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I.R.S. Moves to Tax Gifts to Groups Active in Politics

By STEPHANIE STROM

Big donors like David H. Koch and George Soros could owe taxes on their millions of dollars in contributions to nonprofit advocacy groups that are playing an increasing role in American politics.

Invoking a provision that had rarely, if ever, been enforced, the Internal Revenue Service said it had sent letters to five donors, who were not identified, informing them that their contributions may be subject to gift taxes depending on whether the donations exceeded limits under the tax laws.

These advocacy groups have been drawing more scrutiny, from President Obama as well as others, as they have proliferated and funneled vast sums of money in support of campaigns and causes, without having to publicly disclose their donors.

During the midterm cycle, for example, groups like Crossroads GPS, which has ties to the Republican strategist Karl Rove, and Americans for Prosperity, backed by Mr. Koch and his brother Charles, were heavily involved in politicking, spurring campaign finance watchdogs to complain that they were flouting election and nonprofit laws.

Spokesmen for the Koch brothers and for Mr. Soros would not comment as to whether they had paid gift taxes on these types of donations, or whether they had received letters from the I.R.S.

These organizations were established as nonprofit corporations under a section of the tax law, 501(c)(4), and the rules governing them say their primary purpose cannot be political.

The timing of the agency's moves, as the 2012 election cycle gets under way, is prompting some tax law and campaign finance experts to question whether the I.R.S. could be sending a signal in an effort to curtail big donations.

"There are a whole heck of a lot of people misusing (c)(4) groups as a means of getting around campaign finance regulations, and we lack a coherent system of laws to deal with that," said Donald B. Tobin, a legal expert on campaign finance and tax laws at the Moritz College of Law at Ohio State University. "Now here's a stick, frankly, that says there are consequences for doing that."

In a statement released Thursday, Michelle L. Eldridge, a spokeswoman for the I.R.S., said that the inquiries were initiated by agency employees, not White House or other Obama administration officials, "as part of their increased efforts in the area of nonfiling of gift and estate tax returns."

The letters informed donors that investigations had been opened to determine why a gift tax form had not been filed, and requested that donors submit records of all donations in the year 2008, according to a redacted copy obtained by The New York Times.

While tax lawyers who learned of the investigations have been issuing warnings to clients of potential trouble on a broader scale, the I.R.S. statement denied casting a wider net, "These examinations are not part of a broader effort looking at donations to 501(c)(4)'s."

The White House would not comment. Some members of Congress have been asking the I.R.S. to investigate the tax-exempt status of these groups, too, although lawmakers have also cautioned that since the Nixon years, the agency has been strictly prohibited from what could be considered politically motivated inquiries.

Still, experts are sensing that the message being sent may deter large donations to these groups, at a time when big corporate, union and like-minded political contributions are expected to flood the election cycle through the barriers lifted by last year's Supreme Court ruling in the Citizens United case.

Both major political parties and candidates have benefited from these types of organizations, but the Republican groups grew in force and size after the 2008 election, partly in recognition of Mr. Obama's proficiency at fund-raising. For example, Mr. Rove's group, one of the best known from the 2010 midterm cycle, raised $70 million. Americans for Prosperity, a libertarian group that is opposed to many of President Obama's policies, has been generously financed by David Koch.

Democrats have embraced the model, too. Bill Burton, Mr. Obama's former deputy press secretary, was skewered by critics of these groups for creating Priorities USA Action to help Democrats. In 2009 and 2010, Mr. Soros, the billionaire investor, donated more than $12 million to advocacy groups.

In general, individuals incur gift taxes of 35 percent on any amount exceeding $13,000 in a year, with a limit for couples of $26,000. A lifetime exemption covers $5 million in gifts — to be reduced to $1 million in 2013 — but experts say many wealthy donors are likely to have used that in their estate plans.

The I.R.S. definitively declared these gifts taxable in 1982. "That was their last word on it, so these letters just look like a sort of trap for the unwary, which is not fair," said Ofer Lion, a lawyer who has written about the issue.

In December, after the 2010 midterm elections, officials with the I.R.S. division that oversees tax-exempt organizations indicated it would pay closer attention.

But at a meeting of an American Bar Association subcommittee last Friday, they were surprised to learn that their colleagues in the estate and gift tax unit also had an increased interest, according to lawyers who were there.

"I don't know how extensive this effort is, but I have one such client and I've spoken with others with clients who have received similar letters," said Gregory L. Colvin, a lawyer specializing in nonprofit law.

Other groups rarely receive donations big enough to incur the gift tax, which is why many of them have established affiliated charities. Charities, unlike almost all other tax-exempt organizations, offer their donors a tax deduction and so attract large gifts.

Big donations to the largely unregulated 527 groups that were influential in the 2004 election cycle are not subject to the gift tax. "Congress specifically exempted donors to 527 organizations from the gift tax in 2000, but it didn't exempt contributions to (c)(4) groups because there wasn't an issue at the time," said Alan P. Dye, a lawyer who represents a number of conservative advocacy groups. Now that the Citizens United case permits big donors like corporations and unions to spend money in elections, Mr. Dye added, "I think it's going to be really interesting to see how this plays out in Congress or the courts."

In the meantime, Marcus S. Owens, a lawyer who represents nonprofits and who formerly headed the I.R.S. division that oversees tax-exempt organizations, predicted that the tax agency's moves would be watched warily by contributors. "The lack of clarity and the potential for not-insignificant taxation on these gifts will cause many of the biggest donors to think twice," he warned.