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Roslyn A. Mazer

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RECENT DEVELOPMENTS

Taxing Political Contributions: The IRS Balks at Reform

Tax treatment of political contributions, a subject which has received scant treatment in both tax law and literature, became a controversial topic as a result of unique forms of campaign fund solicitation by presidential campaign committees in the 1972 elections. Following exposure in the media of a proliferation of hundreds of "dummy" committees whose only purpose was to facilitate gift tax avoidance, the Internal Revenue Service (IRS), siding with the position taken by the Republican and Democratic National Committees, issued Revenue Ruling 72-355.¹ In contrast to the IRS' historic displeasure with similar tax avoidance mechanisms, the ruling sanctioned continued use of the transparent multiple committee device. A second tax avoidance scheme—solicitation of contributions of appreciated securities to avoid capital gains taxes—was stymied by the IRS, albeit belatedly, in an August, 1973 policy statement resolving to tax political committees on gains realized by their subsequent sales of securities.²

The Service's rulings revealed not only a divergence from the historic principles governing gift and income tax law, but a curious inclination to exert only the mildest tax levy on political committees. In addition to fostering taxpayer cynicism which usually attends enactment of tax provisions catering to favored groups or enterprises, the IRS' stance threatened to blunt the long-awaited reforms in federal election financing embodied in the Federal Election Campaign Act³ and the Revenue Act of 1971.⁴

1. 1972 INT. REV. BULL. NO. 29, at 4-6. Also released as T.I.R. 1179 (June 21, 1972). A Revenue Ruling is defined as "an official interpretation by the Service that has been published in the Internal Revenue Bulletin. Revenue Rulings are issued only by the National Office and are published for the information and guidance of taxpayers, IRS officials, and others concerned." Rev. Proc. 69-1, 1969-1 CUM. BULL. 381, § 2.05.

2. 1973 INT. REV. BULL. NO. 33, at 18-19.

3. 2 U.S.C. § 431 (Supp. 1973).

4. PUB. L. NO. 92-178 (Jan. 19, 1972).

I. Gift Tax Treatment of Political Contributions

In recent years contributors to political campaigns who desired to make contributions in excess of \$3,000 to one candidacy made their gifts in blocks of \$3,000 or less in order to avoid payment of gift taxes. Although the present federal gift tax was originally designed⁵ to prevent the avoidance of estate and inheritance taxes by means of transferring one's wealth before death,⁶ political donors were utilizing the gift tax structure to make their political contributions tax-free.

Section 2503(b) of the Internal Revenue Code⁷ permits a donor to exclude from the tax the first \$3,000 in gifts to each "person" to whom he makes gifts during a calendar year, the exclusion to recur annually. In addition, a \$30,000 lifetime exemption is allowed against the gift tax which the taxpayer may take whenever he chooses.⁸ Married taxpayers have been afforded the privilege of splitting their gifts which effectively doubles the exemptions and exclusions they may take.⁹

The congressional committee reports which accompanied the 1932 enactment of the current gift tax law reveal that the original reason for the annual exclusion was "to obviate the necessity of keeping an account of and reporting numerous small gifts . . . and to fix the amount sufficiently large to cover in most cases wedding and Christmas gifts . . . of relatively small amounts."¹⁰ Congress' intention to reach practically all transfers by way of gift is indicated in the Regulations.¹¹

Tax experts believe that the present structure of the gift tax enables artful

5. 48 U.S.C. § 495 (1970).

6. "From the very beginning of the Estate Tax in 1916, fertile minds began exploring methods of avoiding its effects. One of the most effective means is not to possess property at death. Persons possessed of large fortunes thereupon began to make lifetime gifts of substantial portions of their property, as a result of which the Estate Tax impact was considerably lessened." H. HARRIS, *FEDERAL ESTATE AND GIFT TAXES* 611-12 (2d ed. 1972). For other historical accounts of the gift tax, see C. LOWNDES & R. KRAMER, *FEDERAL ESTATE AND GIFT TAXES* § 22.1 at 563 (2d ed. 1962) and Harris, *Legislative History of Federal Gift Taxation*, 18 *TAXES* 531 (1940).

7. INT. REV. CODE OF 1954, § 2503(b).

8. INT. REV. CODE OF 1954, §§ 2521-24.

9. INT. REV. CODE OF 1954, § 2513.

10. S. REP. NO. 665, 72d Cong., 1st Sess. 40 (1932) and H.R. REP. NO. 708, 72d Cong., 1st Sess. 28 (1932), both reprinted in 1939-1 CUM. BULL. (Pt. 2) 496, 525-26.

11. Treas. Reg. § 25.2511-1 provides:

- (a) The gift tax applies to a transfer by way of gift whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. . . .
- (c) The gift tax also applies to gifts indirectly made. Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or service employed, constitute gifts subject to tax. . . .

dodgers to utilize the \$3,000 annual exclusion and the \$30,000 lifetime exemption to give away substantial portions of their properties without incurring either estate or gift tax.¹² But the prospect of hundreds of campaign committees springing up during election years merely to facilitate gift tax avoidance was not recognized until the 1968 presidential election,¹³ and was not challenged until the 1972 campaigns. One account revealed that Richard M. Scaife, an heir to the Mellon fortune, acknowledged giving the Committee for the Re-Election of the President \$990,000 through 330 separate committees, thereby escaping payment of between \$224,000 and \$590,000 in federal gift taxes.¹⁴ McGovern financiers admitted organizing as many as 350 separate "gift tax committees" which served no other purpose than to collect contributions in \$3,000 blocks and summarily turn the money over to the major finance committees for disbursement.¹⁵ And W. Clement Stone reportedly saved as much as one-half million dollars in gift taxes by preparing 700 checks of \$3,000 each in order to contribute \$2 million to the Nixon Re-Election Committee, tax-free.¹⁶

The applicability of the federal gift tax to political contributions is a largely uncharted area of the tax law. The Internal Revenue Service has, however, taken several formal positions on the subject which are informative in analyzing the June, 1972 gift tax ruling. A 1959 Revenue Ruling held that political contributions used for campaign and related purposes constitute taxable gifts.¹⁷ Not until 1971 did the Service take another formal position on the gift tax when it responded to a fifth circuit decision in *Stern v. United States*.¹⁸

Stern examined transactions made by Edith Stern, a member of a cam-

12. See, e.g., C. LOWNDES & R. KRAMER, FEDERAL ESTATE AND GIFT TAXES § 21.2 at 564 (2d ed. 1962).

13. See Lehrfeld, *The Gift Tax Implications of Political Contributions*, 54 A.B.A.J. 1032 (1968) where the author argues that since the proliferation of political committees during election years had thus far been unchallenged, multiple gifts should be entitled to multiple exclusions.

14. See Mintz, *Politics, Gift and Taxes*, The Washington Post, Dec. 25, 1972, at 1, col. 1.

15. Landauer, *How Political Donors Avoid Gift, Gains Taxes by Contributing Stock*, The Wall Street Journal, Sept. 27, 1972, at 1, col. 1 [hereinafter cited as Landauer].

16. Rogovin, *Revenuers vs. Republicans*, 169 THE NEW REPUBLIC, (July 7 & 14, 1973), at 16, 18. Stock contributions to the Committee to Re-Elect the President from April 7, 1972 to December 31, 1972 totalled \$4,876,731.99.

17. Rev. Rul. 59-57, 1959-1 CUM. BULL. 626 provides:

Any individual who makes a contribution or gift in excess of \$3,000 in any one calendar year to a political party or to a candidate for public office must file a Federal Gift Tax Return, Form 709. To the extent that such a contribution or gift is in excess of \$3,000 it may be applied against any or all unused portion of the \$30,000 lifetime specific exemption authorized by section 2521 of the Code.

18. 436 F.2d 1327 (5th Cir. 1971).

paign committee which made expenditures on behalf of a slate of candidates in a New Orleans election. Ms. Stern and other committee members retained strict control over all expenditures which went to the purchase of handbills, posters, sample ballots and advertisements. When the taxpayer filed her federal gift tax return, she contended that the \$60,850 she had contributed to the New Orleans campaign committee "were not gifts, but expenditures which I made to protect my property and personal interests by promoting efficiency in Government. . . ." ¹⁹ When federal gift taxes and interest totalling \$35,908.41 were nevertheless assessed against the taxpayer, she paid them, and, after unsuccessfully seeking a refund, she brought suit in district court which entered judgment in her favor.

The fifth circuit's affirmance of the lower court finding that the contributions were not taxable gifts rested principally upon a Treasury Regulation which provides, in part:

However, a sale, exchange or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth. . . . ²⁰

The court held that the taxpayer's expenditures were so permeated with economic motivation that they were to be considered as made for adequate and full consideration as defined by the Regulation. It did not decide, however, into what category the contributions fell.

Reaction to the *Stern* decision was generally unfavorable. One commentator suggested that it was "unsupportable" in the case law, and, in any event, was a matter for Congress to decide, not the courts. ²¹ Others accurately forecasted the intense efforts on the part of campaign financiers to create numerous committees to divert smaller, non-taxable gifts into large central funds. ²²

Within days of the *Stern* decision, the IRS announced that it would not honor the decision except in the fifth circuit and in cases factually identical to it. ²³ Because the IRS normally appeals an unfavorable decision to the Supreme Court or waits for a conflicting circuit court decision before appealing, the IRS' reaction to *Stern* could arguably be interpreted as an effort to avoid the possibility of a ruling which might apply that holding nationwide. Although the peculiarly intense and personal economic motiva-

19. 304 F. Supp. 376, 377-78 (E.D. La. 1969).

20. Treas. Reg. § 25.2512-8.

21. Note, 12 B.C. IND. & COM. L. REV. 1268 (1971).

22. Note, 40 U. CIN. L. REV. 381 (1971) and Note, 46 TUL. L. REV. 344 (1971).

23. T.I.R. 1125 (Dec. 17, 1971).

tions of the taxpayer in *Stern* would seem to be an exception rather than the rule in political giving, the IRS would, at least in cases factually consonant with *Stern*, have to treat campaign contributions as taxable income to political committees and parties if the Supreme Court upheld that holding.

In June, 1972, in response to requests regarding the criteria by which political organizations would be recognized as separate donees for purposes of Section 2503(b), the IRS issued Revenue Ruling 72-355.²⁴ The ruling set forth the following:

In general, political organizations will be recognized as separate donees for purposes of the annual gift tax exclusion. Where, however, political organizations have essentially the same officers and supported candidates and no substantial independent purpose, the organizations will be treated as one, and gifts to them by an individual will be aggregated for purposes of section 2503 (b) of the Code. *For purposes of this paragraph, the officers or supported candidates will not be deemed to be essentially the same if at least one-third of the officers or candidates are different in each of the committees.*²⁵

Illustrative examples which accompanied the Ruling suggest that so long as political entities manifest a surface dissimilarity in name, officers or supported candidates, the IRS would not look through the form to reach the substance of gift transactions.

Since the Ruling was handed down four months before election day, litigation and congressional reaction came swiftly. The IRS composed a public record of the various letters and memoranda received (hereafter IRS Record).²⁶ Suspicious of heavy-handed White House intervention in the Ruling,

24. 1972 INT. REV. BULL. No. 29, at 4-6. Also released as T.I.R. 1179 (June 21, 1972).

25. *Id.* at 5 (emphasis supplied).

26. The IRS received twenty-seven memoranda and letters from Congressmen, public interest and tax groups and the Republican and Democratic National Committees submitted to the IRS prior to its March, 1973 hearing on contributions of appreciated property. Complaint Requesting an Injunction against Unlawful Withholding of Records at 1 Nader v. I.R.S., Civil No. 1851-72 (D.D.C., filed May 18, 1973). The request was made pursuant to the Freedom of Information Act and Treas. Reg. § 601.702(c). The IRS denied the request, and Public Citizen appealed to the Commissioner of Internal Revenue who affirmed the denial. On Sept. 14, 1972, Public Citizen sought a permanent injunction enjoining the IRS from further withholding the information requested. On May 8, 1973, defendants made available to plaintiffs certain inter-agency and intra-agency records of the IRS and the Treasury Department. Prompted by evidence of alleged White House interference with the original IRS decision that contributions to multiple committees be allowed only one \$3,000 exclusion, Public Citizen, on May 18, 1973 requested that the court issue a declaratory judgment that (1) Revenue Ruling 72-355 was unlawful, unconstitutional and unlawfully adopted and issued; and (2) that defendants be enjoined from continuing to apply the Ruling. In a deposition of Peter Weidenbruch, IRS Assistant Commissioner (Technical), Weidenbruch suggested that the Ruling was not issued through normal channels. Usually, the Technical Division

Ralph Nader's Public Citizen brought suit against the IRS, its Commissioner and the Secretary of the Treasury requesting the defendants to produce all communications between the White House and other agencies in the Executive Branch as well as all requests for advice and internal memoranda submitted to and written by IRS personnel.²⁷ Tax Analysts and Advocates, joined by the National Committee for an Effective Congress, sought a declaratory judgment that the Ruling was unlawful, and a permanent injunction requiring the Service to withdraw it.²⁸

Congressional reaction was equally vigorous. In March, 1973, Senators Hugh Scott (R.-Pa.) and Charles McC. Mathias (R.-Md.) introduced a bill that would eliminate political contributions from the definition of "gifts" for purposes of the gift tax.²⁹ Senator Adlai E. Stevenson III (D.-Ill.) introduced legislation which would eliminate abuse of the multiple-committee device by providing that "gifts to a committee which supports a candidate will be deemed to have been made directly to the candidate unless the contributor establishes that he could not reasonably have been expected to know which candidate would benefit from his gift."³⁰

On the other hand, tax lawyers and accountants, though pausing to consider the questionable vitality of the gift tax laws as applied to political contributions, began to publish mathematical formulae to determine precisely how many persons and committees would be necessary to safely avoid liability for gift taxes.³¹

The Ruling was attacked on other substantive grounds. In comments submitted prior to the March, 1973 IRS hearing on a related matter,³² many

prepares a draft which is reviewed by the General Counsel's Office and main Treasury. In this instance, the Ruling originated in the Office of General Counsel which discussed it with main Treasury, then referred it to Technical for review.

27. See letter from William Dobrovir, counsel for Public Citizen to IRS, Jan. 2, 1973, to which an excerpt of the Weidenbruch deposition is attached. *IRS RECORD*, *supra* note 26. See also Press Release from Congressman Henry S. Reuss (D. Wisc.) (June 9, 1973) at 3, where the congressman challenges "the apparent combination in restraint of tax collection."

28. Complaint for Declaratory Judgment and Permanent Injunction at 1, *Tax Analysts & Advocates v. Shultz*, Civil No. 594-73 (D.D.C. filed March 28, 1973).

29. S. 1097, 93rd Cong., 1st Sess. (1973), reprinted in 119 *CONG. REC.* 3860 (daily ed. March 6, 1973). The bill has been referred to the Committee on Finance.

30. S. 2065, 93rd Cong., 1st Sess. (1973) and discussed in 119 *CONG. REC.* 11849, 11850 (daily ed. June 25, 1973). The bill has been referred to the Committee on Finance.

31. "Whether the one-third rule has the effect of making the gift tax a nullity as applied to political contributions remains to be seen. However, careful advance planning, including the creation of a sufficient number of committees, use of enough officers in various combinations, and support of multiple candidates, should make it possible for a donor to give substantial funds for political campaigns without imposition of gift taxes." Fernschreiber & Granwell, *Avoiding Gift Tax on Political Contribution: Obstacles and Opportunities*, 50 *TAXES* 671 (1972).

32. See Part II, *infra*.

charged that the Ruling was totally inconsistent with the Supreme Court's holding in *Helvering v. Hutchings*.³³ Not many years after the gift tax was enacted, *Hutchings* resolved a problem which arose with respect to gifts in trust, namely the determination of whether the trustee or the ultimate beneficiary of the trust was to be considered the donee. The Court held that a gift in trust was a gift to the beneficiaries of the trust for purposes of the gift tax exclusion. The language from the opinion seems to indicate that, as is the case with gifts in trust, the donor to a political committee bestows the benefit of his donation upon the candidate or candidates whose campaign it would help finance:

. . . for present purposes it is of more importance that in common understanding and in the common use of language a gift is made to him upon whom the donor bestows the benefit of his donation. One does not speak of making a gift to a trust rather than to his children who are its beneficiaries. . . .

Moreover, the very purpose of allowing a gift tax exemption measured by the number of donees, would be defeated if a distinction were to be taken between gifts made directly to numerous donees and a gift made for their benefit by way of a single trust, and we are unable to discern in the statute or its legislative history any purpose to make such a distinction. . . . *Further, such an assumption would open the way to avoid the \$5,000 limitation upon the allowed exemption, by resort to the simple expedient of the creation by a single donor of any number of trusts of \$5,000 each for the benefit of a single beneficiary.*³⁴

The Ruling was criticized as an unjustified and all-too-friendly invitation for political committees to deliberately avoid tax payments.³⁵

Apart from the IRS' apparent divergence from the *Hutchings* rule, it seemed difficult to justify the Ruling in light of the position taken by the IRS in *Estelle Morris Trusts v. Commissioner*.³⁶ There, two individuals

33. 312 U.S. 393 (1941). This view was argued in letters contained in IRS RECORD from Tax Analysts and Advocates to IRS at 11-12 (Dec. 15, 1972); Letter from Public Citizen, Inc. to IRS at 4, Nov. 20, 1972; Memorandum from Professor Charles Davenport and Meade Emory of the University of California School of Law at Davis to IRS at 4, Dec. 15, 1972, sponsored by Taxation With Representation; and Letter from National Committee For an Effective Congress to IRS at 1, Dec. 6, 1972. The IRS distinguished *Hutchings* in the revenue ruling on the basis that political organizations must be distinguished from private trusts, but gave no reason to support the distinction.

34. 312 U.S. at 396-97 (emphasis supplied).

35. "The Service's view is extremely permissive. Even though several committees are formed for the sole purpose of supporting one candidate and have no 'substantial independent purpose', they will be treated as separate entities for purposes of the annual exclusion so long as their officers were different." Faber, *Gift Tax Planning*, 2 N.Y.U. THIRTY-FIRST ANNUAL INSTITUTE ON FEDERAL TAXATION, 1217, 1260-61 (1973) [hereinafter cited as Faber].

36. 51 T.C. 20 (1968), *aff'd per curiam*, 427 F.2d 1361 (9th Cir. 1970).

executed ten trust instruments each, established for the same beneficiary, and whose sole purpose was gift tax avoidance. In summarizing the Service's position which supported consolidation of the trust instruments, the court said: ". . . respondent [IRS] characterizes these trusts as shams lacking business purpose which, apart from the anticipated tax benefit, are without substance."³⁷

II. *Income Tax Treatment of Political Contributions*

One would be hard pressed to find statutory or constitutional support for the IRS' failure to tax ordinary income of political parties and committees. However, the Service, under both Republican and Democratic administrations, has perpetuated a "hands off" policy when it comes to requiring parties to file tax returns or to collecting taxes on income realized by them.

Under the Code, a political party's income would seem to be taxable. Section 6011 of the Code³⁸ requires "any person" liable for any federal taxes to file a return; section 7701(a)(1) defines a "person" to include "an individual, a trust, estate, partnership, association, company or corporation."³⁹ In addition, Subchapter F of the Code does not exclude political entities from liability for income tax. A Treasury Regulation also precludes from treatment as tax exempt organizations, those organizations which are engaged in "direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office."⁴⁰ Unless Congress has specifically granted an exemption for political parties, they appear to be within the reach of the Code.⁴¹

A discernible pattern emerges when one examines the federal government's record of selective enforcement of the tax laws with respect to political parties. In 1965, the IRS took what seemed to be an unequivocal posi-

37. 51 T.C. at 39. The court held that it would not consolidate the trusts even though they were established with the express purpose of obtaining tax benefits through multiple entries.

38. INT. REV. CODE OF 1954, § 6011.

39. INT. REV. CODE OF 1954, § 7701(a)(1).

40. Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (1959).

41. "The Internal Revenue Code of 1954 taxes income from whatever source derived, and exempts only certain enumerated types of organizations, specifically defined and limited. Political parties are not exempted. Notwithstanding the function of parties in the scheme of American politics, assuming that patterns of taxation are applied evenly without regard to partisanship, parties have no obvious characteristics that necessarily place at least their ordinary and commercial investment income beyond the reach of the nondiscriminatory tax gatherer. This conclusion is based upon an elementary distinction between the nature and source of income, as differentiated from its use or application, no matter what its original nature. The purposes for which resources are spent, be they income or capital, do not render income exempt from taxation unless Congress has particularly said so." Boehm, *Political Expenditures*, 231 TAX MANAGEMENT A-41 (1970).

tion in an internal memorandum in *Democratic League of San Francisco* when it said that "unless a political party has received some sort of tax dispensation, the operative presumption must be that its income is subject to taxation."⁴²

Again, when exerting pressure against the American Communist Party, the Department of Justice, in *Communist Party v. Commissioner*,⁴³ said in its brief: "Political parties are simply not exempt from income tax by statute, regulation or ruling—public or private, published or unpublished."⁴⁴ The court specifically said in its opinion, "[T]he Government now assures us that all political parties, including petitioner, are taxable associations under the statute. . . ."⁴⁵ And in 1968, the Service published Revenue Procedure 68-19 which provided that political committees were to file U.S. Fiduciary Income Tax Returns to report the unexpended balance of any political funds set aside in separate bank accounts—and pay any taxes shown to be payable.⁴⁶

Aside from this explicit evidence to support the susceptibility of political entities to income taxation—at least insofar as splinter groups or parties not in the mainstream of American politics are concerned—the Service clarified its equivocal use of the word "may" in Revenue Procedure 68-19 when it admitted to members of Congress that there is no justification for not taxing income to political parties and committees across the board:

In a letter to Congressman Frank E. Evans (D.-Colo.) dated May 8, 1972,⁴⁷ the Service cited Revenue Procedure 68-19 in support of its direction that an Evans' political committee pay any income tax for which it was liable from interest earned on excess funds deposited in a financial institution.

In a letter to Senator Gaylord Nelson (D.-Wisc.) dated March 22, 1973,⁴⁸ the IRS said that although revenue procedures do not carry the same force and effect of revenue rulings, the word "may" used in Revenue Procedure 68-19 is to be interpreted as meaning "shall" since the "Service has ruled consistent with Sec. 4.02 of

42. G.C.M. 32991, A-618266 (March 19, 1965) as excerpted in Press Release from Congressman Henry S. Reuss (D. Wisc.), June 9, 1973 at 3.

43. 373 F.2d 682 (6th Cir. 1967).

44. Brief for Government at 8, *Communist Party v. Commissioner*, 373 F.2d 682 (6th Cir. 1967).

45. 373 F.2d at 684.

46. Rev. Proc. 68-19, 1968-1 CUM. BULL. 811 provides:

If an unexpended balance of political funds is set aside in a separate bank account, the political candidate, committee or organization holding such funds may report any income credited to the account on a U.S. Fiduciary Income Tax Return, Form 1041, for the taxable year in which such income is so credited, and pay any tax shown by such return to be payable. (Section 4.02)

47. Letter from IRS to Congressman Frank E. Evans (D.-Colo.), May 8, 1972.

48. Letter from IRS to Senator Gaylord Nelson (D.-Wisc.), March 22, 1973.

the Revenue Procedure that political candidates, committees or organizations holding political funds on behalf of political candidates should report the income earned through the investment of such funds." This rule applies, said the IRS, no matter what election year such funds were solicited for.

Contributions of Appreciated Property: Shouldn't Somebody Be Taxed?

In an article published in *The Wall Street Journal*⁴⁹ it was revealed that, for the first time in any significant degree, the major political parties were soliciting contributions of appreciated securities to help finance the 1972 presidential elections. Republican financiers, relying on the standard tax principles applicable to transfers of appreciated property, sent out form letters to prospective donors which, in addition to indicating that payment of the capital gains tax could be avoided, also suggested that such contributions could be fashioned to avoid imposition of the gift tax.⁵⁰ According to the *Journal*, neither the donors nor the donees were reporting gains realized on subsequent sales or conversions of appreciated assets.

The practice of making contributions of appreciated property instead of cash is hardly unusual. Often persons make charitable contributions of appreciated securities in order to avoid payment of capital gains taxes, but the application of the tax in this instance turns in large measure on whether or not transfers in the form of political contributions are to be treated as "gifts" for income tax purposes. A different standard is applicable in income tax law than in gift tax law: while the gift tax generally looks to the presence or absence of consideration, the income tax looks to the donor's motive and intent.⁵¹ In the income tax area, the definition was set out by the Supreme Court in *Commissioner v. Duberstein*⁵² where the Court said a transfer is to be treated as a gift if it is given with "detached and disinterested generosity."⁵³ Although scholarly political journals and the findings

49. Landauer, *supra* note 15.

50. The form letter reads in part:

"I am delivering this stock to you as my agent to effect transfer as herein set forth. You are authorized and directed to divide this stock into certificates with values not to exceed \$3,000 each, on the date of transfer, and to cause one of the certificates, as my agent for such purpose, to be transferred to each of the following separate entities. . . ." Landauer, *supra* note 15 at 24, col. 6.

51. *See, e.g., United States v. Davis*, 370 U.S. 65, 69 n.6 (1962) where the Court said: "In interpreting the particular income tax provisions here involved, we find ourselves unfettered by the language and considerations ingrained in the gift and estate tax statutes." For an explanation of the relationship between gift and income tax, *see* C. LOWNDES & R. KRAMER, *FEDERAL ESTATE AND GIFT TAXES* § 31.10 at 678, § 32.12 at 699 (2d ed. 1962).

52. 363 U.S. 278 (1960).

53. *Id.* at 285.

of public opinion polls on the subject are extensive, the only consensus that can be reached about motivations behind political contributions is that they are sometimes obscure, often diverse and seldom predictable.⁵⁴ Two tax experts, sponsored by Taxation With Representation, submitted a memorandum to the IRS which argued that motives behind political contributions—be they strongly felt political or ideological beliefs, the expectation of economic benefit or the expectation of favors in return—do not meet the *Duburstein* test, and therefore relieve recipients from income tax liability.⁵⁵ Tax Analysts and Advocates theorized that insofar as political contributions are predicated upon use for expenses of a campaign, they may be likened to transfers “in trust” for the accomplishment of a specific purpose, and do not constitute income to the recipient.⁵⁶

Assuming such contributions are gifts, however, Section 1015 of the Code provides that, for purposes of computing gain, the donee must assume the donor's basis, *i.e.* “tax cost” where a gift is made of appreciated property.⁵⁷ Thus, the appreciation in value in the hands of the donor and the donee is subjected to tax upon disposition by the donee.⁵⁸ In the case of the transfer of appreciated stock worth \$10,000, for example, which the donor purchased for \$2,000, an \$8,000 taxable gain to the donee is realized when the committee sells or converts the appreciated stock.

Less than one week after the *Journal's* story, the IRS, obviously embarrassed by what seemed to be a blatant scheme to cheat the government, announced that it was soliciting briefs and comments in preparation for public hearings on the subject of tax treatment of appreciated property contributed to political parties and committees.⁵⁹ In what was a notable oversight in not mentioning its letters of advice to congressmen and their supporters or its postions in the cases cited above, the announcement said:

It is a matter of history that the Internal Revenue Service has never required the filing of income tax returns by political parties as such. It appears that this practice had its inception and was continued in the belief that virtually all of the receipts of the parties were from gifts and that the parties would not have taxable income.

54. See, *e.g.*, A. HEARD, *THE COSTS OF DEMOCRACY* (1960) and H. ALEXANDER, *MONEY IN POLITICS* (1972).

55. IRS RECORD, Memorandum from Professors Charles Davenport and Meade Emory of the University of California School of Law at Davis to IRS at 4, Dec. 15, 1972.

56. IRS RECORD, Letter from Tax Analysts and Advocates to Commissioner of Internal Revenue, at 7-8, Dec. 15, 1972.

57. INT. REV. CODE OF 1954, § 1015.

58. In *Taft v. Bowers*, 278 U.S. 470 (1929), the Supreme Court upheld the constitutionality of this taxing device.

59. IRS Press Release, No. 1257 (Oct. 3, 1972).

*This practice made it unnecessary to decide finally whether parties were subject to tax.*⁶⁰

A formal notice in the Federal Register two weeks later⁶¹ yielded twenty-seven submissions from counsel for the Democratic and Republican National Committees, individual congressmen, public interest and tax groups, and other interested parties, some of whom also gave oral testimony at a public hearing held on March 1, 1973.

Two of the more important issues raised in the comments to IRS were (1) whether the contributor or the political party actually realizes the gain upon disposition of capital assets and (2) whether any future IRS ruling with respect to such transfers should be applied retroactively. One of the theories advanced in several briefs was that gains realized on sales of appreciated assets should be taxable to the donor.⁶² Support for this position was based upon the accepted practice of taxing the donor where there is an implicit or express agreement that the property is to be sold by the donee. Alternatively, the theory was supported on the basis that the donor's gain, though often intangible, is realized when his contribution serves to further ideological beliefs or gain access to the candidate.⁶³

The sensitive political decision the IRS would have to make in deciding whether to apply the ruling retroactively was also considered in the IRS record of briefs.⁶⁴ Predictably, the Democratic and Republican National Committees vigorously exhorted the IRS to apply its rule only prospectively, while public interest groups said the Service would have no sound basis for applying the ruling with other than retroactive effect. By allowing gains realized by donors or political committees to go untaxed, it was argued, an increased tax burden would be placed on taxpayers who did not support the candidate and would be permitting legislation of a tax subsidy by the Treasury Department.⁶⁵ Public Citizen urged that retroactive application would be reasonable and equitable in light of the fact that there had been no

60. *Id.* at 2 (emphasis supplied).

61. 37 C.F.R. § 22427 (1972). See also Mintz, *Taxes and Political Structures: IRS Takes a Look*, *The Washington Post*, Dec. 26, 1972, at C2, col. 1.

62. See IRS RECORD, Memorandum from Professors Charles Davenport and Meade Emory of the University of California Law School at Davis to IRS at 5-10, Dec. 15, 1972, sponsored by Taxation with Representation; Letter from Tax Analysts and Advocates to IRS at 6, Dec. 15, 1972; and Letter from Marmet & Webster to IRS at 4, Jan. 5, 1973.

63. See IRS RECORD, Memorandum from Professors Charles Davenport and Meade Emory of the University of California Law School at Davis to IRS at 4, Dec. 15, 1972, sponsored by Taxation With Representation.

64. Section 7805(b) of the 1954 Code provides that "The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation relating to the Internal Revenue laws shall be applied without retroactive effect."

65. See IRS RECORD, Memorandum from Mark F. Corriera to IRS at 19-20, Dec. 15, 1972.

definitive statement by IRS upon which taxpayers might have justifiably relied.⁶⁶ Finally, on August 1, 1973, the IRS proposed to end decades of uncertainty by henceforth requiring political parties and committees to file appropriate tax returns. Gross income to political parties and committee was now deemed to include interest and dividends from investments, income from any ancillary commercial activity and gains from the sales by the committee or party of appreciated property.⁶⁷ In view of what it called the "major inequities" which would result if the new policy were to be applied retroactively, the Service, siding with the position taken by both major political parties, decided it would be enforced only against sales subsequent to its October 3, 1972 statement of its concern with the problem.⁶⁸

Although the Service made a major breakthrough in finally requiring parties and committees to file income tax returns, the "prospective-only" application focused, as did the gift tax ruling, on the IRS' inclination to exert only its mildest tax levy on political parties. One wonders how often the IRS points to "major inequities" and the possibility of placing entities in bankruptcy when levying against the ordinary taxpayer who cannot meet his tax obligations. And to those who found it inequitable that the IRS retained tax monies it had accepted from political organizations who chose to be cautious and pay the tax, the discomfiting prospect that the Service was rewarding the clever "tax dodger" while maintaining a hard line against the responsible taxpayer, was very apparent.⁶⁹

III. *The IRS and Congressional Reform of Election Financing*

Congressional enactment of the Federal Election Campaign Act⁷⁰ and

66. See IRS RECORD, Letter from Public Citizen, Inc. to IRS at 10, Nov. 20, 1972. Retroactive application was also supported in the Memorandum from Professors Charles Davenport and Meade Emory of the University of California Law School at Davis to IRS at 17, Dec. 15, 1972, sponsored by Taxation With Representation.

67. 1973 INT. REV. BULL. No. 33 at 18-19 provides, in part: "Gains on the sale of appreciated property, net of any losses, shall be included in income of political parties or committees to the extent provided in the Internal Revenue Code." The Service also reaffirmed its adherence to Revenue Ruling 72-355 for the determination of gift tax liability.

68. Three revenue rulings issued by the IRS on December 20, 1973 clarify Federal income tax treatment of political parties, unexpended campaign contributions transferred to the U.S. government by political committees, and the receipt and disbursement of funds by political candidates. See IRS Press Release No. 1344 (Dec. 20, 1973). The text of the rulings—Revenue Rulings 74-21, 74-22 and 74-23—are published in 1974 INT. REV. BULL. No. 2.

69. See Letter from Senator Adlai E. Stevenson III (D.-Ill.) to IRS Commissioner, Aug. 3, 1973, in IRS RECORD where the Senator says: "Your policy statement does not address the question whether taxpayers such as the [Citizens for Stevenson] Fund are entitled to a refund. On the face of it, there appears to be a serious inequity in retaining the pre-October taxes paid by political committees which did comply with the law, while allowing political committees which did not pay the tax to escape liability."

70. 2 U.S.C. § 431 (Supp. 1973).

the Revenue Act of 1971⁷¹ had already made the IRS a focal point for efforts to reform campaign financing. Replacing the loosely-drawn and rarely enforced 1925 Federal Corrupt Practices Act, the Federal Election Campaign Act provides for comprehensive disclosure of significant receipts and expenditures among its major provisions. Simultaneously, the Revenue Act of 1971 allows contributors to take a tax credit against federal income tax for 50 percent of their contributions up to a maximum of \$12.50 on a single return and \$25 on a joint return.⁷² Alternatively, the taxpayer may take a deduction for the full amount of contributions up to a maximum of \$50 on a single return and \$100 on a joint return.⁷³ Taken together, the acts were designed to encourage wider participation in campaign financing by pledging that the government would share the cost.⁷⁴

The IRS rulings on gift and income tax treatment for political contributions will have a number of adverse side effects on the administration of the acts and on the broad policy goals Congress hoped to implement. First, the three supervisory officers charged with responsibility for compiling and making available campaign financial reports—the Secretary of the Senate, the Clerk of the House of Representatives and the Comptroller General of the United States—are now burdened with additional administrative duties as a result of IRS' acquiescence to multiple gift tax exclusions. Insofar as Revenue Ruling 72-355 invites proliferation of gift tax committees having no substantial independent purpose, the huge amount of paper work to be handled by the supervisory officers may cause further delays in getting campaign finance data to the press and public well in advance of primaries and general elections.⁷⁵

71. PUB. L. No. 92-178 (Jan. 19, 1972).

72. INT. REV. CODE OF 1954, §§ 41, 642(a)(3).

73. INT. REV. CODE OF 1954, § 218, *amending* § 642(i). The Act also created a Presidential Election Campaign Fund through which taxpayers may finance presidential campaigns of their choice by "checking off" \$1 or \$2 (in the case of a joint return) to be used for the first time in the 1976 presidential election. INT. REV. CODE OF 1954, § 802, *amending* § 6096(a).

74. "The theory was that the tax credits and deductions, if accompanied by an educational campaign to acquaint the American people of their availability, and if the candidates and committees stepped up their solicitation campaigns accordingly, could bring in more small funds for several reasons. Tax incentives signifying government encouragement of the act of giving are in effect a 'sales tool' enabling solicitors to ask small contributors—say, those giving up to \$25 in the past—to double the amount of their gifts since the government is now sharing in the cost. In short, the combination of disclosure of large contributions and of tax incentives could, if properly exploited, serve to broaden the financial base of politics." Paper presented by Dr. Herbert E. Alexander, Director of the Citizens Research Foundation, to the International Political Science Association Congress in Montreal at 5, Aug. 22, 1973. *See also* B. Jordan, *Report of the Senate Committee on Rules and Administration on S. 382*, S. REP. No. 229, 92d Cong., 1st Sess. 57-58 (1972).

75. *See* IRS RECORD, Letter from Phillip S. Hughes, Director of the Office of Federal Elections in GAO, to the IRS Commissioner at 2, Nov. 17, 1972.

Numerous administrative difficulties also arise with respect to reporting contributions of appreciated property which are split into \$3,000 gifts to avoid payment of gift taxes. The Director of the Office of Federal Elections in the General Accounting Office (GAO) posed this example of an individual's contribution of \$100,000 worth of stock which is divided among 30 separate committees:

The substance of the transaction is that the main committee receives \$100,000 and expends \$10,000, for a net contribution of \$90,000. Should that committee report a contribution received of \$100,000 or \$90,000 or \$3,000. If the committee reports either \$100,000 or \$90,000, the actual transaction is more accurately reflected, but the donor would be subject to gift tax liability. If the committee and its 29 affiliates each report \$3,000, it means that a person must look at 30 reports to discover the total contribution. Furthermore, the reports may show different dates and probably will not reflect any connection with the overall transaction. . . .⁷⁶

Perhaps more important than the administrative handicaps resulting from the IRS' rulings is the decidedly dampening effect they will have on Congress' attempt to broaden the base of political financing. While, on the one hand, Congress is telling taxpayers that their government will share in the cost of small contributions, the Service seems to be telling large contributors that it will continue to allow creative gimmickry in fashioning political contributions and committees to avoid gift tax liability. Students of tax policy who have noted the effect that special tax provisions favoring certain groups or activities have on taxpayer morale report that dangerous attitudes may develop.⁷⁷ In a tax system so largely dependent upon voluntariness, the possibility that the IRS' position towards large contributors might engender hostility among taxpayers generally and among the class of taxpayers attracted to the idea of tax credits and deductions on political contributions in particular, is apparent.⁷⁸

Congressional Options

There are many possibilities which Congress may examine in shaping legislative alternatives to tax treatment of political contributions.⁷⁹ Even a

76. *Id.* at 3.

77. Blum, *The Effects of Special Provisions in the Income Tax Law on Taxpayer Morale*, Joint Committee on the Economic Report, *Federal Tax Policy for Economic Growth and Stability*, 251-260 (1955) appearing in F. SANDER & D. WESTFALL, *READINGS IN FEDERAL TAXATION* 41-49 (1970).

78. An Illinois attorney wrote to the IRS Commissioner, "I sincerely believe that there has been a lot of alienation among the not so affluent classes in the country concerning the past treatment of these privileged political committees." IRS RECORD, Letter from Kevin M. Teeven to IRS Chief Counsel Lee H. Henkel, Jr., Dec. 14, 1972.

79. The House Ways and Means Committee has listed tax status of political organ-

cursory glance at the range of suggestions included in the record of IRS' hearings in March, 1973, reveals the practical flexibility of tax law in dealing with the policy questions incident to political campaign financing.

In the gift tax area, several organizations have suggested that Congress should exempt political contributions from liability for gift taxes for any number of reasons. Counsel for the Republican National Committee argues that it is contrary to sound public policy to impose a tax on the political process by penalizing the operation of "bona fide separate committees."⁸⁰ Tax Analysts and Advocates thinks that "gift tax committees" created only for tax avoidance purposes should be characterized as nominees or agents of the operating finance committees to which they transfer contributions; "operating" political finance committees, however, which are organized to finance the campaign of a single candidate, should be characterized as trusts for federal income tax purposes.⁸¹ Another tack was taken in an article which persuasively reasons that exempting political contributions from the gift tax would in no way defeat the policies which inform gift tax law:

The policy reasons for having a gift tax would not be undermined by an exclusion for political contributions any more than they are by the present deduction for charitable gifts. Aside from revenue raising considerations, the legislative history indicates that the gift tax was primarily designed to prevent avoidance of the estate tax by lifetime gifts and of the income tax by splitting income. Political contributions are not motivated by the desire to avoid estate taxes by passing property during the donor's lifetime to the ones who will eventually inherit it, nor is income splitting a consideration.⁸²

Congress also has the option of deciding whether or not to permit contributions of appreciated property, and, if they are permitted, to decide if and how subsequent gains on sales by the committee or party will be taxed. Certainly an imposition of capital gains tax on the donor would discourage these contributions, and such a move would be justified by a strong equitable argument. When a small contributor gives \$5 or \$25 to a political party, it is "after tax income," *i.e.* what the taxpayer can afford after his taxes are paid. When the stock contributor gives, however, it is *in anticipation* of his income tax liability—a manipulator of assets to assure he will pay less taxes at the end of the year. Unless the IRS is contending that stock con-

izations as a major topic to be covered in tax reform hearings scheduled for the second session of the 93rd Congress.

80. IRS RECORD, Letter from Henry R. McPhee to the IRS at 18, Jan. 5, 1973, on behalf of the Republican National Finance Committee.

81. IRS RECORD, Letter from Tax Analysts and Advocates to IRS at 7, Dec. 15, 1972.

82. Faber, *supra* note 35 at 1263-64.

tributors should be able to give the same dollars *cheaper* than the small contributor, some modification of the present rule is necessary to rectify the manifest inequity now permitted.⁸³ No matter who is taxed when contributions of appreciated property are made, however, the burden on members of the press and public in trying to ascertain the full transaction will not be lessened so long as multiple gift tax exclusions are still permitted. Only by prohibiting contributions of appreciated property altogether will these confusing and unnecessary reporting complexities be eliminated.

Conclusion

The role which Congress may choose to play in revoking or modifying the IRS decisions will surely tell taxpayers how serious it is about lessening the role of "big money" in financing the American electoral process. Studies of the interplay between Congress and the IRS when dealing with special interest tax provisions reveal an inclination on the part of Congress either to defer by not acting at all,⁸⁴ or to affirmatively favor such provisions, particularly where there is no organized lobbying group to protest and no interested public to whom the congressman is held accountable. When a special tax provision has to do with labor, oil, gas or farm legislation, champions of the special interests give Congress sharply defined interpretations of the impact of new proposals. So too, here, have the special interests and more public-spirited groups provided Congress with articulate and divergent viewpoints. Although Congress sometimes rationalizes its acquiescence to favored tax provisions by pointing to its lack of time, staff, budget and expertise in tax matters, no such protestations will suffice to excuse congressional inaction in an area so intimately tied to its pivotal role in election reform.⁸⁵ By clarifying the role tax policy is to have on our political financing system, Congress can help enhance the attractiveness of small political giving and counter IRS' inclination to wink at the tax laws when they hit influential groups.

Roslyn A. Mazer

83. In support of this argument, see Letter from Senator Stevenson, *supra* note 69 at 3.

84. Note, *Toward New Modes of Tax Decision-Making—The Debt-Equity Imbroglia and Dislocations in Tax Lawmaking Responsibility*, 83 HARV. L. REV. 1695 (1970).

85. See generally, Surrey, *The Congress and the Tax Lobbyist—How Special Tax Provisions Get Enacted*, 70 HARV. L. REV. 1145 (1957).