

In Political Fundraising, the Price of Anonymity May Be Rising

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Large, anonymous political contributions increased significantly during the 2008 and 2010 election cycles — but the Internal Revenue Service (IRS) may now limit this practice by effectively levying a tax on anonymous individual (but not organizational) contributors.

As a general rule, contributions to political campaigns and committees (commonly described as “527s,” a reference to a tax code provision relating to political campaigns and committees) may not be anonymous. Political campaigns and committees must register with the state and federal agencies that regulate them and report the sources of their funding.

In the 2008 and 2010 elections cycles, however, individuals, corporations and labor unions increasingly began to funnel their political contributions through “social welfare” organizations. (Social welfare organizations are commonly described as “501(c)(4)s,” a reference to a tax code provision exempting social welfare organizations from income tax.) Because 501(c)(4)s are generally not required to publicly disclose the identities of their contributors, individuals and corporations were able to make indirect political contributions through 501(c)(4)s during the 2008 and 2010 election cycles without public attribution.

Moreover, in 2010, after the U.S. Supreme Court’s decision in *Citizens United v. Federal Election Commission* that the government cannot limit the size or quantity of political expenditures by corporations that are not coordinated with candidates, corporations may make unlimited contributions, without public attribution, to 501(c)(4) organizations that, in turn, manage very large political advertising campaigns.

Anonymous fundraising through 501(c)(4)s has been subject to certain regulations. For example, an anonymous contributor generally cannot “earmark” his or her contribution for a certain purpose, and the 501(c)(4)s are prohibited from making political activism their “primary” purpose. In practice, the latter restriction resulted in many 501(c)(4)s spending slightly more than half their funds on non-electioneering advertisements and outreach.

The rise in anonymous influence on elections has prompted many politicians and political observers to call for reform. Although Congress recently considered legislation to prevent

anonymity in political contributions, that legislation was successfully filibustered in the Senate. The six-member Federal Election Commission (FEC), similarly, has deadlocked on reforms that would have ended anonymity.

Activists, meanwhile, have filed complaints with the IRS to challenge the tax-exempt status of 501(c)(4) organizations that help anonymize political contributions — but the review process on such complaints is expected to last several years. The political opponents of anonymous contributions, therefore, do not appear likely to achieve a ban on the practice in the near term.

The IRS recently sent letters to five individuals, each of whom had apparently contributed more than \$13,000 to a 501(c)(4) organization without reporting the contribution as a taxable gift. The letters asserted that “[d]onations to 501(c)(4) organizations are taxable gifts and your contribution... should have been reported on your...Federal Gift Tax Return (Form 709).” Federal tax law generally requires individual donors, but not organizations, to report any gifts valued at more than \$13,000 and to pay gift tax, if due. The gift tax does not apply to contributions to 527 organizations and, prior to the IRS inquiry, many individuals were reportedly donating to 501(c)(4) organizations on the assumption that such gifts would be treated as if the gifts were made to 527 organizations (*i.e.*, that the gift tax would not apply). The public release of the IRS’ inquiry letters has therefore gained much attention among tax professionals and political observers because it could significantly increase the tax burden on 501(c)(4) contributors.

Although some observers have reacted to the IRS letters as a sign that anonymity through 501(c)(4) organizations is coming to an end, this overstates the significance of the recent IRS inquiries.

First, the gift tax applies only to individuals — not corporations — so the IRS inquiry does not affect the contribution options available to corporations.

Second, the IRS letters described above at most signify an increase in the *price* of anonymity, not an elimination of the *option* of anonymity. If the IRS is successful in applying the gift tax to 501(c)(4) contributions, individuals will still have the option of contributing anonymously through 501(c)(4)

s, albeit only if they file gift tax returns and pay any resulting gift tax.

Third, it is possible that a taxpayer will successfully challenge the enforcement of the gift tax to 501(c)(4) contributions. Nearly all commentators have noted the likelihood of legal challenges to the IRS' enforcement of the gift tax in this context, and a court might eventually agree that the gift tax cannot be levied in these circumstances based on the First Amendment or other legal doctrines.

Fourth, the IRS letters apparently are not part of a broader effort to change the permissible political involvement of 501(c)(4)s, according to IRS responses to public inquiries after the release of the letters. In fact, since the Nixon administration, the IRS has been prohibited from instigating investigations for political purposes.

If the IRS's position regarding the application of the gift tax is upheld, however, the price of anonymity for individuals will have increased substantially. At a minimum, an individual's contributions to a 501(c)(4) organization would trigger an

obligation to file a gift tax return for contributions exceeding \$13,000 in a calendar year. And if a particular contributor has previously used his or her available credit against the gift tax, then gift tax may be payable at a 35 percent rate. As a result, many contributors may choose to contribute non-anonymously to 527 organizations rather than incur a tax reporting obligation, and possibly a tax liability, for contributing anonymously to a 501(c)(4) organization.

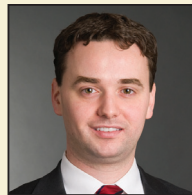
It is possible that Congress, the FEC or the IRS may eventually change the law to prevent anonymity altogether — but such changes do not appear imminent. So for now at least, individuals still have the option of contributing anonymously through 501(c)(4) organizations, although they should now consider the possible gift tax consequences of the contribution.

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