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SECTION 501(c)(4) CONTRIBUTIONS

The Law Remains Unsettled on Gift Taxation of Section 501(c)(4) Contributions

There is authority that such gifts are taxable, but ways to avoid the tax as well.

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The federal gift tax is typically assessed on transfers of wealth within families. Consequently, practitioners often view gift tax as an estate planning issue. There is authority, however, indicating that gift tax also applies to some contributions to nonprofit organizations, including contributions to social welfare organizations exempt under Section 501(c)(4). Whether the gift tax applies is not certain, though, since there are a number of substantial legal arguments against the taxability of contributions.

Although the IRS does not appear to enforce the gift tax on Section 501(c)(4) contributions, the issue concerns exempt organization practitioners because the potential gift tax liability discourages some potential donors from making large gifts to advocacy and lobbying organizations. At the same time, the legal uncertainty and lack of enforcement mean that many major donors to Section 501(c)(4) entities never even consider declaring their contributions on gift tax returns. The unsettled state of the law therefore results in an unfortunate public policy outcome--the gift tax "serves as a penalty for the cautious and no restraint at all for those who are ignorant or tolerant of the risk." [1]

This article is the first of two on the application of gift tax to Section 501(c)(4) contributions. The discussion below examines federal gift taxation generally, and whether and in what circumstances contributions to social welfare organizations are taxable gifts. A second article, to appear in a future issue of *Taxation of Exempts,* raises some constitutional arguments against the application of gift tax to Section 501(c)(4) contributions.

The federal gift tax

Section 2501 imposes a tax on the transfer of property by gift. This tax is separate and independent from the federal income tax. The income tax treatment of a transfer does not determine whether gift tax will be due, nor does the gift tax govern the income tax consequences for either the donor or recipient.

The gift tax is paid by the donor although the recipient is secondarily liable if the donor fails to pay. [2] The IRS can assess gift tax against the recipient for up to a year after the expiration of the statute of limitations for assessment against the donor.

Gift tax is imposed only on individuals; corporations are not subject to it. The transfer of property by a corporation for less than adequate consideration is treated as a gift from the shareholders of the corporation, and gift tax may be assessed against the shareholders. [3]

Gift tax rates and rate brackets are identical to the estate tax rates and brackets; both taxes use the same schedule in Section 2001(c). Prior to the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), the maximum gift and estate rate was 55% percent. [4] The maximum rate for gifts in 2003 is 49%, and will gradually decline to 45% percent by 2007. In 2010, gifts will effectively be taxed at a flat rate of 35% percent, while the estate tax will be eliminated. In 2011, the changes made by the EGTRRA are to expire; the estate tax will spring back into existence, and the top tax rate under Section 2001(c) for both gift tax and estate tax purposes will again be 55% percent. [5]

Domestic taxpayers are allowed a lifetime $1 million "unified credit" against transfers that would otherwise be subject to gift or estate tax. [6] In other words, a donor's first $1 million of otherwise taxable gifts can be made without tax liability; but using the credit to shelter taxable gifts will reduce the amount of the credit remaining to the donor's estate. For example, a donor who makes $600,000 in taxable gifts during his or her lifetime will not pay any gift tax, but only $400,000 of the unified credit will remain to his or her estate, and the estate will thus pay tax on the portion of the taxable estate that exceeds $400,000. Consequently, for donors with sufficiently large estates, making a taxable gift will ultimately result in a larger tax bill. Even if no tax is immediately due because the donor can use the unified credit, the exhaustion of the credit will cause more tax to be paid by the donor's estate.

Once the unified credit is exhausted, donors must pay gift tax on the amount of their taxable gifts made during the year. The tax rates are graduated, with the brackets based on the aggregate amount of the taxpayer's lifetime taxable gifts. [7]

Definition of a taxable gift

Section 2501(a) imposes a tax on "the transfer of property by gift." This section does not use the term "gift" in its colloquial sense, and transfers may be considered taxable gifts even if they do not "accord with the common law concept of gifts." [8] Although nominally a valuation rule, Section 2512(b) provides an indirect definition of "gift" for gift tax purposes:

> Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be

> deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

By using the mandatory term "shall," Section 2512(b) creates a substantive rule that transfers for less than full and adequate consideration are taxable as gifts. [9] The term "consideration" also has a special meaning for gift tax purposes. While nearly any promise can satisfy the consideration element requisite for a binding contract, Reg. 25.2512-8 provides that "consideration not reducible to money or money's worth, as love and affection, promise of marriage, etc., is to be wholly disregarded" for gift tax purposes.

In *Wemyss*, 33 AFTR 584, 324 US 303, 89 L Ed 958, 45-1 USTC ¶10179 (1945), the Supreme Court held that a transfer may be a taxable gift even if the transferor lacks donative intent. The Court's holding was based largely on a statutory provision similar to the present language of Section 2512(b), which the *Wemyss* opinion called a "workable external test" to determine when a taxable gift had occurred, dispensing with any inquiry into the donor's state of mind. Reg. 25.2511-1(g)(1) also states that donative intent is not an essential element of a taxable gift, as have subsequent judicial decisions. [10]

Nevertheless, donative intent remains a "helpful factor" in determining whether a gift has occurred. [11] In particular, Reg. 25.2512-8 states:

> [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.

Reg. 25.2512-8 provides an exception to the general rule that transfers will be taxable as gifts if made for inadequate consideration. [12] Under this exception, if a transfer is made without donative intent as part of a bona fide, arm's-length business transaction, the transfer will be deemed to be made for adequate consideration—regardless of the actual value of the consideration—and thus will not be subject to gift tax. This exception prevents bad business deals from being treated as taxable gifts. "Bad bargains, sales for less than market, sales for less than adequate consideration in money or money's worth are made every day in the business world, for one reason or another; but no one would think for a moment that any gift is involved...." [13]

Statutory exceptions to gift tax

Not all gifts are taxable. The Code includes a number of gift tax exclusions and deductions that permit gifts to be made without payment of any gift tax and without using up any part of the donor's lifetime unified credit. Gifts between spouses are not generally taxable, for example. Three such exceptions are relevant to the issue of gift tax on Section 501(c)(4) contributions.

Annual exclusion.

The most important gift tax exception, in Section 2503(b), allows taxpayers to exclude the first $11,000 of their gifts to be made during the year to each recipient. [14] A married couple may give up to $22,000 to each recipient tax-free.

Donations to Section 501(c)(4) organizations are eligible for the annual $11,000 exclusion. Thus, an individual donor may give up to $11,000 per organization per year without paying gift tax or using up any portion of the $1 million lifetime unified credit. A married couple may give up to $22,000 per organization per year tax-free. The gift tax issue arises only when larger gifts are made during one year to a single Section 501(c)(4) organization.

Gifts to Section 501(c)(3) organizations.

The Code specifically provides that gifts of any amount may be made tax-free to charitable organizations described in Section 501(c)(3). This is accomplished by giving taxpayers an offsetting deduction for charitable gifts. [15] In other words, gifts to Section 501(c)(3) organizations are supposed to be included in the taxpayer's total amount of taxable gifts made during the year (and reported on gift tax returns; see the sidebar), but then deducted under Section 2522 from the total, effectively making the Section 501(c)(3) gifts tax-free.

Gifts to Section 527 organizations.

Another statutory exception is provided by Section 2501(a)(5) for gifts to political parties or committees described in Section 527. In this instance, tax-free treatment is provided through an exception to the gift tax rather than a deduction. Section 2501(a)(5) states that gift tax "shall not apply to the transfer of money or other property to a political organization (within the meaning of Section 527(e)(1)) for the use of such organization." Consequently, gifts to Section 527 organizations need not be reported on gift tax returns. [16]

Prior to the 1974 enactment of Section 2501(a)(5), the IRS maintained that campaign contributions were taxable gifts to the extent they exceeded the annual exemption amount. [17] However, in the only two cases considering the taxability of political contributions, courts found in favor of the taxpayers and held that no taxable gifts had been made. [18] These cases will be discussed in detail below.

Gift taxation of donations to Section 501(c)(4) organizations

Social welfare organizations exempt from tax under Section 501(c)(4) include many types of entities. Many are organizations concerned with public policy that are disqualified from more favorable Section 501(c)(3) status because of the extent of their lobbying or electioneering activity. Ballot committees formed to support or oppose initiatives, referenda, bonds, or other measures in a state or local election are also typically exempt under Section 501(c)(4), since their activities are almost entirely directed to influencing legislation to be adopted by popular vote. Not all Section 501(c)(4) groups are focused on public policy issues, however. Many large HMOs are exempt under Section 501(c)(4), for example, and so are most service clubs such as Kiwanis International and multi-purpose organizations like AARP (formerly the American Association of Retired Persons).

The gift tax issue is potentially very significant for ballot committees, since wealthy donors may want to make large contributions in support or opposition to a measure and cannot practically spread their gifts over several years to take advantage of the annual exclusion. While contributions to campaign committees for candidates are explicitly excluded from gift tax, ballot committees cannot ordinarily qualify as Section 527 organizations. Thus, their donors cannot take advantage of this statutory exclusion.

Advocacy organizations with broader agendas are similarly affected. Their donors are also precluded from using the exclusion for Section 527 organizations. While donors may in some cases avoid the issue by spreading their contributions over multiple tax years, the possible imposition of gift tax deters wealthy donors from making large contributions in a single year to respond to particular legislative issues. Furthermore, established public policy organizations have more to fear from the possible assessment against the donee of delinquent taxes, since they may be in existence and solvent for a number of years after the contribution while ballot committees tend to dissolve shortly after an election.

There is little authority directly considering whether gift taxes apply to donations to Section 501(c)(4) social welfare organizations, but what authority exists indicates that they are indeed taxable. Only a few cases appear to have considered the issue, and all upheld taxability of the gifts. [19]

In addition, an IRS ruling indicates that such donations are taxable. In Rev. Rul. 82-216, 1982-2 CB 220, the IRS stated:

> [G]ratuitous transfers to persons other than organizations described in section 527(e) of the Code are subject to the gift tax absent any specific statute to the contrary, even though the transfers may be motivated by a desire to advance the donor's own social, political, or charitable goals.

While "person" is not defined in the ruling, for tax purposes the term generally includes corporations, trusts, and associations. [20] Rev. Rul. 28-216 went on to emphasize that the charitable gift tax deduction was limited to organizations that have not been disqualified from exemption under Section 501(c)(3) by reason of legislative or political activity. The clear implication of the ruling is that gifts to Section 501(c)(4) organizations will be subject to gift tax.

Notwithstanding this authority, it is possible that courts today would not uphold the assessment of gift tax on donations to Section 501(c)(4) organizations. In the closely related area of campaign contributions, two appellate courts found that such transfers were not gifts subject to the tax, [21] and these appellate cases were decided much more recently than the handful of lower court decisions holding to the contrary. Furthermore, only one 1951 district court case considered whether the contributions to a social welfare organization were gifts within the meaning of the gift tax statute; in the other cases, gift treatment was assumed and the only issue was whether the charitable gift deduction applied. [22]

Given the paucity of authority, it remains an open question whether the IRS could prevail in the face of a court challenge to the gift taxation of Section 501(c)(4) contributions. The answer depends, first, on whether the donation falls within the general definition of gift in Section 2512(b)—whether it is a transfer of property for less than adequate consideration in money or money's worth. If the donation does fall within the general definition of a gift, the second inquiry is whether the transfer escapes taxation under the Reg. 25.2512-8 exception for transfers in the ordinary course of business if bona fide, made at arm's length, and free of donative intent. If a Section 501(c)(4) donation is a gift under both of these tests, the donation would be subject to gift tax unless a statutory or judicial exception applied.

Does the donor receive consideration for the transfer?

Under Section 2512(b), a transfer of property constitutes a gift unless the donor receives adequate consideration. Donors arguably contribute to Section 501(c)(4) organizations to fund lobbying and advocacy activities that they support, and a donee's agreement to engage in these activities constitutes full and adequate consideration for the transfer. This argument comes in two distinct flavors. One variation emphasizes the benefits flowing to the donor if legislation supported by the organization is enacted; the other variation considers the advocacy activities themselves to be services performed for the donor.

DuPont, *Stern*, and *Carson.*

Both flavors of the argument were considered and rejected in *DuPont*, which found that contributions to the National Economic Council were subject to gift tax. As described in the *DuPont* opinion, the purposes of the Council were "to preserve private enterprise, private property and private initiative and American Independence." [23] To further its mission, the Council maintained a speakers bureau; distributed publications to subscribers, members of Congress, writers, commentators, and others; and made appearances before committees of Congress. The organization sought to influence legislation and claimed that its activities did influence legislation. [24] This description of the Council fits with the definition of a social welfare organization that would have been exempt from tax under the predecessor to Section 501(c)(4). [25]

The taxpayer in *DuPont* claimed that his transfer to the Council was not a gift, but rather "a payment to that corporation for services to be performed by them as experts in the field of monetary, business and political conditions in the United States and elsewhere, warning against dangers and encouraging soundness." [26] As a man of "large means and many investments," the taxpayer's economic interests were affected by economic trends, tax policy, government spending, and economic regulation; he claimed that his contributions to the Council benefited him by influencing public policy in his favor. [27]

The district court rejected this argument, finding that the connection between the taxpayer's contribution to the Council and economic benefits flowing to the taxpayer was too attenuated to treat this benefit as consideration for the transfer. While the court acknowledged that the plaintiff benefited from an improved economy, it found that it would be impossible to determine to what extent, if any, the improved economy was attributable to the actions of the Council. Furthermore, if the Council's actions did improve the economy, the benefits would flow broadly to all Americans (although admittedly Mr. DuPont benefited more than most).

The *DuPont* court also rejected the argument that Mr. DuPont received full and adequate consideration for his donation because the Council performed services for him. The court noted that the taxpayer had no control over the activities of the organization and, if he lost sympathy with its activities or policies, his only recourse would be to refuse to renew his membership. Hence, "in no sense would it seem to be a payment for services where the return has either a direct or recognizable connection with the payment." [28]

On the other hand, in *Stern,* a federal district court did find that campaign contributions were made for adequate consideration. The taxpayer in *Stern* made transfers to two informal committees, each of which made independent expenditures in support of candidates for local office. The taxpayer took that position that the committees were her agents in promoting efficiency in government.

The district court, in a terse opinion, found on two alternative grounds that no taxable gifts had been made. First, it found that the transfers were made for adequate consideration, and thus were not gifts:

> Plaintiff received full and adequate consideration for her political expenditures in the form of (a) goods and services purchased therewith, such as handbills, posters, sample ballots, newspaper and television advertising and the like; (b) the undertakings by candidates to campaign for political office in return for backing by plaintiff and others; and (c) promotion of efficiency in government and protection of personal interests. [29]

This finding does not seem to rely on the benefits Mrs. Stern would reap if legislation favorable to her interests were enacted; rather, consideration was apparently found in the conduct of the campaign activities themselves.

The district court also found that Mrs. Stern's transfers were made in the ordinary course of business, at arm's length, and without donative intent, and thus fell within the exception of Reg. 25.2512-8 (see below). The Fifth Circuit affirmed the trial court decision only on the latter basis, and did not consider whether the transfer was supported by consideration.

The other case on political contributions, *Carson*, 71 TC 252 *acq'g in result*, 1982-2 CB 1, *aff'd* 47 AFTR 2d 81-1619, 641 F2d 864, 81-1 USTC ¶13396 (CA-10, 1981) involved facts fairly similar to those in *Stern.* Mr. Carson made several contributions to candidate-controlled committees, but most of the transfers at issue were independent expenditures in support of candidates for office. These expenditures were under his direct control and were used to purchase postage, printing, and advertising, and to employ consultants. The Tax Court appears to concede that these contributions and independent expenditures fell within the technical definition of gifts, and thus implicitly viewed them as transfers without adequate consideration. The court decided the case on broad policy grounds, however, holding that Congress did not intend for the gift tax to apply to campaign contributions, and the Tenth Circuit affirmed on this basis. The court therefore did not make any finding as to the adequacy of the consideration, but did include language alluding to the value that the donor received:

> These facts do not suggest a gift to the candidate, but the use of petitioner's resources to promote the social framework petitioner considered most auspicious to the attainment of his objectives in life. Petitioner focused on the social structure most conducive to his economic aspirations; others may focus on a social structure advancing their own notions of social justice, or conditions they deem essential for world peace or public order. In either case, in the particular circumstances before us, the individual candidate may generally be viewed, for the purposes of the gift tax, as the means to the ends of the contributor. [30]

As a dissenting judge pointed out, however, this would be equally true of many gifts to charitable Section 501(c)(3) organizations. If activities directed towards bringing about the donor's view of social betterment were found to constitute adequate consideration for donations, donations to Section 501(c)(3) organizations would not be taxable gifts, and if that were the case, the gift tax deduction for gifts to Section 501(c)(3) organizations would be unnecessary. [31] The existence of an explicit charitable gift deduction during the entire history of the gift tax implies that Congress believed transfers to charities were taxable gifts. This, in turn, suggests that having an organization advance the donor's notions of social justice is not full and adequate consideration for gift tax purposes.

Consideration for Section 501(c)(4) contributions.

The first gloss on the consideration argument—that legislation benefiting the donor's interests provides consideration for the transfer—seems unlikely to prevail in court. The *DuPont* facts did not present the strongest possible case, since the taxpayer claimed a broad and amorphous return benefit. The argument would presumably be stronger if the donor stood to gain more directly from the organization's activities—for example, if a regulatory change or tax break supported by the organization would provide a significant benefit to the donor, and the donor's contribution was limited to activities furthering that goal. A donation to a pro-school voucher lobbying group made by the owner of a for-profit private school would fall into this category of donations with a clear nexus to the donor's self-interest.

Even under those circumstances, the rationale of *DuPont* would defeat the argument, since any connection between the donation and the return benefit is tenuous. The sought-after law or regulatory change might not be enacted; and even if the organization were successful, it would usually be difficult to demonstrate that the policy change was attributable to the activities of the organization. Furthermore, this line of argument would create a distasteful distinction in the tax treatment of gifts to advocacy organizations. The more a contribution advanced the naked self-interest of the donor, the more favorable the donor's tax treatment would be. For this reason, a court is unlikely to reject or distinguish *DuPont* in order to find that a Section 501(c)(4) organization provides consideration by bringing home the bacon for the donor.

The second version of the consideration argument, that engaging in advocacy activities on behalf of the donor is consideration, is more promising. First, there is precedent for it in the district court's *Stern* decision, which found that a donor received full and adequate consideration for her political donations (in the form of goods and services purchased for the campaign and exposition of her views during the campaign). The *DuPont* court rejected this argument, but the facts are distinguishable—Mr. DuPont made a contribution for general support of the organization, while Mrs. Stern's transfers were directed to the conduct of particular campaigns. The more that a donor's contributions are restricted to supporting particular activities, the stronger the argument that the donor is receiving consideration in the form of goods and services. This gloss is also inclined to get a more sympathetic hearing in court because it does not favor self-interested advocacy. Donations to fund environmental education and advocacy would be on an equal footing with donations to lobby for looser environmental regulations.

On the other hand, this form of consideration is somewhat intangible. The goods and services are not provided to the donor for his or her benefit, but rather to the public for the donor's satisfaction in having the donor's views expressed or objectives advanced. This kind of consideration is not reducible to money or money's worth and thus is arguably ignored under Section 2512 and Reg. 25.2512-8 .

There is another weakness in this argument—if the organization's exempt activities constituted consideration to the donor, it is difficult to see why contributions to Section 501(c)(3) organizations would be gifts and, if they were not, why the charitable gift tax deduction would not be surplusage. A rebuttal might be that some gifts to Section 501(c)(3) organizations are taxable gifts and others are not. For example, unrestricted donations to the United Way might be gifts, while restricted contributions to perform a concert of new music or purchase open space may not be gifts because they are paying for particular projects of importance to the donor. The charitable gift deduction could have been enacted because there is a class of Section 501(c)(3) transfers that are taxable gifts, even if some restricted donations for particular purposes would not fall within the definition of a gift. Drawing a distinction between restricted and unrestricted gifts seems artificial, however, and a court may find the difference between restricted and unrestricted gifts to be too insubstantial to justify a difference in tax treatment. [32]

In sum, there is a reasonable basis for the argument that transfers to Section 501(c)(4) organizations are not gifts when they are restricted to the funding of goods and services meeting the donor's specifications and expressing his or her views. This argument, though, rests on the thinnest of authority—one district court opinion, decided over 30 years ago, that was affirmed on an alternative rationale. Moreover, it rests on making fairly artificial distinctions between restricted and unrestricted gifts that a court may decline to view as justifying differing tax treatment.

Was the transfer in the ordinary course of business?

Even if a transfer is not made for full and adequate consideration in money or money's worth, it nevertheless escapes gift taxation if it falls within the exception provided by Reg. 25.2512-8 for a 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)."

There is some uncertainty regarding the construction of the "ordinary course of business" requirement. One interpretation is that the parenthetical elements—that the transaction be "bona fide, at arm's length, and free from any donative intent"—constitute the definition of a transfer in the ordinary course of business. Under this interpretation, the Reg. 25.2512-8 exception will apply as long as the three parenthetical requirements are met, and nothing additional must be shown. [33] On the other hand, the IRS argued in *Stern* that the language of the regulation created a four-element test, and that a transfer must satisfy the "ordinary course of business" requirement in addition to three parenthetical elements. [34] The *Stern* court sidestepped the question, and it remains unclear whether a taxpayer must demonstrate some business or financial interest in order for a transfer to fall within the "ordinary course of business" exception.

A leading case interpreting the "ordinary course of business" language is *Estate of Anderson*, 8 TC 706 (1947) *acq.*, which held that two principal shareholders of a closely-held corporation did not make taxable gifts when they sold stock to junior executives of the company because the transfers were "in the ordinary course of business." The narrow holding of *Anderson* is that transfers may be in the ordinary course of business for the purposes of the gift tax even if the taxpayer is not engaged in any trade or business for income tax purposes. [35] However, the opinion more broadly construed the nature of the "ordinary course of business" requirement:

> The pertinent inquiry for gift tax purposes is whether the transaction is a *genuine business* transaction, as distinguished, for example, from [a] marital or family type of transaction. [36]

In other words, the question is whether "business purposes rather than family relationships were the impelling considerations." [37]

In Harris, 39 AFTR 1002, 340 US 106, 95 L Ed 111, 50-2 USTC ¶10786 (1950), the Supreme Court found that even interfamily transactions can be treated as business transactions for gift tax purposes. It held that a property settlement between a divorcing couple fell within the scope of the gift tax exception, even though it was not "in the ordinary course of business in any conventional sense." [38] A number of other cases have held that transactions among family members were "in the ordinary course of business." For example, in *Beveridge*, 10 TC 915 (1948), *acq.*, the Tax Court held that a payment to the taxpayer's daughter to settle a legal claim was a business transaction, not a gift. In *Hull*, TC Memo 1962-199, PH TCM ¶62199, 21 CCH TCM 1076 the taxpayer sold property to a family corporation in exchange for an annuity that the Tax Court found was worth less than half of the fair market value of the property she sold. Nevertheless, the court found that the bargain transfer was not a gift because it was made in the ordinary course of business.

In both *Beveridge* and *Hull*, the Tax Court's findings on the ordinary course of business issue were intertwined closely with findings regarding the transferor's motives and objectives. The lack of donative intent justified treating the transfer as having been made in the ordinary course of business. In *Beveridge*, for example, the Tax Court reasoned as follows:

> The testimony of petitioner's advisors and attorneys convinces us that in making the transfer petitioner was not actuated by love and affection or other motives which normally prompt the making of a gift, and, further, that the settlement to which she agreed on her attorneys' advice was that which they and she regarded as advantageous economically under the circumstances. Perhaps she could have successfully resisted the daughter's threatened suit, but her attorneys were not certain of the outcome of the litigation and so advised her; the value of the property defended was substantial, and by accepting that settlement, she avoided additional legal expenses. She acted, in our opinion, as one would act in the settlement of differences with a stranger. [39]

The Tax Court appeared to find that the transaction was in the ordinary course of business in part because the taxpayer lacked donative intent. Similarly, in *Hull*, the Tax Court opinion relied on the taxpayer's motives to determine that the sale was in the ordinary course of business. The court noted that the taxpayer believed the price was fair and that "[h]er purpose in assigning this lease to Hull Enterprises was to divest herself of the management problems attendant upon the property's ownership." [40]

Whether a transaction is made at arm's length has also been treated by some courts as a factor in determining whether it was made in the ordinary course of business. For example, in *Estate of Cullison*, TC Memo 1998-216, RIA TC Memo ¶98216, 75 CCH TCM 2490 *aff'd without published opinion*, 221 F.3d 1347, AFTR2d 2000-1908 (CA-9, 2000), the Tax Court held that a bargain sale was not made in the ordinary course of business because there was no arm's-length bargaining. Similarly, in *Natkanski*, TC Memo 1992-380, RIA TC Memo ¶92380, 64 CCH TCM 55 the Tax Court treated arm's-length negotiations as a factor to determine whether interfamily payments to settle claims were business transactions rather than gifts.

This intertwined analysis of donative intent or arm's-length negotiations and the ordinary course of business requirement supports the view that the parenthetical elements serve as a definition of a transaction in the ordinary course of business, rather than separate requirements of a four-part test. In addition, a number of court opinions seem to describe the parenthetical elements as the definition of a transaction in the ordinary course of business. Thus, the Tax Court has stated:

> It is well established that this exception is not limited strictly to a business transaction but includes *all* bona fide transfers at arm's length in which no donative intent is present. [41]

Similarly, the Tax Court stated in *Cullison* that to qualify for the Reg. 25.2512-8 exception, the transaction must be bona fide, at arm's length, and free of donative intent. Neither of these cases held that a transaction qualified for the exception, however, so the language in the opinions treating the parenthetical criteria as a definition of "ordinary course of business" is arguably dicta.

There are several court opinions, including similar language stressing the parenthetical elements, holding that transactions did qualify for the ordinary course of business exception. In these cases, however, the connection to the transferor's property interests is generally evident from the facts, so they do not establish that satisfying the parenthetical elements is enough to qualify for the exception. For example, in *Shelton v. Lockhart*, 52 AFTR 303, 154 F Supp 244, 57-2 USTC ¶11722 (DC Mo., 1957), a district court held that a transfer was not a gift, and appeared to treat the parenthetical criteria as a three-part test. The transfer at issue was made in part to secure valuable property rights, however, so the case does not stand for the proposition that no "business" interest needs to be shown.

No case construing the regulation explicitly holds that satisfying the three parenthetical requirements, without more, is enough to make a transfer qualify for the "ordinary course of business" exception. In fact, a number of opinions pointedly emphasize the financial and business purposes of the taxpayer to justify treating a transfer as one made in the ordinary course of business. [42]

In Rev. Rul 68-558, 1968-2 CB 415, the IRS applied the exception without specifying how the transfer might relate to the transferors' business or property interests. The ruling involved a group of citizens who transferred land to a corporation at a below-market price in order to induce the corporation to operate a manufacturing plant in the community. Initially the property was leased to the company, but was deeded over when the company's payroll reached a target level. The ruling stated that the phrase "'ordinary course of business' refers to a transaction that is bona fide, at arm's length and free of any donative intent." Finding those criteria had been met, the IRS ruled that no gift tax would apply. This ruling seems to dispense with any requirement that the transfer involve the financial interests of the transferors in order to meet the "ordinary course of business" requirement. The ruling does not even discuss who the citizens were or how they stood to benefit from the transaction. This ruling may be the best authority for treating the three parenthetical requirements as a three-part definition of a transfer in the ordinary course of business.

The IRS disavowed that interpretation in *Stern*, however, and argued in district court that four requirements must be met for a transfer to qualify for the regulatory exception. On appeal, the IRS conceded that Mrs. Stern's political contributions were bona fide, made at arm's length, and free of donative intent; but it contended that the political contributions could not be considered "business transactions" and thus could not meet the fourth requirement of the regulatory exception for transfers in the ordinary course of business. The Fifth Circuit held that the IRS construed the regulation "too narrowly," but it sidestepped the issue of whether the "ordinary course of business" language created a fourth requirement for application of the regulatory exception. Instead, the appellate court cited the *Anderson* holding that a taxpayer need not be engaged in a regular business for a transfer to be made in the ordinary course of a business for gift tax purposes; and the court emphasized the financial motivations for making the campaign contributions in *Stern:*

> The contributions were motivated by appellee's desire to promote a slate of candidates that would protect and advance her personal and property interests.... Mrs. Stern was making an economic investment that she believed would have a direct and favorable effect upon her property holdings and business interests.... [43]

Because the *Stern* court emphasized the effect of the transfers on Mrs. Stern's property interests, the case does not refute the contention that a taxpayer must show some connection between a transfer and business or property interests for the "ordinary course of business" exception to apply. The case does set a low bar for meeting the requirement, however, since Mrs. Stern would benefit only indirectly from the contributions and only if her candidates won.

Under *Stern*, donors to Section 501(c)(4) organizations could meet the "business" requirement, if any, as long as the donee organizations were engaged in activities to further the donors' economic interests, even if the connection was fairly loose. It is less clear whether the exception for transfers in the ordinary course of business can apply to contributions with no plausible connection to donors' financial or property interests. While there is dicta in some cases suggesting that it is sufficient to show that transfers were bona fide, at arm's length, and free of donative intent, no decided case firmly stands for this proposition, and all existing favorable cases could be distinguished on the grounds that the connection to the transferors' property interests was evident from the facts. Following the *Stern* decision, the IRS reportedly announced that it would not in future restrict use of the regulatory exception to business situations, but that position may well have changed in the 30 years since the announcement was made. [44]

Rev. Rul. 68-558 appears to dispense with any requirement that taxpayers demonstrate a connection between their transfers and their business interests. While the IRS disavowed that interpretation in *Stern*, the Tax Court has held that the IRS cannot take litigating positions adverse to taxpayers that contradict published revenue rulings without first withdrawing the rulings. The Tax Court treats such rulings as concessions made by the IRS. [45] Thus, taxpayers should be able to rely on the statement in the revenue ruling that "ordinary course of business" means that the transaction is bona fide, free of donative intent, and made at arm's length. However, since Rev. Rul. 68-558 does not specifically state that no financial or pecuniary connection is required for transfers to be treated as made in the ordinary course of business, the IRS would not necessarily be treated as having conceded the point, especially since the potential benefit to donors from improved business conditions is easy to spot under the facts of the ruling. Thus, there is a risk that a donation unconnected to the donor's financial interests (or adverse to them) will be held to be ineligible for the exception.

Bona fide, at arm's length, and free of donative intent.

Whether or not there is a fourth "ordinary course of business" requirement, the exception in Reg. 25.2512-8 only applies if the three parenthetical elements of the exception are satisfied. The transaction must be bona fide, at arm's length, and free of donative intent.

Bona fide The "bona fide" element requires only that the parties not be involved in a collusive attempt to make the transaction appear to be something it is not. A sale of property for a promissory note is not a bona fide business transaction if the seller has no intention of collecting on the notes, for example. [46]

Arm's length. "Arm's length" is a frequently used term in regulations. It generally refers to dealings between unrelated parties, or to transactions that are similar to transactions between unrelated parties. For example, the transfer pricing rules use an "arm's length standard," meaning that transactions must be consistent with similar transactions between parties that are not commonly controlled. [47] Since many transactions among family members have been found to qualify for the ordinary course of business exception, Reg. 25.2512-8 must be satisfied as long as the taxpayer acts "as one would act in [dealings] with a stranger." [48]

In determining whether a transaction was made at arm's length, courts will at times look for evidence that the parties acted as strangers; in particular, bargaining is an indicia of an arm's-length transaction. [49] Adequacy of consideration is also a factor in determining whether transactions are made at arm's length. [50]

Contributions to organizations do not fit neatly into the usual framework for interpreting the phrase "arm's length." In *Stern*, the district court found that Mrs. Stern's political contributions were made at arm's length, but it did not explain the basis for the finding. The IRS did not dispute this finding on appeal. Perhaps the district court based its conclusion on the fact that Mrs. Stern was unrelated to the candidates she supported, or perhaps the fact that she received full consideration for her transfers (as the district court also held) caused the court to treat them as arm's-length transactions. In Rev. Rul. 68-558, the IRS found that the citizens contributing to a fund that would induce a manufacturing plant to locate in the community acted at arm's length, also without explaining the basis of the decision. There, the "arm's length" finding is probably attributable either to the fact that the parties were unrelated, or the fact that the terms of the subsidy to the manufacturer were negotiated.

Following the *Stern* decision, the IRS announced that in future, it would apply the ordinary course of business exception only to transactions characterized by negotiations or bargaining. [51] This implies that the IRS planned to take the position that something more than a lack of relationship between the parties was required to satisfy the "arm's length" requirement.

When restricted grants are made to Section 501(c)(4) organizations, the "arm's length" requirement will likely be satisfied if the parties are unrelated and engaged in negotiations regarding what the organization would be required to do. The IRS might argue successfully, however, that an unrestricted or generally restricted contribution made without negotiations is not made "at arm's length," even if the parties are not related, because there is no adversity of interest or negotiations. This represents another uncertain issue and another tax risk in relying on the Reg. 25.2512-8 exception.

Free of donative intent. "Donative intent" appears to mean an intent to benefit the other party in the transaction. In *Beveridge*, for example, the court applied the ordinary course of business exception after finding that a mother was "not actuated by love and affection or other motives which normally prompt the making of a gift" in reaching a settlement of threatened suit with her daughter. [52] In *Stern*, the district court held that Mrs. Stern lacked donative intent in making political contributions; a conclusion apparently based on its finding that "[p]laintiff was not motivated by affection, respect, admiration, charity, or like impulses" in making her transfers. [53]

Contributions to Section 501(c)(4) organizations are free of donative intent under this standard if donors are motivated by their desire to have the organizations express their public policy views and advance their government objectives. While *Carson* was decided on policy grounds, as discussed below, the Tax Court opinion in the case recognized that pursuing one's own public policy objectives through political contributions was not an expression of donative intent:

> The facts do not suggest a gift to the candidate, but the use of petitioner's resources to promote the social framework petitioner considered most auspicious to the attainment of his objectives in life. [54]

This suggests that transfers to Section 501(c)(4) organizations for lobbying and public policy activism also would be found to be a use of the donor's resources to promote the donor's own policy goals, a self-interested objective that negates any donative intent in the transfer.

On the other hand, contributions may also be motivated by charitable impulses to the extent that Section 501(c)(4) organizations engage in charitable activity unrelated to any public policy agenda. While Section 501(c)(4) organizations are usually ineligible for

Section 501(c)(3) status because of their lobbying and political activity, they may nevertheless conduct social service programs as part of their mission. One notable example is the Sierra Club's Inner City Outings program for disadvantaged urban youth. Similarly, a donor may conceivably give to a Section 501(c)(4) health maintenance organization to fund care for the poor or health education. A donor making a restricted gift to support such a program appears to be caught between two chairs under the gift tax statute—the motivation is too charitable and "donative" to qualify for the ordinary course of business exception, and yet the gift does not qualify for the charitable gift tax deduction because the recipient organization as a whole is not described in Section 501(c)(3) .

If a donor makes an unrestricted contribution to a Section 501(c)(4) organization, and the organization engages in a variety of activities, a factual issue could arise as to motives of the donor. While a donor could always argue that the transfer was motivated by a desire to advance a policy agenda, the IRS could point to social service programs (and solicitation materials describing such programs) as evidence that the contribution was not entirely free of donative intent. Where gift tax is a concern, then, donors would be in a stronger position if their gifts were restricted to public policy issues.

In sum, contributions motivated by the donor's desire to participate in the political process or affect public policy are arguably free of donative intent under *Stern* and the dicta in *Carson.* If a donation is made to support a social service program, however, the donor may be found to have acted with donative intent.

Applicability of the exemption.

The Reg. 25.2512-8 exception may be available to shelter contributions to Section 501(c)(4) organizations from gift taxation. While no case has applied this exception to such contributions, the argument is strong if the contribution is directed to supporting advocacy or policy change, and thus is free of donative intent; this is particularly true if the terms of the contribution were negotiated, an indicia of an arm's-length transaction. The *Stern* case provides indirect authority for this application of the regulation, since it applied the ordinary course of business exception to campaign contributions.

However, the law is not clear whether there must be some connection to the donor's business interests for the exception to qualify. While there is an IRS revenue ruling and *dicta* from Tax Court cases indicating that a transfer will be in the ordinary course of business if it satisfies the "arm's length" and bona fide requirements and is free of donative intent, there is no explicit authority on point, and a contribution with no nexus to the donor's financial interests may not qualify if the exception is interpreted to require some showing of a connection to the donor's business.

In addition, the IRS could assert that unrestricted or loosely restricted gifts are not made at "arm's length," even though the parties are unrelated, so contributions made via negotiated gift agreements would have a stronger case.

Is there a judicial exception?

In *Carson,* the Tax Court carved out a judicial exception to application of the gift tax for campaign contributions. While conceding that campaign contributions appeared to be taxable gifts "within the letter of the statute," the Tax Court held taxing such transfers as gifts was alien to the purpose of the gift tax statute. Consequently, the Tax Court laid down, and the Tenth Circuit affirmed, a broad rule that "campaign contributions, like those before us, when considered in light of the history and purpose of the gift tax, are simply not 'gifts' within the meaning of the gift tax law." [55] The Tenth Circuit agreed with this reasoning and affirmed the decision.

The Tax Court based its holding on the legislative history of the gift tax, which "clearly demonstrates that [the gift tax] was intended to backstop the estate tax—to impose a tax on *inter vivos* dispositions to beneficiaries that (aside from the time of making the arrangements) are akin to dispositions generally made at death." [56] Campaign contributions were not dispositions that substituted for testamentary transfers, the Tax Court found, thus taxing them would be outside the intended purpose of the statute.

The Tax Court noted that in reenacting the gift tax in 1932, Congress intended to tax property "donatively passed to or conferred upon another." The court cited the following legislative history:

> Since the tax is designed to reach all transfers to the extent that they are donative, and to exclude any consideration not reducible to money or money's worth, it is provided in this section that where the transfer is made for less than an adequate and full consideration in money or money's worth, the excess in value of the property transferred over such consideration shall be deemed a gift." [57]

The Tax Court acknowledged that Congress did not mean "donative" to refer to the test required to make a common law gift, but nevertheless saw in this statement support of a congressional intention to exempt certain transfers from the gift tax. "It apparently contemplated cases that, despite the literal words of the statute and considering all of the facts and circumstances, were simply transfers foreign to the purpose of the statute." [58] The regulatory exception for transfers in the ordinary course of business is consistent with this intent, the court noted.

The Tax Court's reasoning in *Carson* is also applicable to transfers made to Section 501(c)(4) organizations to support lobbying or public policy initiatives. Like campaign contributions, such transfers are a use of the donor's resources to promote the social framework the donor considers most auspicious. Such contributions are not ordinarily devices through which taxpayers transfer wealth to the natural objects of their bounty. Based on *Carson,* an exception to gift taxation could be claimed for Section 501(c)(4) transfers, although the *Carson* court limited its holding to campaign contributions. [59]

A court today may decline to extend this reasoning to a new class of transfers, however. First, the current Supreme Court frowns on creating judicial exceptions based on legislative intent and history, believing the plain language of the statute should prevail. Here, the plain language of Section 2512 appears to create an objective rule that the difference between the amount transferred and the value of the consideration received is gift.

Second, the reasoning of the Tax Court opinion is strained. It cites legislative history stressing that gift tax was intended to apply to donative transfers, but fails to cite the landmark Supreme Court case of *Wemyss*, holding that donative intent is not a necessary element of a taxable gift. The legislative history cited by the court does not establish that Congress intended for there to be exceptions to the tax based on motive or purpose of the donor. On the other hand, the court correctly notes that Reg. 25.2512-8 makes an exception to the general rule that transfers without adequate consideration are gifts, and this exception is based partly on the intentions of the donor. If that regulatory exception is a valid interpretation of the gift tax, then presumably the court is correct that other transfers outside the purpose of the gift tax statute should be exempt from tax.

Third, the enactment of EGTRRA in 2001 undermines the argument that the gift tax and estate tax should be construed as a unified whole. Congress has provided that the gift tax will persist in 2010 while the estate tax is eliminated, implying that Congress now, at least, intends for the gift tax to have a purpose separate from the estate tax.

Finally, even if the *Carson* court was correct that taxing campaign contributions would be foreign to the purpose of the gift tax, a distinction could be drawn between campaign contributions and Section 501(c)(4) contributions. Campaign contributions tend to be for immediate use and so, as noted by the court, they are unlikely to be substitutes for testamentary dispositions. By contrast, contributions to social welfare organizations may be intended to promote social or policy objectives over the long term, and bequests to such organizations are not unheard of in testamentary instruments. Congress has specifically chosen to provide an estate tax deduction for charitable bequests, and to limit that deduction to organizations that are not disqualified from Section 501(c)(3) status because of legislative activities.[60] Arguably, making an *inter vivos* gift to a Section 501(c)(4) entity is a substitute for leaving a bequest and hence should be subject to gift tax in accordance with the purpose of the tax.

In short, it is possible that a court would extend *Carson* to cover contributions to Section 501(c)(4) organizations, but it is far from certain. Such a construction of the statute is perhaps most likely if a reviewing court found that taxing Section 501(c)(4) contributions raised significant constitutional issues, since a "cardinal principal of statutory interpretation" is that "when an Act of Congress raises a serious doubt as to its constitutionality, [the Supreme] Court will first ascertain whether a construction of the statute is fairly possible by which the question may be avoided."[61]

Conclusion

As a matter of tax law, contributions to Section 501(c)(4) organizations could be subject to gift tax. However, no court appears to have considered whether the gift tax may be constitutionally applied to contributions made to Section 501(c)(4) organizations in order to fund lobbying or other expressive activities supported by the donor. The taxability of contributions could be attacked under both the Free Speech and Equal Protection clauses. The nature and legitimacy of such attacks will be examined in a future edition of *Taxation of Exempts.*

Gift Tax Returns

Section 6019 provides that a gift tax return must be filed by every person who made a transfer by gift during the year, but only if the gift did not fall within certain categories. The categories of gifts that do not give rise to a reporting requirement, described in Section 6019(a), include (1) gifts exempt from tax under Section 2503(b) (annual $11,000 exclusion) or Section 2503(e) (education/medical expense exclusion), (2) deductible gifts to spouses, and (3) deductible gifts to charity if certain criteria are met.

In other words, if a person's only gifts during the year fall into these categories, no gift tax return has to be filed. However, if a person must file a gift tax return under Section 6019 because gifts were made during the year that were not within the favored categories), charitable gifts must be reported on the gift tax return with a corporate deduction claimed.

1

Subcommittee on Political and Lobbying Organizations and Activities, Exempt Organizations Committee, ABA Section on Taxation, "Report of Task Force on Section 501(c)(4) and Politics," 1/23/03.

2

See Section 6324(b) (imposing a lien on gift property for unpaid gift taxes); Stephens et. al., *Fed. Estate and Gift Tax'n* (Warren Gorham & Lamont, 2002) (hereinafter Estate & Gift Tax'n), ¶9.04[11].

3

See Reg. 25.2511-1(h)(1); Epstein, 53 TC 459 (1969) (imposing gift tax on shareholders for bargain sales to their family trusts).

4

Prior to the enactment of EGTRRA, Section 2001(c)(2) imposed a 5% surtax on lifetime gifts in excess of $10 million, assessed until the average rate of tax equaled the maximum 55%. The surtax thus eliminated the benefit of the graduated gift tax rate structure for very large givers. It was phased out when the taxpayer's gifts reached $17,184,000, the point at which the taxpayer's average rate of tax on his or her gifts reached 55% percent. EGTRRA eliminated the surtax, but it, too, is to return when the legislation sunsets.

5

See Estate & Gift Tax'n, ¶9.03[2] (describing the changes in gift tax rates made by the EGTRRA).

6

See Section 2505.

7

See Sections 2001(c)(1), (2).

8

Wemyss, 33 AFTR 584, 324 US 303, 89 L Ed 958, 45-1 USTC ¶10179 (1945); Reg. 25.2512-8.

9

See Stern, 27 AFTR 2d 71-1647, 436 F2d 1327, 71-1 USTC ¶12737 (CA-5, 1971) (stating the "general rule that a transfer of property, to avoid characterization as a taxable gift, must be for full and adequate consideration"); Berkman, TC Memo 1979-46, PH TCM ¶79046, 38 CCH TCM 183 (accord).

10

See, e.g., Wells Fargo Bank New Mexico, 91 AFTR 2d 2003-857, 319 F3d 1222 (2003); Estate of Lang, 45 AFTR 2d 80-1756, 613 F2d 770, 80-1 USTC ¶13340 (CA-9, 1980); Estate of Christ, 54 TC 493 (1970).

11

See Wells Fargo Bank New Mexico, *supra* note 10; Weller, 38 TC 790 (1962).

12

See Stern, *supra* note 9 (describing Reg. 25.2512-8 as an exception to the general rule); Berkman, *supra* note 9 (accord).

13

Estate of Anderson, 8 TC 706 (1947) (holding that bargain sales of stock to employees did not give rise to taxable gifts).

14

The annual exclusion amount is $10,000, adjusted for inflation since 1998, but only in increments of $1,000. The annual exclusion amount was first adjusted for inflation (from $10,000 to $11,000) in 2002. See Rev. Proc. 2001-59, 2001-2 CB 623; Rev. Proc. 2001-13, 2001-1 CB 337. Gifts of future interests in property are not eligible for the annual exclusion, even if their value is less than $11,000. See Section 2503(b)(1).

15

See Section 2522. Some gifts of partial interests in property are not eligible for the gift tax charitable deduction. See Section 2522(c); Reg. 25-2522(c)-3. Such gifts are theoretically subject to gift tax.

16

Unlike contributions to Section 501(c)(3) organizations, contributions to Section 527 organizations do not need to be reported on gift tax returns, even if the donor files a return to report other gifts made during the year. See the Instructions for Form 709, "United States Gift (and Generation-Skipping Transfer) Tax Return" (2002), page 5.

17

See GCM 38930, 12/3/82; Rev. Rul. 59-57, 1959-1 CB 626.

18

Carson, 71 TC 252 (1978), *acq'g in result*, 1982-2 CB 1, *aff'd* 47 AFTR 2d 81-1619, 641 F2d 864, 81-1 USTC ¶13396 (CA-10, 1981); Stern, 24 AFTR 2d 69-6101, 304 F Supp 376, 70-1 USTC ¶12640 27 AFTR 2d 71-1647, 436 F2d 1327, 71-1 USTC ¶12737 (DC La., 1969), *aff'd* 436 F.2d 1327, 27 AFTR2d 71-1647 (CA-5, 1971).

19

See Est. of Blaine, 22 TC 1195 (1954) (donations to a social welfare organization taxable because charitable gift deduction did not apply); DuPont, 40 AFTR 915, 97 F Supp 944, 51-1 USTC ¶10810 (1951) (donations to apparent social welfare organization taxable, rejecting argument that such donations were not "gifts" because donor received consideration); Falkner, 41 BTA 875 (1940) (donations to Birth Control League of Massachusetts taxable because organization failed to qualify for charitable gift deduction due to its legislative activities), *mod. by* 42 BTA 1019 (1940) (charitable gift deduction applicable in light of appellate court finding that recipient organization was qualified charitable donee).

20

See Section 7701(a)(1). Rev. Rul. 82-216 finds some indirect support in Reg. 25.2511-1(h)(1), although the regulation is not cited in the ruling. Reg. 25.2511-1(h)(1) states that the transfer of property to a corporation is generally treated as a gift to the shareholders in proportion to their interests in the corporation, but provides that "[t]here may be an exception to this rule, such as a transfer made by an individual to a charitable, public, political or similar organization which may constitute a gift to the organization as a single entity ... "

21

See Carson, *supra* note 18, and Stern, *supra* note 18.

22

In DuPont, *supra* note 19, a district court considered whether the transfer at issue was a gift; this case is discussed in detail below. In Blaine, *supra* note 19, and Falkner, *supra* note 19, the court considered only whether the charitable gift tax deduction applied.

23

DuPont, *supra* note 19 at 97 F. Supp. 946.

24

See *Id.*

25

Section 101(8) of the 1939 Code provided exemption for social welfare organizations; the text of the statute was identical to current Section 501(c)(4)(a).

26

DuPont, *supra* note 19 at 945.

27

Id. at 946.

28

Id. at 947.

29

Stern, *supra* note 18 at 304 F.Supp. 377.

30

Carson, *supra* note 18 at 71 TC 258.

31

Id. at 270 (Chabot, J., dissenting).

32

C.f. Carson, *supra* note 18 at 71 TC 258 fn. 6 (declining to make any distinction between the taxpayer's independent expenditures on behalf of a candidate and his contributions to campaign committees).

33

This view is expressed in Shindler, "Donations for Political Campaigns as Transfers in the Ordinary Course of Business," 46 Tul. L. Rev. 344 (December 1971).

34

See Stern, *supra* note 9.

35

The opinion states that the IRS "relied on" Deputy v. DuPont, 23 AFTR 808, 308 US 488, 84 L Ed 416, 40-1 USTC ¶9161 (1940) and Welch v. Helvering, 12 AFTR 1456, 290 US 111, 78 L Ed 212, 3 USTC ¶1164 (1933), cases holding that a shareholder cannot deduct payments made on behalf of a corporation as business expenses because the shareholder is not personally engaged in a business. Hence, the IRS must have argued that transfers were not in the ordinary course of business for gift tax purposes because the transferors were not engaged in a business, as that term is construed for income tax purposes. The Tax Court rejected the argument, stating that the considerations underlying the income tax decisions were not relevant for gift tax purposes.

36

See Estate of Anderson, *supra* note 13, (emphasis in original).

37

See Estate of Hendrickson, *TCM 1999-278*, (applying Estate of Anderson, *supra* note 13).

38

See Harris, 39 AFTR 1002, 340 US 106, 95 L Ed 111, 50-2 USTC ¶10786 (1950). The Court argued that a marital property settlement was comparable to the "unscrambling of the business interests" of partners in a dissolving partnership, and should therefore be similarly free of gift tax.

39

Beveridge, 10 TC 915 at 918 (1948).

40

Hull, TC Memo 1962-199, PH TCM ¶62199, 21 CCH TCM 1076 at 62-1187.

41

Berkman, TC Memo 1976-46, PH TCM ¶76046, 35 CCH TCM 199, 38 CCH TCM 903 (emphasis added).

42

See, e.g., Harris, *supra* note 38 at 340 U.S. 112 (comparing a marital property settlement to a partnership dissolution); Stern, *supra* note 9 (see below); Beveridge, *supra* note 39 (taxpayer's payment to settle a claim was "advantageous economically," and "the value of the property defended [through the settlement] was substantial").

43

Stern, *supra* note 18 at 436 F.2d 1330.

44

See Faber, "Gift Tax Planning," 31st Annual NYU Inst. 1217, (1973), citing Technical Information Release No. 1125 (12/17/71).

45

See Rauenhorst, 119 TC 157 (2002).

46

See Minnie Deal, 29 TC 730 (1958); Rev. Rul. 77-299, 1977-2 CB 343.

47

See Reg. 1.482-1(b).

48

See Beveridge, *supra* note 39.

49

See Cullison, TC Memo 1998-216, RIA TC Memo ¶98216, 75 CCH TCM 2490 *aff'd without published opinion*, 221 F.3d 1347, AFTR2d 2000-1908 (CA-9, 2000); Natkanski TC Memo 1992-380, RIA TC Memo ¶92380, 64 CCH TCM 55 (presence or absence of negotiations was a factor in whether interfamily transfers were made in the ordinary course of business); Shelton v. Lockhart, 52 AFTR 303, 154 F Supp 244, 57-2 USTC ¶11722 (DC Mo., 1957) (emphasizing lengthy negotiations that led to the transfer). Adversity of interests is another factor that may be considered. C.f. Creme Manu. Co., 33 AFTR 2d 74-1543, 492 F2d 515, 74-1 USTC ¶16137 (CA-5, 1974) (to be at arm's length under Section 4216, transaction must be between parties with adverse interests).

50

See Saltzman, *1994-641*, *rev'd on other grounds*, 80 AFTR 2d 97-8365, 131 F3d 87, 98-1 USTC ¶50164 (CA-2, 1997) (adequacy of consideration is a factor in determining whether a transaction is made at arm's length and free of donative intent).

51

See Faber, *supra* note 44.

52

See Beveridge, *supra* note 39; *accord* Est. of Noland, TC Memo 1984-209, PH TCM ¶84209, 47 CCH TCM 1640

53

Stern, *supra* note 18 at 304 F. Supp. 378.

54

See Carson, *supra* note 18 at 71 TC 258.

55

Carson, *supra* note 18 at 71 TC 263.

56

Id. at 71 TC 261.

57

Id. (citing H. Rep't No. 72-708, 72d Cong., 1st Sess. (1932), 1931-1 CB (Part 2) 477-48).

58

Carson, *supra* note 18 at 71 TC 261.

59

See Carson, *supra* note 18 at 71 TC 260, fn. 9 (distinguishing DuPont, *supra* note 19).

60

See Section 2055.

61

See Zadvydas v. Davis, 533 US 678, 150 L Ed 2d 653 (2001) (internal quotations omitted).