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Citizens United and Taxable Entities: Will Taxable Entities Be the New Stealth Dark Money Campaign Organizations?

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CITIZENS UNITED AND TAXABLE ENTITIES: WILL TAXABLE ENTITIES BE THE NEW STEALTH DARK MONEY CAMPAIGN ORGANIZATIONS?

Donald B. Tobin*

I. INTRODUCTION

The electoral process in the United States is going through a major transition as money increasingly pours into non-candidate independent groups ("IGs"). The Center for Responsive Politics estimates that over $300 million flowed into IGs involved in elections in the 2012 election cycle.[1] Before 2000, IGs could engage in significant electoral advocacy without having to disclose the IG's donors or its expenditures.[2] In 2000, Congress sought to address the lack of disclosure by requiring political organizations to disclose their contributions and expenditures.[3] IGs quickly sought an alternative organizational form for engaging in political advocacy. For the most part, the organizational form of choice

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1 *Total Outside Spending by Election Cycle, Excluding Party Committees*, OPENSECRETS.ORG, https://www.opensecrets.org/outsidespending/cycle_tots.php (last visited Mar. 23, 2015), *archived at* http://perma.cc/M6YV-V3AC.

2 *Buckley v. Valeo*, 424 U.S. 1, 79–80 (1976) (per curium). Before 2001, IGs that were not classified as political action committees were only required to disclose if they engaged in "express advocacy." In *Buckley v. Valeo*, the Court limited several provisions contained in the Federal Election Campaign Act ("FECA"). *Id*. The Court determined that only communication that expressly advocated the election or defeat of a candidate would be subject to regulation. *Id*. In many cases, Federal Communications Commission ("FCC") regulations required groups to disclose that they purchased a particular advertisement. *See* 47 C.F.R. § 73.1212 (2013) (showing regulations for radio advertisements); 47 C.F.R. § 76.1715 (2013) (showing regulations for television advertisements); 47 U.S.C. § 317(a)(1) (2012) (illustrating the requirements for types of sponsorship information). These disclosures, however, usually only required the name of the organizations, which could be created specifically for the purpose of the advertisement. *See* Daniel L. Simmons, *An Essay on Federal Income Taxation and Campaign Finance Reform,* 54 FLA. L. REV. 1, 4 (2002) (providing discussion on pre-2000 law of disclosure and IGs); Donald B. Tobin, *Anonymous Speech and Section 527 of the Internal Revenue Code,* 37 GA. L. REV. 611, 612–13 (2003) (continuing discussion on the provisions requiring disclosure of campaign contributions or expenditures) [hereinafter *Anonymous Speech and Section 527*].

3 Pub. L. No. 106-230, 114 Stat. 477 (2000).

has been designated as a social welfare organization under section 501(c)(4) of the Code.[4]

Section 501(c)(4) organizations, however, are not supposed to be campaign organizations.[5] They are allowed to engage in some political activity, but the groups' primary purpose must be social welfare activity.[6] If Congress or the Internal Revenue Service ("Service") clamps down on recent abuses, section 501(c)(4) status may be an imperfect alternative form for avoiding section 527's disclosure provisions.[7] Moreover, recent proposed regulations by the Treasury, seeking to create clear rules for social welfare organizations, might limit the attractiveness of social welfare organizations and campaign vehicles.[8] If social welfare organizations become less attractive entities, IGs may look to taxable organizations, which have significantly less regulation, as alternative campaign vehicles.

In a 2007 article, I explored whether tax-exempt entities would be the next loophole used by IGs to avoid disclosure of contributions and expenditures.[9] I concluded that in most cases taxable entities would not be an attractive vehicle because there would be significant tax implications if an entity forwent tax-exempt status, and because taxable corporations were prohibited from expressly advocating the election or defeat of a candidate.[10] The Supreme Court, however, overturned the ban on independent corporate spending in *Citizens United v. Federal Election Commission*.[11] Post *Citizens United*, taxable entities are now a far more attractive vehicle for campaign activity than they were in 2007.

Social welfare organizations and other tax-exempt entities are now subject to increased scrutiny. There have been calls for increased

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4 Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (2013).

5 *Id.* at § 1.501(c)(4)-1(a)(2)(ii).

6 *Id.*

7 Short term, it does not appear that either Congress, the Treasury, or the Service will provide for further regulation of social welfare organizations. The Treasury recently proposed further rulemaking. Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71535 (proposed Nov. 29, 2013). After receiving over 150,000 comments, the Service noted that it would likely make revisions to the proposed rule and seek further comment. *IRS Update on the Proposed New-Regulation on 501(c)(4) Organizations*, IRS.GOV (May 22, 2014), http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501(c)(4)-Organizations, *archived at* http://perma.cc/KG7C-J6NR?type=source.

8 *See* 78 Fed. Reg. 71535 (expressing the guidelines of contributions from section 501(c) organizations); *supra* notes 5–6 and accompanying text (discussing the creation of clear orders for social welfare organizations).

9 Donald B. Tobin, *Political Advocacy and Taxable Entities: Are They the Next "Loophole"?*, 6 FIRST AMEND. L. REV. 41, 42 (2007) [hereinafter *Political Advocacy and Taxable Entities*].

10 *Id.* at 99.

11 558 U.S. 310, 372 (2009).

enforcement of the existing rules regulating tax-exempt organizations involved in election related activities.[12] In the campaign finance arena, further regulation in one area often entices entities to conduct activities in another. As Congress and the Service consider further regulation of social welfare groups, they must also consider whether further regulation of tax-exempt organizations will encourage IGs to reorganize as taxable organizations. This Lecture discusses whether taxable entities will be attractive vehicles for IGs interested in avoiding broad based disclosure.

Since taxable entities are subject to less regulation, they will be attractive vehicles as long as the tax consequences to the IGs do not outweigh the economic and regulatory benefits of forgoing tax-exempt status. The key question is a tax question, not an election law question: can taxable entities engage in campaign activity without incurring significant tax liability?

II. CURRENT REGULATORY FRAMEWORK

Currently, most IGs organize as tax-exempt organizations under either section 501(c) or section 527 of the Code.[13] Section 527 was specifically created as the organizational structure for political organizations.[14] Section 527 organizations are tax-exempt, donors to section 527 organizations are not subject to the gift tax, contributions to the organization are not tax deductible, and the organization must disclose its donors and its expenditures.[15] Section 501(c)(3) charitable organizations are exempt from tax, they are prohibited from intervening in a political campaign for or against a candidate for public office, and contributions to the organization are tax deductible.[16] Other 501(c) organizations operate in the space between these two organizations. For the most part, these organizations are not subject to tax on income related to the organizations' purpose and are not subject to public disclosure obligations with regard to contributions to organizations or

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12 *See supra* note 7 and accompanying text (discussing tax-exempt organizations' permissible involvement in election activities).

13 *See generally* I.R.C. § 501(c) (2012) (detailing the list of exempt organizations); *id*. § 527(a) (2012) (defining political organization).

14 *See* Pub. L. No. 93-625, § 10(a), 88 Stat. 2108 (1975) (amending Section 527 of the Internal Revenue Code and providing a specific tax exempt category for Political Organizations in 1975).

15 *See* I.R.C. §§ 527(c)(3), (f)(1) (2012) (exempting contributions to political organizations from gift tax); *id.* § 2501(a)(4) (exempting transfers of money or other personal property to political organizations from gift tax).

16 *See id*. §§ 170(a)(1), (b)(A)(vi) (explaining the allowance of deductions for charitable contributions and gifts); *id*. § 501(c)(3) (explaining the exemption from tax).

expenditures of organizations.[17] Tax-exempt organizations that are not organized under section 527, however, must have a primary purpose that does not involve intervening in candidate elections.[18]

In previous work, I have argued that the section 527 disclosure provisions apply to all organizations, including taxable ones that have as their primary purpose the election or defeat of a candidate for public office.[19] To date, however, there have been no cases considering the reach of section 527s disclosure provisions.[20] Moreover, in light of the Service's reluctance to aggressively enforce existing provisions, it is questionable whether taxable entities will be subject to section 527's disclosure provisions even if the organizations have as their primary purpose engaging in election advocacy.[21]

If section 527 does not apply to taxable entities, or taxable entities avoid engaging in electoral advocacy on behalf of a candidate as their primary purpose, a taxable entity could engage in non-coordinated electoral advocacy without having to disclose contributions to the organization or expenditures of the organization. To the extent the organization engaged in electioneering communication or express advocacy, the entity might be subject to regulation under FECA, but even in those instances the organization would likely not be subject to donor disclosure.[22]

Thus, absent tax consequences, taxable entities allow organizations to avoid serious disclosure. Moreover, taxable entities are also not

17 *See id*. § 501(c)(4)(A) (discussing social welfare organizations); *id*. § 501(c)(5) (composing the wording for labor unions); I.R.C. § 501(c)(6) (providing language for business leagues). These organizations are still subject to disclosure under FECA, but these organizations can very easily avoid donor disclosure under election law. Donald Tobin, *Campaign Disclosure and Tax-Exempt Entities: A Quick Repair to the Regulatory Plumbing*, 10 ELECTION L. J. 427, 427 (2011) (stating that many IGs have figured out how to manipulate the tax classification).

18 Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (2013).

19 *See Anonymous Speech and Section 527*, *supra* note 2, at 619 (establishing that section 527 does not apply to all political organizations).

20 *See* I.R.C. § 527(j)(2) (2012) (explaining required disclosures of expenditures and contributions).

21 *See id*. § 527(a) (stating a political organization is subject to tax, and although the primary purpose test requires express advocacy, IRC section 527 does not).

22 *See* Electioneering Communication, 72 Fed. Reg. 72899, 72911 (Dec. 26, 2007) (codified at 11 CFR Part 104, 114) (analyzing electioneering communications). The FEC has determined that donations to a social welfare organization only need to be disclosed if the donation was made for the purpose of electioneering communication. *Id*. Donors can avoid disclosure easily by not designating the payment for a specific communication. *Id*.

subject to initial review by the Service nor are they subject to public disclosure of their tax returns.[23]

III. TAX LIABILITY

If tax-exempt entities are subject to robust disclosure provisions and taxable entities are not, taxable entities may become very attractive vehicles for IGs seeking to engage in election advocacy without being subject to a disclosure regime. In the past, the two main hurdles for using taxable entities were: (1) the ban on corporate spending on electioneering activity; and (2) the fear that there would be significant tax consequences if an entity organized as a taxable organization.[24]

In theory, a taxable organization engaged in campaign advocacy would have little to no income. A taxable campaign organization would not make a profit and its business deductions would offset any income the organization received. For example, if contributions to the organization were considered income, that income would be offset by deductions the organization would claim for advertising and wages. The costs of advocacy would generally be similar to the contributions received and the organization, therefore, would have no net income.

Congress, however, has sought to equalize the tax treatment associated with electioneering activity. When citizens participate in the electoral process by making contributions, they do so out of post-tax dollars.[25] Political contributions are not tax deductible.[26] Congress sought to ensure a similar treatment for taxable entities, and taxable entities are therefore prohibited from deducting political expenditures as business expenses.[27] Thus, if contributions to a taxable IG are considered income, the taxable IG will incur significant tax liability. If, however, the contributions are not considered income, the taxable IG will have no taxable income and therefore no tax liability.

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23 *See* I.R.C. § 6033(a)(1) (2012) (providing tax-exempt entities are required to file Form 990 information returns, which are available to the public); Treas. Reg. §§ 1.6033-2(a)(1), (a)(2)(i) (2014) (providing every organization exempt from taxation under section 501(a) shall file an annual information return).

24 *See Political Advocacy and Taxable Entities*, *supra* note 9, at 99 (establishing the hurdles for using taxable entities).

25 *See id.* at 76 (referring to the post-tax dollar payments that individuals make to political organizations).

26 *See* I.R.C. § 162(e)(1) (2012) (outlining instances when a deduction is not allowed).

27 *Id*. § 162(e)(4)(A) (prohibiting deductions for political expenditures, and defining influencing legislation as "any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of legislation").

In my 2007 Article, I reviewed the history of the taxation of political organizations and traced the theoretical basis for determining whether contributions to political organizations are subject to tax.[28] There are several tax theories, including a conduit theory, a capital contribution theory, and a gift theory "that could potentially be used to argue that payments received by taxable IGs should not constitute [gross] income to the organizations."[29] In my previous work, I rejected the conduit theory as being applicable here but determined that the capital contribution theory, while very questionable, might provide the basis for exclusion.[30] I ultimately concluded that these payments are best classified as gifts to the IG.[31] As gifts, the payments would not be taxable to the IG, but in most cases, the gifts would be subject to gift tax.[32] Legal and political developments since 2007 raise the specter that taxable entities could avoid tax by arguing that payments are contributions to capital. While less likely, taxable entities might even be able to argue that the payments are not income because they are gifts, but are also not subject to gift tax.

A. Conduit Theory

Under the conduit theory, "payments to IGs are not considered income because the organizations are merely acting as conduits for spending that a [contributor] could have made by herself."[33] In some cases, the Service appears to use a pooling rationale when applying the conduit theory and in others a trust rationale.[34] In both situations, the basic idea is that the contribution is not income because the organization acts as merely an aggregator of the individual payments.[35]

Professors Gregg Polsky and Guy-Uriel E. Charles rely on the pooling theory to argue that contributions to political organizations should not be considered income to the organization.[36] They note that there would be no tax implications if neighbors joined together to build a fence because it would simply be a pooling of funds.[37] They argue that

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[28] *See Political Advocacy and Taxable Entities*, *supra* note 9, at 44–45 (discussing taxation of political organizations and the theories of whether contributions are taxable).
[29] *Id.* at 75.
[30] *See id.* at 79 (rejecting the conduit theory).
[31] *See id.* at 98 (concluding that contributions to IGs will be treated as gifts).
[32] *See* I.R.C. § 102(a) (2012) (stating gross income does not include gifts).
[33] *See Political Advocacy and Taxable Entities*, *supra* note 9, at 75–76 (explaining the conduit theory).
[34] *See id.* at 80–81 (exhibiting the pooling rationale and trust rationale of the conduit theory).
[35] *See* Gregg D. Polsky & Guy-Uriel E. Charles, *Regulating Section 527 Organizations*, 73 GEO. WASH. L. REV. 1000, 1015–16 (2005) (explaining why contribution is not income).
[36] *Id.* at 1016.
[37] *Id.*

neighbors joining together to support a political cause should not be treated differently.[38] If the Polsky-Charles rationale was applied to contributions to taxable organizations, then the organization's contributions would not be subject to tax.[39]

I am skeptical of the pooling rationale because the theory applies when the joint activity is taking the place of what an individual could do on her own if she joined together with others. In the fence example, the entity is created to pool money and paint the fence.[40] The entity only serves to aggregate the payments.[41] The project itself is controlled by the individual members of the community. In the fence example used by Professors Polsky and Charles, the entity itself is just created to pool the money.[42] The neighbors have decided upon the project, and the person or persons who control the entity serve only an administrative function.[43] The organization itself had no real function but to act as a conduit for the contributors.[44] Campaign entities are not simply conduits for contributors. The entity, through its management, makes significant decisions regarding the organization's direction. For example, the entity's management might decide the content of advertisements, the strategy of a campaign, the amounts spent on various candidates, and even which candidates are worthy of support.

The pooling theory, however, may provide a rationale to aggressive organizations seeking to organize as taxable political campaign entities. If the pooling theory applies, the organization would not be required to include contributions to the organization as income under general income tax principles.

B. Capital Contribution Theory

A second possibility for excluding contributions from taxable income would be to structure the contributions to the entity as contributions to

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38 *Id.*

39 *Id.* (explaining Professors Polsky and Charles's rationale). Proponents of the pooling theory also note that the Service does not tax social clubs because of the conduit theory. The Joint Committee indicated that "the organization merely facilitates a joint activity of its members." STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., REP. ON HISTORICAL DEVELOPMENT AND PRESENT LAW OF THE FEDERAL TAX EXEMPTION FOR CHARITIES AND OTHER TAX-EXEMPT ORGANIZATIONS 28 (2005) (referencing S. Rep. No. 91-522, at 71 (1969)), *available at* http://www.jct.gov/x-29-05.pdf, *archived at* http://perma.cc/NT5J-WUEG.

40 *See* Polsky, *supra* note 35, at 1016 (explaining the fence example).

41 *See id.* (describing the aggregation of funds in the fence example).

42 *See id.* (showing that the entity is merely created to pool funds).

43 *See id.* (reiterating Professors Polsky and Charles's fence scenario).

44 *See id.* (discussing pooling and the conduit theory).

capital.[45] In most cases, contributions to capital are not considered income to the recipient organization.[46] In my previous work, I outlined the difficulties with treating the contributions as contributions to capital.[47] To be considered a contribution to capital, either the contributor would have to receive something real in exchange for the contribution, or the contribution would have to qualify as a non-shareholder contribution to capital.[48]

Treating contributions to the taxable entity as contributions to capital likely provides the best opportunity for taxable entities to avoid tax liability on the contribution. The idea is that the contributor would receive some type of ownership interest in the taxable entity in exchange for the contribution. For example, suppose a group of wealthy individuals want to form an IG to engage in political advocacy. The IG provides that for $1,000,000, a contributor will receive a percentage ownership in the IG. The contributor might also receive voting rights and some type of dissolution rights. The $1,000,000 would then possibly be treated as a contribution to capital and the contribution could remain anonymous.[49]

Section 118 also provides some opportunities for non-shareholder contributions to capital.[50] The regulation implies that this is a very limited exclusion.[51] Before passage of section 118, the Court has set out a

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[45] *See Political Advocacy and Taxable Entities*, *supra* note 9, at 81 (explaining the capital contribution theory).

[46] *Id.*

[47] *See id.* at 82 (outlining the five part test used for contributions to capital).

[48] *See* I.R.C. § 118(a) (2012) ("In the case of a corporation, gross income does not include any contribution to the capital of the taxpayer."); Treas. Reg. § 1.118-1 (2014) (explaining the general rules and requirements for contributions to the capital of a corporation).

[49] Lots of issues are raised by the use of the contribution to capital theory and they are outside the scope of this Lecture. For example, would this be considered a private offering? Would the advertisements be subject to securities regulations? Could the organization limit this problem by limiting the number of investors and then joining with other corporations to engage in the activity?

[50] Treas. Reg. § 1.118-1 (2014).

[51] *See id.* (quoting language from the regulation). § 1.118-1 reads:

> Section 118 also applies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of inducing the corporation to locate its business in a particular community, or for the purpose of enabling the corporation to expand its operating facilities. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid for the purpose of inducing the taxpayer to limit production.

Id.

five-part test for determining whether a payment by a non-shareholder is a contribution to capital: (1) the payment must be a permanent part of the working capital structure; (2) it must not be compensation; (3) it must be bargained for; (4) it must result in a "benefit to the transferee in an amount commensurate with its value"; and (5) the asset will ordinarily contribute to the production of additional income.[52]

This test has not been applied in a situation similar to that here and it is difficult to determine exactly how a non-shareholder contribution would be treated. It is likely, however, that a payment to an IG would fail this test. These payments are not a permanent part of an organization's working capital. The payments may even be classified as a payment for services since the IG may be deemed to perform a service for the payment. The payments also do not contribute to the production of income for the organization. The non-shareholder contribution to capital also is vulnerable to a sham transaction analysis by the Service.[53] Another theory that has been mentioned previously is the gift theory, which would make contributions to the entity considered a gift and therefore the IG would not have to include the contribution in income.[54]

C. Gift Theory

If contributions to the taxable entity are considered a gift, the taxable entity will not have to include the contribution in income.[55] While taxable entities are not usually thought of as the recipient of gifts, there is nothing in section 102 that prohibits a taxable entity from receiving a gift.[56] If the contribution is considered a gift, there is a separate issue whether the contributor would be subject to gift tax on the contribution.

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52 *Political Advocacy and Taxable Entities*, *supra* note 9, at 82. This test is principally employed when government or nonprofit entities make contributions to a corporation's capital. *See* United States v. Chicago, Burlington & Quincy R.R. Co., 412 U.S. 401, 413–14 (1973) (explaining when assets are considered contributions to capital); JACOB MERTENS, JR., THE LAW OF FEDERAL INCOME TAXATION 38–29 (2006) (discussing when government or nonprofit entities make contributions to a corporation's capital).

53 A sham transaction is "[a]n agreement or exchange that has no independent economic benefit or business purpose and is entered into solely to create a tax advantage (such as a deduction for a business loss). The Internal Revenue Service is entitled to ignore the purported tax benefits of a sham transaction." BLACK'S LAW DICTIONARY 1585 (10th ed. 2014).

54 *See infra* Part III.C (introducing gift theory).

55 I.R.C. § 102(a) (2012).

56 *See generally id*. § 102 (explaining gifts and inheritances).

There are two different tests for determining whether a contribution is a gift for income tax and for gift tax purposes.[57] The contribution to the taxable entity will be considered a gift if it is made with detached and disinterested generosity.[58] A donor will be subject to gift tax if it is made for money or money's worth.[59] Therefore, although it does not really make sense in this context, it is possible for a contribution to be considered a gift for income tax purposes and not for gift tax purposes. If the contribution is considered a gift for both income and gift tax purposes, the donor will likely be subject to gift tax on the contribution.

Contributions to taxable organizations appear to be gifts under the standard definition. The contributions are made to further the general ideals of the organization, in a way that is similar to when a donor makes a contribution to a charity.[60] The donor in the charitable context gets some type of intangible benefit, but the Service has usually found these types of intangible benefits insufficient to defeat a contribution to a charity.[61] If the contributions are gifts under section 102 of the Code, the recipient organization does not have to include the gift in income.[62]

Payments to taxable organizations, however, may not be considered gifts if the courts determine that the contributor has received something of value in exchange for the payment.[63] For example, in *Stern v. United States*, a wealthy investor made large contributions to an organization that was fighting political corruption in Louisiana.[64] Stern believed the

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57 *See* Comm'r v. Duberstein, 363 U.S. 278, 285–86 (1960) (outlining the test regarding "disinterested generosity"); *see also* Treas. Reg. § 25.2512-8 (2013) (outlining the value of property test).

58 *See Duberstein,* 363 U.S. at 285–86 (illustrating one of the tests for contribution to a taxable entity through disinterested generosity).

59 *See* I.R.C. § 2512(b) (2012) (providing that a gift is made when property is transferred for less than adequate consideration in money or money's worth); Treas. Reg. § 25.2512-8 (2013) (determining that there is a gift when the "value of property transferred by the donor exceeds the value in money or money's worth of the consideration given").

60 *See* I.R.S. Tech. Adv. Mem. 6812121000A (Dec. 12, 1968) ("[t]o illustrate, when an exempt organization like the Cancer Fund receives a voluntary contribution . . . the Service would not argue that this contribution was anything but a voluntary payment of something for nothing . . . "); *see also* Treas. Reg. § 53.4941(d)-2(f)(2) (2014) (stating that naming rights are only an incidental or tenuous benefit for purposes of determining self-dealing in the private foundation context); Rev. Rul. 68-432, 1968-2 C.B. 105 (1968) ("[s]uch privileges as being associated with or being known as a benefactor of the organization are not significant return benefits that have a monetary value").

61 *See supra* note 60 and accompanying text (exhibiting that the Service generally finds intangible benefits insufficient to defeat a charitable contribution).

62 *See* I.R.C. § 102 (2012) (explaining the general rule for gifts).

63 *See* Hernandez v. Comm'r, 490 U.S. 680, 696 (1989) (outlining what may be considered a gift and potential consequences for charitable organizations).

64 436 F.2d 1327, 1328 (5th Cir. 1971).

corruption in Louisiana was hurting the business climate.[65] The Service contended that the payments were gifts because Stern received nothing of value in exchange for the contribution.[66] The court sided with Stern, finding the expenditures were ordinary and necessary business expenses lacking donative intent, and were designed to protect Stern's business interests.[67] This holding saved Stern from gift tax, but it might have subjected the receiving organization to tax, if it were not tax exempt.[68] Although the test in the gift tax and income tax context are different, receipt of a tangible benefit defeats gift tax treatment in the income tax context because the payment is then not given with detached and disinterested generosity.[69]

The next question is whether the gift is subject to gift tax. Gift tax is generally owed on transfers that were not made for "money or money's worth"[70] There is a yearly gift tax exemption amount, now set at $14,000.[71] It is highly questionable, however, whether this exemption amount would apply to donations to taxable corporations.[72]

The Service's position with regard to gift treatment in situations like this is no longer clear. The Services's position was that these types of contributions were gifts for both gift tax and income tax purposes, but it may be backing away from this treatment.[73] Treating contributions to an

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65 *Id.*

66 *Id.* at 1329.

67 *Id.* at 1328–29.

68 *Id.* at 1330.

69 *See* Hernandez v. Comm'r, 490 U.S. 680, 696 (1989) (explaining whether a payment is a contribution or gift).

70 *See* Treas. Reg. § 25.2512-8 (2013) (providing there is a gift when "the value of property transferred by the donor exceeds the value in money or money's worth of the consideration given").

71 Rev. Proc. 2012-41, Treas. Reg. § 601.602, *available at* http://www.irs.gov/pub/irs-drop/RP-12-41.pdf, *archived at* perma.cc/L688-XSWV.

72 *See* BRANT J. HELLWIG & ROBERT T. DANFORTH, ESTATE AND GIFT TAXATION 75–76 (2011) (treating contributions to corporations as contributions to its members for purposes of the gift tax exclusion). This is considered a contribution of a future interest and the annual exclusion is therefore not available. *See also* Treas. Reg. § 25.2511-1(h)(1) (providing an exception to donations to political organizations, but political organizations in that context likely refer to political organizations under § 527, which are now specifically exempted from the gift tax).

73 *See* Ellen P. Aprill, *Once and Future Gift Taxation of Transfers to Section 501(c)(4) Organizations: Current Law, Constitutional Issues, and Policy Considerations*, 15 N.Y.U. J. LEGIS. & PUB. POL'Y 289, 291 (2012) (discussing the Service's Exempt Organizations division's ignorance when asked whether "[d]onations to 501(c)(4) organizations are taxable gifts"); *Political Advocacy and Taxable Entities*, *supra* note 9, at 70 (discussing the Service's position on the gift tax provision as it relates to political organizations); Donald B. Tobin, *The Application of the Gift Tax Provisions in the Internal Revenue Code to § 501(c)(4) Organizations,* ELECTIONLAW@MORITZ (2011), http://moritzlaw.osu.edu/election-law/

organization as gifts would have likely led to the conclusion that contributions to social welfare organizations were subject to gift tax.[74] After pressure from Republican Senators, the Service announced that it was examining the issue and any action to enforce the gift tax would only be prospective.[75] If a gift to social welfare organizations is not subject to gift tax, then similar logic should apply to gifts to taxable organizations.

IV. GAMES WE PLAY

With these tax concepts in mind, the new loophole can be exploited. A taxable organization has two possible avenues for obtaining funds for its organization without having to include those funds in income for income tax purposes. First, it can seek very large contributions, classifying them as contributions to capital. It can either argue that these are non-shareholder contributions to capital or it can provide some ownership or other rights to the contributor in exchange for the contribution. If the contributions are contributions to capital, the taxable organization will have no income tax liability from the payments.

Alternatively, the organization can argue that the contributions are gifts. The donor has provided a gift to the organization in the same manner that donors make contributions to charities, educational institutions, and other political organizations. As such, the entity will

article/?article=8335, *archived at* http://perma.cc/7WRD-X5J8 (explaining that the Service has indicated contributions are subject to gift tax).

74 *See supra* note 73 and accompanying text (identifying theories of social welfare organizations being subject to gift tax).

75 *See* Orrin G. Hatch, Jon Kyl, Pat Roberts, John Cornyn, John Thune & Richard Burr, *Senators to IRS: Questions Raised by Agency's Recent Actions into Gift Tax Enforcement; Concern about Political Influence*, U.S. SENATE COMMITTEE ON FINANCE (May 18, 2011), http://www.finance.senate.gov/newsroom/ranking/release/?id=ec29441e-aefd-4192-a628-d96966cf4231, *archived at* http://perma.cc/5HAW-4L6Q (detailing several senators' request to the Service for names of individuals who made the decision to enforce the provision, correspondence between the Service's employees, Treasury, and the White House on the issue, and any analysis generated by the Service regarding First Amendment issues related to the collection); Steven T. Miller, *Memorandum for Commissioner, Small Business/Self-Employed Division Commissioner, Tax-exempt and Government Entities Division*, DEP'T. TREAS. (July 7, 2011), http://www.irs.gov/pub/newsroom/guidance_for_irs_sbse_estate_and_gift_tax_and_tege_exempt_organizations.pdf, *archived at* http://perma.cc/ZJE6-XPXL (providing guidance for small business and self-employed estate and gift tax); Letter from Marcus Owens to Emily S. McMahon, Acting Assistant Sec'y, Dept. Treas. (Aug. 8, 2011), http://big.assets.huffingtonpost.com/McMahonletter.pdf, *archived at* http://perma.cc/RH7-7C6Z (criticizing the Service's lack of guidance concerning gift tax and charitable organizations); Donald B. Tobin, *Is Congress Politicizing the IRS and Its Tax Enforcement Process?*, TAX ANALYSTS (Aug. 22, 2011), http://taxprof.typepad.com/files/132tn0853.pdf, *archived at* http://perma.cc/ET9A-EVGS (discussing the Service's announcement that it is re-examining its policies).

argue the donations are not income for tax purposes. If these payments are gifts, there is a risk they would be subject to gift tax. Donors could then argue that, just like donations to social welfare groups, donations to taxable entities should not be subject to gift tax.[76] Organizations following this path are organized as taxable entities but would have little to no tax bill because they would have little to no income. Since these organizations are not tax-exempt, they would not have any obligation to file disclosure returns with the Service nor would they be required to file with the Service seeking recognition. If they were corporations, they would have to file as a state corporation, but little other disclosure would be required.[77] If the corporation engaged in electioneering communication or express advocacy it would have to disclose those expenditures, but it would likely not have to disclose its donors.[78] Taxable entities would still be required to file a tax return with the Service, but those returns would be subject to privacy protections under section 6103 of the Code. Moreover, these taxable organizations would be subject to review only if the Service chose to audit the returns.

V. CONCLUSION

This Lecture discusses the possible next frontier for organizations seeking to avoid donor disclosure. If Congress, the Treasury, or the Service successfully reforms the current structure to ensure donor disclosure by tax-exempt groups, IGs may simply reorganize as taxable entities and seek ways to limit their tax liability. The Service should set out clear guidance regarding whether contributions I have described here are contributions to capital, and whether payments could be considered gifts for gift and income tax purposes. The Service needs to provide guidance in this area before taxable entities become the next campaign vehicle of choice. Guidance could be given today in a nonpolitically charged environment before a particular party or entity is identified with this loophole. Once politically charged organizations start using the loophole, guidance will become more difficult. Congress and the Service can plug this hole before it leaks.

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76 I have argued elsewhere that donations to social welfare organizations are subject to gift tax. The analysis here with regard to taxable entities highlights why gift tax treatment is appropriate under current law in the social welfare context. *Political Advocacy and Taxable Entities*, *supra* note 9, at 70.

77 While outside the scope of this Lecture, the corporation could likely organize as either a nonprofit corporation or as a public benefit corporation under state law. An entity could also organize as a limited liability company and then elect to be taxed as a corporation.

78 *See supra* note 15 and accompanying text (discussing required disclosure of expenditures related to electioneering communications).