buckley, *supra* note 5 at 27.

[9] Citizens Against Rent Control v. Berkeley, 454 U.S. 290, at 298.

and struck down the contribution caps law because the "restraint imposed by the Berkeley ordinance on rights of association and in turn on individual and collective rights of expression plainly contravenes" the First Amendment.[10]

The *Citizens Against Rent Control* opinion distinguished *Buckley* on the strength of the government's interest. "Buckley identified a single narrow exception to the rule that limits on political activity were contrary to the First Amendment," the Court wrote. "The exception relates to the perception of undue influence of large contributors to a candidate."[11] Because ballot measures relate to issues, not candidates, "[t]he risk of corruption perceived in cases involving candidate elections simply is not present in a popular vote on a public issue."[12] Absent this compelling interest, the contribution limit had to fall under the "exacting judicial scrutiny" applicable to regulation of First Amendment rights. The Court has subsequently reiterated that "preventing corruption or the appearance of corruption are the only legitimate and compelling government interests thus far identified for restricting campaign finances."[13]

WHEN CANDIDATE'S SPEECH WAS NOT TREATED AS THE CONTRIBUTOR'S SPEECH, CONTRIBUTION LIMITS WERE FOUND TO IMPOSE ONLY A MARGINAL RESTRAINT.

Citizens Against Rent Control and *Buckley* also differ in the way the Court viewed the connection between a contribution and the expressive rights of the contributor. In *Buckley*, the Court distinguished between the speech of the contributor and the speech of the candidate:

> While contributions may result in political expression if spent by a candidate or an association to present views to the voters, the transformation of contributions into political debate involves speech by someone other than the contributor.[14]

Because the candidate's speech was not treated as the contributor's speech, contribution limits were found to impose only a marginal restraint on the contributor's political expression.[15] By contrast, in *Citizens Against Rent Control*, the Court viewed the ballot committee as an aggregate of its individual and group contributors. Restricting contributions thus directly limited the rights of contributors to express their own views:

> Apart from the impressible 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.[16]

The ordinance thus restrained "individual and collective rights of expression" in contravention of the First Amendment.

The same distinction was made by a plurality of the Court in *California Medical Association v. FEC*, 453 U.S. 182 (1981), which extended *Buckley* to find that FECA limits on contributions by a nonprofit association to a multi-candidate political action committee were constitutional. In weighing the burden on First Amendment rights, the four-justice plurality argued that limits on contributions to a multi-candidate political action committee did not greatly implicate the contributor's own right to free expression:

> [A]ppellants' claim that [multi-candidate committee] CALPAC is merely the mouthpiece of [contributor] CMA is untenable. CALPAC instead is a separate legal entity that receives funds from multiple sources and that engages in independent political advocacy. Of course, CMA would probably not contribute to CALPAC unless it agreed with the views espoused by CALPAC, but this sympathy of interests alone does not convert CALPAC's speech into that of CMA.[17]

The justices noted, however, that their opinion did not address the constitutionality of limits on "expenditures made jointly by groups of individuals in order to express common political views."[18] By contrast, in *FEC v. Nat'l Conservative Political Action Committee*, 470 U.S. 480 (1985), the Court refused to draw a distinction between the speech of individual contributors to a political action committee and the speech of the committee itself. The government had argued that independent expenditures of a political action committee were entitled to less protection because they were "speech by proxy," but the Court did not agree:

> [C]ontributors obviously like the message they are hearing from these organizations and want to add their voices to that message; otherwise they would not part with their money. To say that their collective action in pooling their resources to

[10] *Id.* at 300.

[11] *Id.* at 296-97.

[12] *Id.* at 298, citing First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765 (1978).

[13] See FEC v. Nat'l Conservative Political Action Comm., 770 U.S. 480 (1985). In F.E.C. v. Beaumont, 123 S. Ct. 2200 (2003), the Court acknowledged that the FECA ban on corporate contributions "has always done further duty in protecting the individuals who have paid money into a corporation or union for purposes other than the support of candidates from having that money used to support political candidates to whom they may be opposed."

[14] See Buckley, *supra* note 5 at 19 (emphasis added).

[15] See also Nixon v. Shrink Missouri Gov't PAC, 528 U.S. 377 (2000) (agreeing with *Buckley* that contribution limits restrict the contributor's expressive rights only marginally).

[16] Citizens Against Rent Control, *supra* note 9 at 289 (emphasis added).

[17] See California Medical Association v. FEC, 453 U.S. 182, 196.

[18] *Id.* at 197 n.17.

> amplify their voices is not entitled to full First Amendment protection would subordinate the voices of those of modest means as opposed to those sufficiently wealthy to be able to buy expensive media ads with their own resources.[19]

As the Court explicitly noted, however, this case did not involve contribution limits, but rather the right of the Committee to make independent expenditures. Thus, it is distinguishable from *Buckley* and *California Medical Association.*

Together, these cases demonstrate that the degree of First Amendment protection afforded to contributions depends in part on whether or not the speech funded by the contributions is treated as speech of the contributor. In the case of campaign contributions to candidates, the Court tends to view the candidate as the speaker, not the contributors. But when associations engage in independent expressive activities, whether against a ballot measure or political candidate, the Court appeares to treat the organization's speech as the speech of the contributors, and to recognize that making contributions was closely intertwined with the contributors' own expressive rights.

While the gift tax does not prohibit contributions to Section 501(c)(4) organizations, it does impose a financial burden on making donations to an organization for concerted expression on public issues. The reasoning of *Citizens Against Rent Control* is directly on point. Acting alone, people may spend as much as they want to express their views on social or political issues without triggering any gift tax liability. It is only when they act in concert with others by contributing to an organization that expenditures to express their views become subject to tax. As applied to contributions for expressive activities, the gift tax therefore directly burdens the donor's exercise of First Amendment rights. The fact that the burden is imposed through a tax rather than a prohibition does not immunize it from constitutional challenge.[20]

Applicable standard of review. Because it burdens the right to association, the constitutionality of this application of the gift tax would be determined under a balancing test. The precise standard of review a court would apply to a First Amendment challenge could be crucial to determining the outcome.

In *FEC v. Beaumont,* 123 S. Ct. 2200 (2003), the Supreme Court articulated the "basic premise" it has followed "in setting First Amendment standards for reviewing political financial restrictions: the level of scrutiny is based on the importance of the political activity at issue to effective speech or political association." How strict the judicial scrutiny would be in challenge to the gift taxation of Section 501(c)(4) gifts therefore depends on how important a reviewing court considers the activity at issue—in other words, how important making taxable gifts to Section 501(c)(4) organizations is to the First Amendment right of association.

The *Beaumont* Court noted that restrictions on political expenditures by candidates and committees have been weighted under a strict scrutiny standard of review, and survive constitutional attack only if "narrowly tailored to serve a compelling governmental interest." However, a more relaxed standard of review applies to contribution limits because "contributions lie closer to the edges than to the core of political expression." Because contributions are a less important activity to association and expression, "a contribution limit involving significant interference with associational rights ... could survive if the Government demonstrated that contribution regulation was closely drawn to match a sufficiently important interest ... though the dollar amount of the limit need not be fine tuned."

Possibly the more relaxed test for contributions would be applied to a challenge to the application of the gift tax to Section 501(c)(4) organizations, since a burden on the right to contribute money is at issue. On the other hand, the cases setting forth the lower standard of review for contributions involved the right to contribute to candidates, not the right to contribute to organizations for independent expression. Arguably, contributing to associations that engage in independent expression is a more important right and thus would be reviewed under a higher, strict scrutiny standard.

The Court's analysis in *Citizens Against Rent Control* supports the application of the higher standard. In that case, the Court found that "[c]ontributions by individuals to support concerted action by a committee advocating a position on a ballot measure is beyond question a very significant form of political expression," and applied "exacting" scrutiny.[21] The impor-

THE COURT APPEARED TO TREAT THE SPEECH OF INDEPENDENT COMMITTEES AS THE SPEECH OF THE CONTRIBUTORS.

[19] FEC v. Nat'l Conservative Political Action Comm., *supra* note 13 at 495.

[20] See Murdock v. Pennsylvania, 319 U.S. 105 (1943) (striking down a license fee on door-to-door solicitation)

[21] Citizens Against Rent Control, *supra* note 9 at 289 (emphasis added)..

tance given to contributions in *Citizens Against Rent Control* is likely attributable to the Court's view that limiting contributions to the ballot measure committee impinged on the collective speech of donors. By contrast, in *Beaumont,* the Court indicated that the contributions were less important than independent expenditures precisely because "the transformation of contributions into political debate involves speech by someone other than the contributor." The Court stated that this was true for contributions made to associations as well as to candidates, but *Beaumont* involved contributions to candidates and thus the remark about contributions to associations is dicta

TAXATION BURDENS ON THE RIGHT TO ASSOCIATION WOULD LIKELY BE DETERMINED UNDER THE STRICT SCRUTINY STANDARD.

Citizens Against Rent Control involved an absolute limit on contributions to ballot measure committees of $250; the gift tax only applies to gifts exceeding $11,000 per year, and thus imposes less of a burden on associational and expressive rights. However, the time to consider the weight of the burden on First Amendment rights "is when applying scrutiny at the level selected, not in selecting the standard of review itself."[22] Because the contributing to an association for concerted political expression was held in *Citizens Against Rent Control* to be an important protected activity under the First Amendment right of association, the level of constitutional review applying to burdens on that right should be strict scrutiny, or at least the rigorous level of review that applies to campaign contributions.

The government might argue that an even lower level of scrutiny should apply, since the gift tax statute is a generally applicable tax that only incidentally affects expression. For example, in *Leathers v. Medlock*, 499 U.S. 439 (1991), the Supreme Court upheld the application of a general sales tax to cable television services without applying strict scrutiny. It found that the challenged law was not constitutionally suspect because it did not single out the press, threaten to suppress particular viewpoints, or discriminate on the basis of content.[23] Similarly, in *Swaggart Ministries v. Board of Equalization of California*, 493 U.S. 378 (1990), the Court held that the sale of religious literature was subject to a generally applicable sales tax without applying strict scrutiny.

These cases are distinguishable, however, 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. As the Supreme Court has stated: "It is one thing to impose a tax on the income or property of a preacher. It is quite another thing to exact a tax from him for the privilege of delivering a sermon."[24] Contributing to committees engaged in concerted political expression is an activity protected by the First Amendment, and applying the gift tax to such contributions therefore places a penalty directly on the exercise of a constitutional right. Consequently, the gift tax will likely be reviewed under a strict scrutiny standard or at least the nearly strict scrutiny applicable to campaign contributions.

National Federation of Republican Assemblies, 218 F. Supp.2d 1300, 90 AFTR2d 2002-6150 (2002), a case that considered the constitutionality of disclosure requirements imposed on Section 527 organizations, supports this conclusion. Section 527(j) requires political organizations to disclose both contributions and expenditures to the IRS, and imposes a penalty on the failure to make the required disclosures. The government argued that the Section 527 penalty merely reversed the effect of the subsidies given to Section 527 organizations through their federal tax exemption, and thus should be analyzed as the withdrawal of a subsidy. In *Regan v. Taxation with Representation*, 461 U.S. 540, 42 AFTR2d 78-6140 (1983), the Court had held that Congress may grant or withdraw subsidies without violating the First Amendment as long as the law does not discriminate on the basis of viewpoint. With respect to penalties for the failure to disclose contributions, the district court agreed with the argument, finding that there was no practical possibility that the Section 527 penalty with respect to any contribution would exceed the amount of income tax that the organization would have had to pay on the contribution if it were not afforded the benefit of tax-exempt status. Consequently, the *Republican Assemblies* court found that the Section 527 penalty was not unconstitutional if applied to the failure to disclose contributions connected to federal electoral advocacy.

The district court came to a different conclusion, however, with respect to the application of the Section 527 tax to expenditures. As applied to expenditures, the Section 527 penalty "ceases to represent the offset of a subsidy and becomes an additional exaction." Because the Section 527 tax represented an actual penalty on the exercise of free speech

[22] Beaumont, *supra* note 13 at 2211.

[23] Leathers v. Medlock, 499 U.S. 439, 446 (1991).

[24] Murdock, *supra* note 20 at 111.

rights, the district court found that strict scrutiny applied: "To the extent that Congress goes beyond the cancellation of a subsidy and imposes an additional exaction, the analysis reverts to that required by Buckley."[25] Because taxation of Section 501(c)(4) contributions would impose an "additional exaction" on an activity protected by the First Amendment, a *Buckley* standard of strict or nearly strict scrutiny would likely be applied.

In considering limits on campaign contributions to candidates, the Supreme Court explicitly rejected the application of the intermediate standard of review set forth in *U.S. v. O'Brien*, 391 U.S. 367 (1968), a case that established a four-part test for laws of general application regulating conduct that have only an incidental effect on protected speech. In *Buckley*, the Supreme Court found *O'Brien* to be inapplicable because contribution and expenditure limits were not comparable to conduct. For this reason, a reviewing court is not likely to apply the *O'Brien* intermediate scrutiny standard in a challenge to the assessment of gift tax on Section 501(c)(4) contributions.

Applying the balancing test. To determine whether application of gift tax to Section 501(c)(4) contributions is constitutional, a court would balance the constitutional injury against the government's interest in the challenged law. On one side of the scale would be the severity of the burden on First Amendment rights. In the gift tax context, this would depend on the degree to which the contribution is intended to support expressive activities, and in particular the expression of the donor's own views. In *Citizens Against Rent Control*, the Court saw the ballot committee as an aggregate of its supporters. Limiting contributions to the ballot committee therefore limited the rights of its contributors to join together for the purpose of collective First Amendment expression. This argument will have force in the case of any donation to an ideological organization that is primarily engaged in activities to advance certain ideas or positions. A major donor to either the National Right to Life Committee or the National Abortions Rights Action League is likely to be making contributions with understanding that the funds will be used primarily to advocate the donor's views on abortion, for example. Taxing large contributions to these organizations would burden the donor's ability to associate with others to engage in core political speech, creating a significant impairment to First Amendment rights.

Contributions to social welfare organizations may support activities that are not principally expressive. A gift to a health maintenance organization to subsidize health care services for the poor or to a Kiwanis chapter for service projects in the community would have little connection to the donor's free speech rights. Taxing such contributions may be poor public policy, but does not implicate the First Amendment to any significant degree.

The constitutional injury is also more significant in the case of contributions for lobbying because the donor has no practical alternative. People who wish to engage in collective lobbying expression as a principal activity cannot form a Section 501(c)(3) organization or a Section 527 organization to avoid the gift tax, because lobbying cannot be a primary activity for either type of organization. On the other hand, people who wish to collaborate to disseminate health information or fund health care for the poor can use a Section 501(c)(3) organization, and have their gifts qualify for the gift tax charitable deduction. Similarly, people who contribute towards independent campaign expenditures can contribute to a Section 527 political organization and have their contributions excluded from the gift tax altogether. Their associational rights are burdened by administrative costs of a parallel organization, as the Supreme Court has recognized in cases relating to FECA requirements for a segregated fund.[26] Nonetheless, the availability of alternatives does lessen the infringement on First Amendment rights.[27]

In several cases, the Supreme Court found that the ability of speakers to speak through alternative programs or organizations mitigated any First Amendment injury arising from limits on the speech of government-subsidized organizations. In *Rust v. Sullivan*, 500 U.S. 173 (1991), the Court held that restrictions on the speech of a government grantee did not violate the First Amendment because the grantee could speak through other programs that were not funded by the government. *Rust* cited

THE COURT HAS DISTINGUISHED BETWEEN EXPENDITURE LIMITS AND CONTRIBUTION LIMITS.

[25] National Federation of Republican Assemblies, 218 F. Supp.2d 1300, at 1322, 90 AFTR2d 2002-6150 (2002).

[26] See Austin v. Michigan State Chamber of Commerce, 494 U.S. 652 (1990) (recognizing that requiring corporations to use segregated funds to make independent expenditures burdened expressive rights); FEC v. Massachusetts Citizens for Life, 479 U.S. 238 (1986) (plurality opinion; O'Connor, J., concurring).

[27] See Austin, *supra* note 26.

A CONTRIBUTION LIMIT COULD SURVIVE IF IT WAS CLOSELY DRAWN TO MATCH A 'SUFFICIENTLY IMPORTANT INTEREST.'

Taxation with Representation, which held that the limits on lobbying activities in Section 501(c)(3) did not violate the First Amendment because the plaintiff organization could lobby freely as a Section 501(c)(4) organization, and could still raise tax-deductible funds through a Section 501(c)(3) affiliate. *Rust* and *Taxation with Representation* are not on point, since both involved the ability of government to impose speech limits on organizations receiving public subsidies or funding. By contrast, the gift tax imposes an out-of-pocket financial penalty on the making of large contributions and no government subsidy is involved.[28] Nevertheless, these precedents may lead a court to find the burden on a Section 501(c)(4) contributor's associational rights to be mitigated by the availability of tax-free alternatives in cases where the activities or expression supported by the funding could be carried out by a Section 501(c)(3) or Section 527 affiliate.

Additional support is found in *Austin v. Michigan State Chamber of Commerce*, 494 U.S. 652 (1990). In that case, the Court upheld the FECA ban on independent campaign expenditures by corporations, in part because the corporation could create a segregated fund to engage in campaign activities. On the other hand, in *FEC v. Massachussetts Citizens for Life*, 479 U.S. 238 (1986), the Supreme Court found that the administrative and financial burdens of operating a segregated fund for political expression created a practical deterrent to such expression, and therefore regulations requiring such a fund were an infringement of the First Amendment rights as applied to the plaintiff nonprofit corporation. Under *Massachusetts Citizens for Life*, an argument could be made that for social welfare organizations formed for expressive purposes, creating a Section 501(c)(3) or 527 organization in order that donors might avoid the gift tax is too great a burden; nevertheless, gift tax is most likely to be struck down in the case of gifts for lobbying activities where that alternative does not exist.

The availability of the annual $11,000 exclusion lessens the effect of the gift tax in burdening expressive association. People can make sizeable contributions to organizations that express their views without incurring any gift tax liability. Nevertheless, the application of the gift tax to larger contributions does penalize the making of those contributions to a single organization, and thus imposes a de facto limit on the size of contributions to Section 501(c)(4) organization. In *Citizens Against Rent Control*, the Supreme Court held that placing "a Spartan limit—or indeed any limit—on individuals wishing to band together to advance their views on a ballot measure, while placing none on individuals acting alone, is clearly a restraint on the right of association."[29] While the $11,000 annual exclusion amount is much higher than the $250 contribution limit considered in *Citizens Against Rent Control*, this nevertheless places a cap on the amount than can be contributed for concerted speech without penalty, and thus places a practical upper limit on contributions. The fact that a statute's "practical effect may be to discourage protected speech is sufficient to characterize [the statute] as an infringement on First Amendment activities."[30]

On the other side of the scales in the First Amendment balancing test is the importance of the government interest. The gift tax is a revenue-generating statute that is unrelated to the suppression of ideas, and the Supreme Court has recognized that collecting revenue is an important government interest.[31] However, in a constitutional challenge to a particular application of an otherwise valid statute, the relevant inquiry is the strength of the government's interest in applying the law to the circumstances at hand.[32]

The government does not appear to have any weighty interest in assessing gift tax on Section 501(c)(4) contributions, as demonstrated by the Service's apparent failure over many years to enforce this application of the law.[33] The lack

[28] While Section 501(c)(4) organizations do receive a subsidy through their income tax exemption, the gift tax applies whether or not the recipient organization is exempt from tax. The gift tax imposes a financial penalty on the donor for engaging in protected First Amendment activity, and the donor receives no offsetting tax subsidy or benefit. The application of the gift tax to contributions should therefore be analyzed as a penalty rather than a subsidy. See National Federation of Republican Assemblies, *supra* note 25.

[29] See Citizens Against Rent Control, *supra* note 9 at 296.

[30] See Massachusetts Citizens for Life, *supra* note 26 at 255. (1986).

[31] See Arkansas Writers' Project v. Ragland, 481 U.S. 221 (1987).

[32] See Massachusetts Citizens for Life, *supra* note 26 (finding that the FEC lacked compelling interest in prohibiting plaintiff corporation from making campaign contributions from general funds, though the FEC did have compelling interest in applying the law to business corporations); Brown, *supra* note 2 (finding the government had a diminished interest in applying contribution disclosure laws to minor party plaintiff).

[33] The lack of enforcement is evidenced by the lack of any recent reported court cases considering whether gift tax applies to Section 501(c)(4) contributions, as well as anecdotal evidence from practitioners in the field.

of enforcement does not lessen the burden on First Amendment rights, since the possibility of tax liability is sufficient to chill the exercise of free association rights.[34] However, the fact that the government evidently makes little effort to collect gift tax on Section 501(c)(4) contributions belies the importance of taxing these transfers. In addition, the enactment of a statutory gift tax deduction for Section 501(c)(3) gifts and an exclusion for Section 527 gifts demonstrates that the government has no compelling interest in taxing contributions to nonprofit organizations. The Supreme Court has held that "[w]here government restricts only conduct protected by the First Amendment and fails to enact feasible measures to restrict other conduct producing substantial harm or alleged harm of the same sort, the interest given in justification of the restriction is not compelling."[35] The government has an equal financial interest in taxing transfers to any type of nonprofit organization. All contributions deplete the assets that otherwise would be part of a donor's taxable estate, and all would generate the same revenue if taxed. The government's interest cannot be compelling if Congress is willing to forgo the tax in the case of charitable gifts or campaign contributions, since exempting those transfers does the same sort of harm to the public fisc that exempting Section 501(c)(4) contributions would do. Also, taxing gifts made by corporations to Section 501(c)(4) organizations would raise revenue, and yet corporations are entirely exempt from gift tax.

Even conceding the importance of the government's interest in raising revenue, direct infringement of First Amendment rights is permissible under strict scrutiny only if the government interest "cannot be achieved through means significantly less restrictive of associational freedoms."[36] Clearly, that standard is not met here; the government can choose to raise revenue by taxing something other than contributions for the purpose of concerted First Amendment activity.

The government could claim an additional interest in enforcing the gift tax on large transfers to Section 501(c)(4) organizations—the gift tax discourages large contributors from circumventing the public disclosure that is now mandated for contributions to Section 527 political organizations.[37] Section 501(c)(4) organizations may engage in partisan politics as long as it is not a primary part of their activities; without the unfavorable gift tax treatment, large donors could make anonymous gifts to Section 501(c)(4) organizations engaged in partisan politics, thwarting the public disclosure that Congress intended for contributions to organizations engaged in partisan activities. However, the gift tax is not closely drawn to address this possible circumvention of Section 527. The gift tax applies not only to contributions used for partisan politics, but also to contributions used for lobbying or other social welfare activities, where this government interest is entirely absent.

Under strict scrutiny, a court would likely find the gift tax unconstitutional as applied to contributions to ideological Section 501(c)(4) organizations formed primarily to lobby or advocate certain social or political views. The burden on First Amendment rights is significant, since contributing to organizations to support concerted action is "beyond question a very significant form of political expression,"[38] and the substantial tax rates create a practical limit on the amount donors may contribute without significant penalty. The government interests supporting this application of the law are not compelling and could be achieved without taxing the exercise of a First Amendment right.

The result would likely be the same if a court applied the slightly reduced level of scrutiny applicable to campaign contributions, under which contribution limits involving a "significant interference" with association rights will be upheld if they are "closely drawn to match a sufficiently important interest."[39] As noted above, the interference with association rights posed by the gift tax is significant; and taxing contributions to ideological associations is not "closely drawn" to any interest in generating revenue, protecting the estate tax base, or penalizing the circumvention of Section 527 public disclosure requirements.

The case for a constitutional exception is not as strong with respect to contributions to Sec-

CONTRIBUTING TO POLITICAL ASSOCIATIONS IS PROTECTED BY THE FIRST AMENDMENT, SO A GIFT TAX PLACES A PENALTY ON THE EXERCISE OF A CONSTITUTIONAL RIGHT.

[34] See NAACP v. Button, 371 U.S. 415 (1963).

[35] See Church of the Lukumi Babalu Aye v. City of Hialeah, 508 U.S. 520, 547 (1993).

[36] See Roberts v. Minnesota Dep't of Human Rights, 468 U.S. 609, 623 (1984).

[37] In Beaumont, the Supreme Court recognized that the government had a valid interest in limiting campaign contributions by corporations in order to prevent their use to circumvent valid contribution limits imposed on individuals. See Beaumont, *supra* note 13 at 2207.

[38] Citizens Against Rent Control, *supra* note 9 at 298.

[39] See Shrink Missouri, *supra* note 15 at 387-88 (internal citations omitted).

tion 501(c)(4) organizations that are not primarily engaged in expressive activities. As Justice O'Connor explained, Supreme Court case law:

> recognizes radically different constitutional protections for expressive and nonexpressive associations.... The proper approach to analysis of First Amendment claims of associational freedom is, therefore, to distinguish nonexpressive from expressive associations and to recognize the former lack the full constitutional protections possessed by the latter.[40]

Organizational activities that are not primarily expressive do not implicate the associational rights of donors to the same degree. In addition, if the organization does not engage in lobbying as a substantial part of its activities, very often the donors could support such activities without gift tax liability if the Section 501(c)(4) organization simply chose to use a Section 501(c)(3) affiliate, lessening if not eliminating the burden of First Amendment rights. Therefore, the application of gift tax to Section 501(c)(4) contributions may pass the constitutional balancing test if the contribution is made to an organization that is not primarily engaged in concerted expression.

THE CONSTITUTIONAL INJURY IS MORE SIGNIFICANT WHEN CONTRIBUTIONS ARE FOR LOBBYING BECAUSE THE DONOR HAS NO PRACTICAL ALTERNATIVE.

Fourteenth Amendment right to equal protection

The application of gift tax to contributions to Section 501(c)(4) contributions also arguably violates the Equal Protection Clause of the Fourteenth Amendment, which commands that no state shall deny the equal protection of the laws to any person. The Supreme Court interprets this clause to be "essentially a direction that all persons similarly situated should be treated alike."[41] The Equal Protection Clause is made applicable to the federal government through the Due Process Clause of the Fifth Amendment.

Under the Supreme Court's equal protection jurisprudence, statutory classifications that provide different treatment for different classes of people are generally valid if they bear a rational relationship to a legitimate governmental purpose.[42] This standard is met so long as there is "a plausible policy reason for the classification, the legislative facts on which the classification is apparently based rationally may have been considered to be true by the government decision maker, and the relationship of the classification to its goal is not so attenuated as to render the distinction arbitrary or irrational."[43] However, statutory classifications are subject to a higher level of scrutiny if they interfere with the exercise of a fundamental right, such as freedom of speech.[44]

Differing treatment of contributions to nonprofit organizations. The gift tax does not treat all people who donate to nonprofit organizations alike. Donors to Section 501(c)(3) charities and Section 527 political committees enjoy statutory exceptions to the gift tax, while donors to Section 501(c)(4) organizations remain liable.

Arguably, this statutory classification does interfere with a fundamental constitutional right, since it imposes gift tax on contributions to lobbying organizations and thus infringes on the right to association. Further, advocacy organizations exempt under Section 501(c)(4) are often ineligible for more favorable Section 501(c)(3) status because of the amount of lobbying they do. Hence, the gift tax not only burdens a fundamental right, but does so on the basis of the content of the recipient organization's speech. Therefore, the distinction between Section 501(c)(3) contributions and Section 501(c)(4) contributions arguably should receive a heightened level of scrutiny under the fundamental rights strand of Equal Protection analysis.

In *Taxation with Representation*, the Court upheld the distinction in income tax treatment between contributions to Section 501(c)(19) veterans organizations, which are deductible by the donor, and contributions to Section 501(c)(4) social welfare organizations, which are not. Both types of organizations may lobby freely in furtherance of their exempt purposes. The appellate court applied strict scrutiny to the classification because it affected First Amendment rights on a discriminatory

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[40] See Roberts v. United States Jaycees, 468 U.S. 609, 638 (1984) (O'Connor, J., concurring). See also Boy Scouts of America v. Dale, 530 U.S. 640, 648 (2000) ("To determine whether a group is protected by the First Amendment's expressive associational right, we must determine whether the group engages in 'expressive association'.").

[41] City of Cleburne v. Cleburne Living Ctr., Inc., 473 U.S. 432, 439 (1985).

[42] Regan v. Taxation with Representation, 461 U.S. 540, 42 AFTR2d 78-6140 (1983).

[43] Nordlinger v. Hahn, 505 U.S. 1, 11 (1992) (internal quotes and citations omitted; rejecting equal protection attack on California's Proposition 13 property tax regime). The Court has stated repeatedly that the standard of review is especially deferential in the context of classifications made by complex tax laws. See *id.*; Exxon Corp. v. Eagerton, 462 U.S. 176 (1983) (upholding an Alabama tax exemption against an equal protection challenge); Regan v. Taxation with Representation, *supra* note 42.

[44] See Regan v. Taxation with Representation, *supra* note 42.

basis, but the Supreme Court reversed and held that no strict scrutiny applied. The Court's decision was based on its finding that the charitable income tax deduction is a government subsidy to the recipient organization:

> Congressional selection of particular entities or persons for entitlements of this sort of largesse is obviously a matter of policy and discretion not open to judicial review unless in circumstances we are not here able to find.... [A]ppropriations are comparable to tax exemptions and deductions, which are also a matter of grace that Congress can, of course, disallow as it chooses.[45]

The Court went on to note that a legislature's decision not to subsidize a fundamental right does not infringe on the right and thus is not subject to strict scrutiny.

Under *Taxation with Representation*, the government could argue that the gift tax charitable deduction, like the income tax charitable deduction, is a subsidy, and that the failure to grant this subsidy to less favored organizations therefore draws no heightened review as long as it is not based on viewpoint. Similarly, the exemption for Section 527 gifts is also a subsidy, and a matter of "legislative grace." This argument fails, however, because unlike the income tax, the gift tax imposes a financial penalty on contributions to lobbying organizations. The creation of a penalty is altogether different from the failure to award a subsidy.[46]

If a donor makes a contribution to a Section 501(c)(4) social welfare organization, the contribution has no effect on his or her income tax liability. The income tax that must be paid on wages or income from investments will be the same whether the money is donated to a social welfare group or spent on personal consumption instead. If the donation goes to a Section 501(c)(3) charity or a Section 501(c)(19) veterans' organization, however, the donor will be able to claim a deduction that will reduce income tax liability on his or her income from wages or investments. As an incentive to make the contribution, Congress leaves money in the taxpayer's pocket that he or she otherwise would have to pay as income tax. The Supreme Court thus correctly viewed the income tax deduction as a subsidy. In the gift tax context, though, a donor to a social welfare organization will actually have to pay for the privilege of making a contribution larger than the annual exemption amount. Here, Congress reaches into the donor's pocket to collect a tax that the donor would not have to pay if he or she saved the money or spent it on personal consumption. Note that the tax would be due whether or not the recipient organization qualified for or received any income tax exemption under Section 501. Even if a lobbying organization received no income tax benefits, the donor would still have to pay the gift tax.

THE APPLICATION OF GIFT TAX ALSO ARGUABLY VIOLATES THE EQUAL PROTECTION CLAUSE.

Because the gift tax is an exaction based on the exercise of a constitutional right, not merely the failure to get a subsidy, *Taxation with Representation* is not on point. Consequently, the disparate gift tax treatment between contributions to Section 501(c)(3), Section 501(c)(4), and Section 527 organizations arguably would receive heightened review because of the interference with a fundamental right. Under strict scrutiny, the distinction in tax treatment between social welfare contributions on the one hand and charitable or campaign contributions on the other would not stand; the government can show no compelling interest in taxing Section 501(c)(4) contributions but not Section 501(c)(3) contributions. On the other hand, a court may decline to apply heightened scrutiny based on interference with fundamental First Amendment right unless the court also finds that the First Amendment has been violated. According to the Supreme Court, "equal protection analysis requires strict scrutiny of a legislative classification only when the classification impermissibly interferes with the exercise of a fundamental right...."[47] If application of the gift tax survives First Amendment challenge, a court may well decline to apply any heightened review to an Equal Protection challenge.[48]

Even if no heightened scrutiny were applied, the gift tax statute could potentially be one of the rare laws that cannot even pass a deferential rationality review.[49] The Equal Protection Clause requires that the government have a plausible and legitimate policy reason for a statutory classification. If the subsidy argument is set aside, it is difficult to articulate a rationale for the current gift tax classification that is not based

[45] *Id.* at 549 (internal quotations and citations omitted).

[46] National Federation of Republican Assemblies, *supra* note 25.

[47] Massachusetts Board of Retirement v. Murgia, 427 U.S. 307, 312 (1976) (emphasis added); Minneapolis Star v. Minnesota Com'r Of Rev., 460 U.S. 575, 600 (1983) (Renquist, J., dissenting).

[48] See Arkansas Writers' Project, *supra* note 31 at 228, fn.3 (indicating that a case raising both First Amendment and Equal Protection concerns should be analyzed primarily under the First Amendment).

[49] City of Cleburne, *supra* note 41.

on the type of speech the recipient organization is likely to engage in, which may not be a "legitimate policy reason."

Often, the main distinction between Section 501(c)(3) and Section 501(c)(4) entities is the amount of lobbying or political activity that the latter type of organization engages in. Otherwise, charities and social welfare organizations can be quite similar and may have identical purposes. For example, both Section 501(c)(3) and Section 501(c)(4) organizations may be dedicated to environmental protection or the promotion of family values, and both may promote their purpose through public education, advocacy, and debate. In such cases, the distinction between two types of organizations may be based on the content of their speech—that is, on the amount of lobbying communications or the existence of electioneering communications.

THE GIFT TAX DOES NOT TREAT ALL PEOPLE WHO DONATE TO NONPROFIT ORGANIZATIONS ALIKE.

Clearly, the content of the organization's speech is no legitimate policy reason for Congress to assess gift tax on contributions to Section 501(c)(4) organizations but exempt gifts to Section 501(c)(3) entities. It is well established that a "statute is presumptively inconsistent with the First Amendment if it imposes a financial burden on speakers because of the content of their speech."[50] Similarly, a Section 527 organization may also exist to promote environmental protection or family values. Again, a social welfare group may be disqualified from that status mainly because it engages primarily in lobbying activities and not in express advocacy of the election or defeat of candidates, and again, this content-based distinction is not a legitimate basis for Congress to create a distinction in tax treatment. Hence, even under the deferential rationality review generally applicable to tax classifications, the application of gift tax to Section 501(c)(4) contributions may violate the Equal Protection Clause.

Rationality review is especially deferential for tax statutes, however, and a court may be satisfied that Congress could have rationally considered the reduction in the estate tax base to be justified in the case of charitable contributions by the role of charities in reducing the burdens on government. Congress could also have rationally believed that campaign contributions did not pose a danger to the estate tax base because the very wealthy are prevented from depleting their estates through vast campaign contributions to candidates by federal and state campaign finance laws. These are legitimate policy reasons that are not based on the content of association speech, and thus the distinctions in the gift tax laws between contributions to Section 501(c)(3), 501(c)(4), and 527 organizations may well survive rationality review.

Differing treatment of individual and corporate contributors. An equal protection challenge could be made as well with respect to a second classification in the gift tax statute—the disparate treatment of individuals and corporations. By its terms, the gift tax is only assessed against individuals. This means that corporations may make unlimited contributions to lobbying organizations without any fear of gift tax liability, while individuals may not. Treasury regulations provide that gifts made by a corporation will be treated as gifts from the shareholders,[51] and gift tax has been imposed on shareholders of closely held corporations that made gratuitous transfers.[52] It is less clear, however, whether gift tax could legally be collected from shareholders who had no involvement in the gifts; Section 2501 imposes gift tax only on "the transfer of property by gift ... by any individual," and thus does not seem to reach an individual who did not participate in the transfer of property. Even if a shareholder was theoretically liable for his or her proportional share, the annual exemption would eliminate any liability for most shareholders of public companies, allowing public companies to make huge lobbying donations tax free while individuals would be taxable on much smaller contributions.

The Supreme Court upheld provisions of FECA that treat corporations differently than individuals, based on the special characteristics of corporations.[53] However, all such cases allowed the government to impose *greater* restrictions on the campaign contributions and expenditures of business corporations as compared to the contributions and expenditures of individuals, justified by the "substantial aggregations of wealth amassed by special advantages which go with the corporate form of organization."[54] The courts are not likely to find these "special advantages" to be plausible and legitimate reasons for granting greater expres-

[50] See Simon & Schuster, 502 U.S. 105 (1991).

[51] Reg. 25.2511-1(h)(1).

[52] Epstein, 53 TC 459 (1969).

[53] See Massachusetts Citizens for Life, *supra* note 26 (citing cases that uphold differential regulations for corporations).

[54] See FEC v. National Right to Work Comm., 459 U.S. 197, 207 (1982).

sive rights to corporations than to individuals, including the right to make tax-free contributions to lobbying organizations. If strict scrutiny is applied to the distinction based on the impairment of individuals' fundamental First Amendment rights, the disparate tax treatment of individuals and corporations would likely be struck down.

Under rationality review, however, the distinction between corporations and individuals could well survive. The gift tax is primarily concerned with donative transfers within the family, and business corporations are generally not in the business of making disinterested gifts. Congress therefore had a rational and legitimate purpose for limiting the gift tax to the class of taxpayers most likely to make taxable gifts. Rationality review demands no more.

Conclusion

Whether contributions to Section 501(c)(4) social welfare organizations are subject to gift tax remains uncertain, and appears to depend on the nature and the purpose of the contribution.

Donors have the best chance of defeating gift taxation on pure tax grounds when they can argue that the contribution qualifies for the ordinary course of business exception as a transfer that was bona fide, made at arm's length, and free from donative intent. Contributions made under a gift agreement for issue education, lobbying, or similar advocacy activities may escape taxation on this theory. The gift agreement will show the "arm's length" requirement was met, and restricting the use of funds to issue advocacy or other political activities (as opposed to direct social services) will help negate any inference of donative intent. If the donor can demonstrate some connection between his or her business interests and funded activities, the case will be stronger yet.

The constitutional arguments are strongest when the recipient organization is engaged primarily in expressive activities, and the donation is intended to enable the organization to engage in legislative advocacy in support of the donor's views. Because the right of expressive association is most significantly affected in this type of gift, the gift tax is most likely to be held unconstitutional as applied to such gifts on Free Speech grounds.

Donations to fund the social service projects of Section 501(c)(4) organizations are in the weakest position. Because such contributions do not fund First Amendment activities, the application of the tax will draw no heightened constitutional review, and the nature of the activity arguably indicates that the contributor has a purely selfless donative intent and therefore cannot qualify for the ordinary course of business exception under the tax regulations.

For major donors wishing to support ideological movements for social and political change, an affiliated group consisting of Section 501(c)(3), 501(c)(4), and 527 entities can offer a consistent set of tax consequences if the gift tax is limited by constitutional constraints. Donations for social service programs; nonlobbying, nonpolitical education; or research can be made to the Section 501(c)(3) charity, and be deductible for income tax and gift tax purposes. Contributions for candidate campaign activities can be made to a Section 527 organization and be exempt from gift tax. Then, if the donor wants to support legislative advocacy, he or she can contribute to a Section 501(c)(4) organization that is primarily focused on lobbying activities and have a strong case that the gift tax cannot be constitutionally applied to the contribution, because the recipient organization is primarily engaged in expressive activities reflecting his or her views and the views of like-minded people with whom he or she chooses to associate.

Because the gift tax treatment appears to depend on the particular facts and circumstances of each contribution, the current state of the law results in enormous uncertainty regarding potential gift tax liability for large donors to Section 501(c)(4) organizations. Further, it creates serious constitutional issues as to the enforceability of the gift tax on contributions for concerted expression. This unsettled area of the law is therefore ripe for a systematic reinterpretation by the IRS, reform by Congress, or both. In the absence of legislative or administrative action, we are only a lawsuit away from judicial intervention that may change the legal landscape in unexpected ways. ■

AN EQUAL PROTECTION CHALLENGE COULD BE MADE AS WELL TO THE DISPARATE TREATMENT OF INDIVIDUALS AND CORPORATIONS.