SOCIAL WELFARE ORGANIZATIONS AS GRANTMAKERS

*David S. Miller**

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Introduction

In 2017, Jeff Bezos, the founder of Amazon and the richest person in the world,[1] tweeted asking for suggestions for his philanthropic giving.[2] The world responded with proposals for his largesse.[3] This Article instead suggests a legal structure for his grantmaking—a social welfare organization—that has many advantages (and some disadvantages) over a private foundation or a limited liability company (an "LLC").

Private foundations are a common grantmaking vehicle for the super wealthy. However, they have drawbacks. Bill Gates (the second richest person in the world),[4] with his wife Melinda, established a private foundation as the vehicle to receive their wealth and make grants. In 2015, Warren Buffett gave over $2.15 billion of appreciated Berkshire Hathaway shares to that private foundation[5]—the Bill & Melinda Gates Foundation (the "Gates Foundation"). Yet, Buffett could not use any appreciable amount of his charitable deduction and, as a private foundation, the Gates Foundation is subject to a long list of restrictions, limitations, and taxes.[6]

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1. *The World's Billionaires List*, Forbes, https://www.forbes.com/billionaires/list/#version:realtime (last updated Aug. 16, 2018).

2. Nick Wingfield, *Jeff Bezos Wants Ideas for Philanthropy, So He Asked Twitter*, N.Y. Times (June 15, 2017), https://www.nytimes.com/2017/06/15/technology/jeff-bezos-amazon-twitter-charity.html.

3. *See, e.g.*, Brian Manzullo, *Madonna Urges Billionaire Jeff Bezos to Invest in Detroit*, Detroit Free Press (June 20, 2017, 10:59 AM), http://www.freep.com/story/news/local/michigan/detroit/2017/06/20/madonna-jeff-bezos-detroit/411588001/ ("@jeffbezos you, me, the motor city. Let's go and I will show incredible opportunities for almost instant impact in one of the coolest cities in America #Detroit").

4. *See* Forbes, *supra* note 1.

5. Actually, Buffett's donation of $2.15 billion in Berkshire Hathaway stock was made to the Bill & Melinda Gates Foundation Trust (the "Trust"). The Trust holds and invests the assets for the Gates Foundation and periodically makes grants to the foundation. *Financials*, Bill & Melinda Gates Found., http://www.gatesfoundation.org/who-we-are/general-information/financials (last visited Jan. 20, 2019) ("In October of 2006, our trustees created a two-entity structure: the Bill & Melinda Gates Foundation (foundation) and the Bill & Melinda Gates Foundation Trust (trust). Both entities are tax-exempt private foundations that are structured as a charitable trust. . . . The foundation works to reduce inequities around the world. . . . Its trustees are Bill and Melinda Gates, and Warren Buffett. The trust holds the donated investment assets from Bill and Melinda Gates, and receives contributions from Warren Buffett. The primary role of the trust is to manage the investment assets and transfer proceeds to the foundation as necessary to achieve the foundation's charitable goals. Its trustees are Bill and Melinda Gates.").

6. Private foundations are subject to: (i) a limitation on income and assets being used exclusively for charitable purposes and not for "private interests," I.R.C. § 501(c)(3) (2012); (ii) a 1% or 2% annual excise tax, *id.* § 4940, or, for foreign private foundations, a 4% excise tax on U.S.-source income, *id.* § 4948(a); (iii) a 5% annual distribution requirement, *id.* § 4942; (iv) a prohibition on lobbying, *id.*

These restrictions and limitations are the quid pro quo to deduct a charitable contribution to a private foundation. So onerous are these restrictions and limitations that while the Gates Foundation welcomed Warren Buffett's gift, it discourages all other donations, instead encouraging prospective donors to give directly to the foundation's grantees, or to Gates Philanthropy Partners,[7] which are public charities.

Jeff Bezos sells about $1 billion of his Amazon stock each year to fund his rocket company, Blue Origin,[8] so, unlike Warren Buffett, he might actually be able to use some amount of charitable deductions. But what if he, like Warren Buffett, cannot take the deduction or is willing to forgo it? Can he avoid the private foundation limitations and restrictions?

Mark Zuckerberg and his wife, Dr. Priscilla Chan, have avoided the private foundation limitations and restrictions by holding their Facebook stock in an LLC they own.[9] It is not clear whether Zuckerberg and Chan intend to use the LLC as a grantmaking vehicle or whether they intend to donate the Facebook stock to some other tax-exempt entity. Although an LLC provides maximum flexibility be-

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§§ 4945, 4911; (v) a prohibition on participating in political campaigns, *id.* §§ 4945, 4955; (vi) strict "self-dealing" rules, *id.* § 4941; (vii) a prohibition on "excess business holdings," *id.* § 4943; (viii) compliance with the "expenditure responsibility rules," *id.* § 4945; (ix) a prohibition on investments that jeopardize charitable purposes, *id.* § 4944; and (x) a requirement that donors be disclosed, *see* Treas. Reg. § 301.6104(d)-1(b)(4)(ii) (as amended in 2005) ("In the case of a tax-exempt organization other than a private foundation, the term annual information return does not include the name and address of any contributor to the organization.").

7. *See Foundation FAQ*, BILL & MELINDA GATES FOUND., http://www.gatesfoundation.org/Who-We-Are/General-Information/Foundation-FAQ (last visited Jan. 20, 2019) ("Q. Does the foundation accept donations? A. The Bill & Melinda Gates Foundation is proud of what our grantees do to improve the lives of people who have the most urgent needs and the fewest champions. We encourage people who want to advance these causes to give directly to our grantees. We prefer that people give directly to our grantees, but from time to time, individuals generously offer to contribute money to the Bill & Melinda Gates Foundation. In response, we created Gates Philanthropy Partners, a 501(c)(3) public charity closely affiliated with the foundation. Gates Philanthropy Partners disburses donor contributions in alignment within the foundation's programmatic objectives.").

8. *Bezos Is Selling $1 Billion of Amazon Stock a Year to Fund Rocket Venture*, CNBC (Apr. 6, 2017, 8:05 AM), http://www.cnbc.com/2017/04/06/bezos-is-selling-amazon-stock-to-fund-rocket-venture.html.

9. *See* Natasha Singer & Mike Isaac, *Zuckerberg's Philanthropy Uses L.L.C. for More Control*, N.Y. TIMES, Dec. 3, 2015, at B1 ("The L.L.C. structure gives Mr. Zuckerberg and Dr. Chan more flexibility in investing in for-profit social enterprises and also supporting political causes, allowing them a freer hand. That is because an L.L.C. has fewer rules than a traditional foundation, such as the 5 percent requirement.").

cause it allows its owners to use the LLC's assets for any purpose without restriction,[10] the Facebook shares held in Zuckerberg and Chan's LLC are treated as owned by the couple for income and estate tax purposes and therefore are subject to income and estate tax with respect to them.[11] Moreover, expenses of an LLC owned by individuals and not engaged in a business are not generally deductible.[12] For these reasons, while an LLC offers maximum flexibility, an LLC is not the ideal vehicle for grantmaking.

But another philanthropic entity exists. Section 501(c)(4) social welfare organizations are not subject to the private foundation rules. The assets of a § 501(c)(4) organization need not be used exclusively for charitable purposes; instead, the assets may be used for more relaxed social welfare purposes and may benefit private interests so long as providing private benefits is not the primary activity of the organization.[13]

Section 501(c)(4) organizations are also not subject to the one percent or two percent annual excise tax,[14] or the five percent annual distribution requirement.[15] They may engage in unlimited lobbying,[16] and may participate in political campaigns.[17] They are not subject to the strict self-dealing rules applicable to private foundations;[18] instead, they are subject to the more relaxed "excess benefit transaction" rules.[19] In addition, § 501(c)(4) social welfare organizations are not subject to the expenditure responsibility rules,[20] the excess business

10. *See id.*

11. *See* Treas. Reg. § 301.7701-2(c)(1), (2)(i) (as amended in 2016) (a business entity, such as an LLC, with two or more owners is generally treated as a partnership, and a business entity with a single owner is generally disregarded for federal tax purposes).

12. *See* I.R.C. § 67(g) (miscellaneous itemized deductions are not permitted from 2018 through 2025).

13. *Compare* I.R.C. § 501(c)(3), *with id.* § 501(c)(4).

14. *See id.* § 4940. The excise taxes in §§ 4911-4945 apply only to private foundations. Private foundations include only organizations described in § 501(c)(3). *See id.* § 509(a).

15. *See id.* § 4942.

16. *See* Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (as amended in 1990) (social welfare organizations may engage in lobbying). *Compare id.*, *with* Treas. Reg. § 53.4945-2 (as amended in 1990) ("taxable expenditure" includes amounts paid by a private foundation to attempt to influence legislation).

17. *See* Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (as amended in 1990). *Compare id.*, *with* I.R.C. § 4955 (tax on political expenditures).

18. I.R.C. § 4941.

19. *Id.* § 4958.

20. *Id.* § 4945.

holdings rules,[21] or the jeopardizing charitable purpose rules,[22] and they need not disclose their donors.[23]

While a donation to a social welfare organization is not deductible, a social welfare organization would offer Bezos an income tax benefit that is often far more valuable to high net-worth individuals and C corporations: nonrecognition of the gain on donations of appreciated property.[24] So Jeff Bezos could contribute his Amazon stock to a social welfare organization and avoid tax on the appreciation.

Until 2015, the cloud of potential gift tax on donations to social welfare organizations hung over their use for grantmaking.[25] In 2015, Congress added § 2501(a)(6),[26] which provides that lifetime gifts to § 501(c)(4), § 501(c)(5) and § 501(c)(6) organizations are not subject to gift tax.[27] With the gift tax cloud now lifted, social welfare organizations are the ideal tax-exempt entity to receive donations from donors who cannot use a charitable deduction or who are willing to forgo the deduction for significantly greater flexibility.[28] Although a social welfare organization is not as flexible as Zuckerberg and Chan's LLC, a social welfare organization would save Bezos from income and estate tax with respect to any Amazon shares he donates to it.

This Article discusses the use of social welfare organizations as an alternative to § 501(c)(3) private foundations and LLCs for receiving donations and making grants. Part I discusses social welfare organizations generally and contrasts them with private foundations. Part I also discusses the new notification requirement for social welfare organizations; whether testamentary gifts to social welfare organizations

21. *Id.* § 4943.

22. *Id.* § 4944.

23. *See id.* § 6104(d)(3) (name and address of any contributor need not be disclosed for organizations that are not private foundations or § 527 organizations).

24. Because the charitable deduction of C corporations is limited to ten percent of their adjusted gross income, *id.* § 170(b)(2)(A), charitable deductions are often not valuable to them either.

Section 84 provides that the transfer of appreciated property to a § 527 political organization is treated as a sale of appreciated property, and the transferor is treated as having realized an amount equal to the fair market value of the property on the date of transfer. However, § 84 applies only to transfers to political organizations.

25. In Revenue Ruling 82-216, 1982-2 C.B. 220, the IRS held that gifts to § 501(c) organizations, other than § 501(c)(3) organizations, were subject to gift tax. However, the gift tax was not enforced.

26. Consolidated Appropriations Act of 2016, Pub. L. No. 114-113, Div. Q, tit. IV, sec. 408(a), § 2501(a), 129 Stat. 2242, 3120.

27. I.R.C. § 2501(a)(6).

28. Charitable deductions for U.S. taxable corporations are limited to ten percent of their adjusted gross income, *id.* § 170(b)(2)(A), and so corporations also may not be able to use a charitable deduction.

are subject to estate tax; and when § 2036(a)(2) could cause the donor's estate to include the assets he or she contributed to a social welfare organization. Part II discusses the use and potential advantages of foreign social welfare organizations. Foreign welfare organizations may be used by foreign donors, by U.S. donors to avoid a future change in U.S. law, or by either to achieve some measure of anonymity. Part III discusses some case studies. Part IV explains some disadvantages of social welfare organizations.

Social welfare organizations are particularly attractive grantmaking entities for the super wealthy like Jeff Bezos. Part V explains why this is and how the law could be corrected to prevent it.

I.
Domestic Social Welfare Organizations

A. *Generally*

Section 501(c)(4) of the Internal Revenue Code (the "Code") provides tax exemption for "[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare."[29] Very generally, a social welfare organization must be engaged in the promotion of the common good and general welfare of those in a "community."[30] Since the promotion of social welfare is described in § 501(c)(3), social welfare organizations can generally engage in the activities in which a § 501(c)(3) organization can engage. However, because donations to social welfare organizations are not deductible for income tax purposes, these organizations have significantly more flexibility.

First, a social welfare organization can benefit classes or a community that would not be charitable for purposes of § 501(c)(3) and can provide private benefits so long as providing private benefits is not the organization's primary activity. Thus, an organization whose sole activity is the beautification of a single city block can qualify as a social welfare organization under § 501(c)(4) because the beautification of a single city block promotes the general welfare of the people of the community as a whole. The organization may qualify under § 501(c)(4) even if the organization's activities will practically assure its members that their property values will increase (thereby providing its members with private benefits), so long as providing private bene-

29. *Id.* § 501(c)(4); Treas. Reg. § 1.501(c)(4)-1(a)(1) (as amended in 1990).

30. Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (as amended in 1990); *see also* Erie Endowment v. United States, 316 F.2d 151, 156 (3d Cir. 1963); Rev. Rul. 76-147, 1976-1 C.B. 151, 1976 WL 36305.

fits is not the organization's primary purpose. Such an organization does not qualify under § 501(c)(3) because the private benefits it provides are considered substantial.[31]

Second, an organization that promotes a political ideology or is seeking to legalize an illegal activity may be exempt as a social welfare organization, even if it would not qualify under § 501(c)(3).[32] A social welfare organization, in contrast to a § 501(c)(3) organization, also may engage in an unlimited amount of lobbying activity,[33] and can engage in some amount of political activity.[34]

Third, as mentioned above, social welfare organizations are not subject to the private foundation rules.[35] They may accumulate unlimited endowments, avoid the excise tax on investment income, and skirt the prohibition against excess business holdings. Therefore, social welfare organizations may hold all of the stock of a for-profit subsidiary indefinitely. Had Newman's Own, Inc., the food product company created by Paul Newman, been given to a social welfare organization rather than to Newman's Own Foundation, a private foundation, the organization would not have experienced the existential crisis that Newman's Own Foundation underwent, which ultimately required Congress's eleventh hour amendment of § 4943 to save Newman's Own Foundation from the excess business holding excise tax.[36]

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31. Rev. Rul. 75-286, 1975-2 C.B. 210. Similarly, a garden club that holds social functions for the benefit, pleasure, and recreation of its members constitutes a social welfare organization and not a § 501(c)(3) organization. Rev. Rul. 66-179, 1966-1 C.B. 139. However, the IRS has denied § 501(c)(4) status to an organization whose purpose was to increase the involvement of women from a single political party because its primary activity was to provide private benefits. *See* I.R.S. Priv. Ltr. Rul. 2012-14035 (Apr. 6, 2012), 2012 WL 1139115.

32. Debs Mem'l Radio Fund, Inc. v. Comm'r, 148 F.2d 948, 949, 951-52 (2d Cir. 1945) (organization that operates a radio station committed to progressive ideals treated as a social welfare organization); Rev. Rul. 76-81, 1976-1 C.B. 156 (anti-abortion rights organization); Rev. Rul. 68-656, 1968-2 C.B. 216 (organization seeking to legalize an illegal activity treated as a social welfare organization).

33. I.R.S. Priv. Ltr. Rul. 2012-24034 (June 15, 2012), 2012 WL 2164601.

34. Rev. Rul. 81-95, 1981-1 C.B. 332; Letter from Internal Revenue Serv. 5228 (Sept. 2013), https://www.irs.gov/pub/irs-tege/letter5228.pdf (organizations that devote less than forty percent of both spending and time to political campaigns can self-certify social welfare status); I.R.S. Priv. Ltr. Rul. 2012-14035 (Apr. 6, 2012), 2012 WL 1139115 (eighty percent political activity is too much).

35. *See* I.R.C. § 509(a) (2012).

36. *See* Bipartisan Budget Act of 2018, Pub. L. No. 115-123, § 41110, 132 Stat. 64, 159-60 (to be codified at I.R.C. § 4943(g)); Colleen Murphy, *Paul Newman's Foundation Fights Looming 200 Percent Tax*, BLOOMBERG: DAILY TAX REPORT (Aug. 17, 2016), https://www.bna.com/paul-newmans-foundation-n73014446520/.

Along the same vein, a New York not-for-profit reportedly owns more than twenty-nine percent of China's HNA Group.[37] If it receives its exemption under § 501(c)(3), it is likely to run into similar problems as Newman's Own Foundation, but is unlikely to benefit from a Newman's Own type of legislative fix. And if the donor is indeed a Chinese resident (and not a U.S. taxpayer), nothing would be lost by forming the not-for-profit as a social welfare organization.

Finally, grantmaking social welfare organizations are not subject to the expenditure responsibility rules[38] and therefore have much more flexibility to make grants to foreign organizations than would a private foundation.

B. Filing Requirements

Section 506 of the Code requires a social welfare organization to file an IRS Form 8976 notifying the Internal Revenue Service ("IRS") of its intention to operate under § 501(c)(4) within 60 days after the date of its organization. The Code does not, however, require that a social welfare organization file an IRS Form 1024 to obtain tax-exempt status, although it may choose to do so.[39]

Social welfare organizations are also required to file IRS Form 990. Failure to file a Form 990 for three consecutive years results in a loss of exemption, which is not restored until the organization actually files a Form 1024.[40]

C. Testamentary Gifts to Social Welfare Organizations

Bequests to a social welfare organization do not appear to qualify for an estate tax deduction. Section 2055(a)(2) provides for a deduction for estate tax purposes for donations to certain organizations.[41]

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37. Michael Forsythe & Alexandra Stevenson, *Murky Firm Is Behind a Donation of $18 Billion*, N.Y. TIMES, July 28, 2017, at B1.

38. Treas. Reg. § 53.4945-5 (as amended in 2015).

39. Section 501(c)(3) organizations must file an IRS Form 1023 to seek recognition of their tax-exempt status. Treas. Reg. § 1.508-1(a) (as amended in 2017). Social welfare organizations must only notify the IRS of their intention to operate as a § 501(c)(4). I.R.C. § 506.

40. I.R.C. § 6033(j)(1), (2).

41. *Id.* § 2055(a)(2) (providing for deduction for donations "to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not

Section 2055(a)(2) is almost, but not quite, identical to § 501(c)(3)—the words "including the encouragement of art" appear in the former but not the latter.[42]

Assume that a social welfare organization's certificate of incorporation provides (1) for purposes described in § 2055(a)(2) and (2) that it may substantially benefit private interests but benefitting private interests is not its primary purpose. This organization would qualify as a social welfare organization but not as a § 501(c)(3) organization.[43]

Arguably, because such an organization may substantially benefit private interests, it does not operate "exclusively" for the purposes described in § 2055(a)(2). However, the private benefit doctrine appears in Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii), and not in the body of § 501(c)(3), and the regulations under § 2055(a)(2) do not refer to § 501(c)(3) and do not necessarily incorporate the regulations under § 501(c)(3). Therefore, there is an argument that § 2055 does not apply.

However, in light of the close similarity between the statutory language of §§ 501(c)(3) and 2055(a)(2), § 2055(a) appears to have the same scope as § 501(c)(3). It is damning that Congress specifically amended § 2501(a) to provide that gifts to social welfare organizations are not subject to gift tax, but left § 2055(a)(2) alone, strongly implying that bequests to social welfare organizations are subject to estate tax.

D. Section 2036(a)(2) and the Prohibition on Donor Management

Under § 2036(a)(2), the value of a decedent's estate includes the value of any property that the decedent transferred to another (other than pursuant to an arm's length sale) if the decedent retained the right for life to designate the persons who will possess or enjoy the transferred property.[44]

In Revenue Ruling 72-552,[45] the decedent organized a § 501(c)(3) organization and transferred property to it. At his death, the decedent was a member of the organization (and therefore was one of the people who named the board of directors), a member of the

participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office").

42. *Compare id.*, *with id.* § 501(c)(3).

43. Because the organization would not be described in § 501(c)(3), § 508(a) would not appear to apply. Section 508(a) requires that organizations described in § 501(c)(3) must apply for an exemption.

44. I.R.C. § 2036(a)(2).

45. Rev. Rul. 72-552, 1972-2 C.B. 525.

organization's board of directors, and its president. The Revenue Ruling provided that the decedent's position as a member of the organization gave him the right, in conjunction with others, to designate the persons who would possess or enjoy the property transferred to the § 501(c)(3) organization. Because of this, § 2036(a)(2) caused the property to be included in the decedent's estate.[46] The reasoning of Revenue Ruling 72-552 seems equally applicable to donations to social welfare organizations. Accordingly, if a donor also directly or indirectly has the right to choose grant recipients throughout his or her life, the donor's estate would appear to include the donation.

Two solutions suggest themselves. First, the taxpayer could step away from the grantmaking function, and not be a member of the organization, a director, or an officer with the authority to participate in grantmaking.[47] Alternatively, the social welfare organization's documents could provide that, upon the donor's death, all remaining assets of the social welfare organization will be transferred to one or more § 501(c)(3) organizations. The rationale for this solution is that, if the donor's estate is deemed to include the assets of the social welfare organization, the estate would receive an estate tax charitable deduction upon the transfer of its assets to the § 501(c)(3) organizations.[48]

II.
Foreign Social Welfare Organizations

A. Advantages of a Foreign Social Welfare Organization

Once a U.S. donor is willing to forgo a charitable deduction, then there is no tax benefit to using a domestic social welfare organization; a foreign one is just as good, and sometimes better.[49]

Assume that a domestic social welfare organization wishes to borrow to purchase a domestic taxable bond, or foreign stocks or bonds. The borrowing would give rise to unrelated debt financed income and the domestic organization would be subject to tax.[50] However, if the social welfare organization is foreign, then it could rely on the portfolio interest exemption—rather than its tax-exempt status—to

46. *Id.*

47. If the donor had these rights and gave them up within three years of death, the donation could still be included in his estate. *See* I.R.C. § 2038.

48. *See id.* § 2055.

49. Foreign social welfare organizations are subject to lobbying registration requirements and prohibitions on campaign contributions. *See* Foreign Agents Registration Act, 22 U.S.C. § 611 *et seq.*; Federal Election Campaign Act, 52 U.S.C. § 30121; 11 C.F.R. § 110.20 (2014).

50. I.R.C. § 514.

avoid U.S. tax completely on the interest and any gain from a domestic bond.[51] Likewise, foreign entities are not generally subject to U.S. federal income tax on foreign-source income.[52] Foreign social welfare organizations can avoid tax to which domestic social welfare organizations would be subject because foreign tax-exempt entities may choose on an asset-by-asset basis to rely on their tax-exempt status or, alternatively, on their foreign status to avoid U.S. federal income tax.[53]

Taxable foreign corporations are generally subject to tax on three types of income. First, foreign corporations are subject to net income tax on income that is effectively connected to a U.S. trade or business ("ETB" and such income, "ECI").[54] For a taxable foreign corporation that benefits from a U.S. tax treaty, only ECI that is effectively connected to a U.S. permanent establishment (a "PE") is subject to U.S. net income tax.[55] Second, foreign corporations are subject to a thirty percent gross basis withholding tax on U.S.-source fixed or determinable, annual or periodic ("FDAP") income that is not ECI.[56] However, portfolio interest is exempt from the withholding tax.[57] Finally, foreign corporations are subject to a net income tax on "FIRPTA gain."[58]

Foreign exempt corporations are not subject to U.S. federal income tax and withholding on income that is (i) related to their exempt purpose or (ii) not debt financed and qualifies for an exemption from the definition of "unrelated business taxable income" ("UBTI").[59]

51. *Id*. § 881(c)(2), (3).

52. *Id*. § 864(c)(4)(A); *id.* §§ 871(a), and 881(a) (imposing a thirty percent gross basis tax only on certain U.S.-source income).

53. *See* Treas. Reg. § 1.1441-9(a) (as amended in 2000) ("A foreign organization described in section 501(c) may choose to claim a reduced rate of withholding under the procedures described in other sections of the regulations under section 1441 and not under this section.").

54. I.R.C. § 882(a)(1).

55. *See, e.g.,* Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains, U.K.-U.S., art. 7(1), July 24, 2001 (business profits of a U.K. resident generally not taxable by the United States on a net income basis, unless the taxpayer has a permanent establishment in the United States).

56. I.R.C. § 881(a)(1).

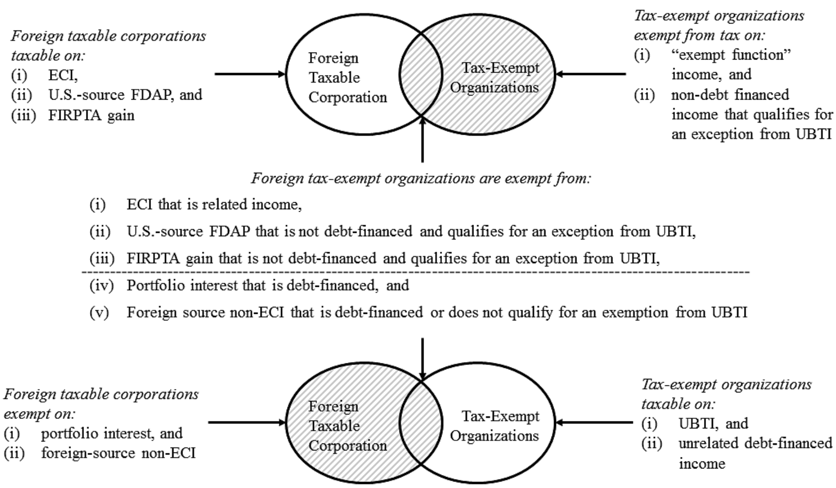
57. *Id*. § 881(c)(1).

58. FIRPTA refers to the Foreign Investors in Real Property Tax Act, I.R.C. § 897. Under § 897, gain on the sale of an interest in United States property is subject to net income tax.

59. I.R.C. § 512(a)(2); Treas. Reg. § 1.1443-1(a) (as amended in 2008) ("In the case of a foreign organization that is described in section 501(c), amounts paid or effectively connected income allocable to the organization that are includible under section 512 and section 513 in computing the organization's unrelated business taxa-

Thus, while a foreign taxable corporation is subject to tax on ECI, a foreign tax-exempt organization can escape tax on ECI that is related to its tax-exempt purpose.[60] Also, while a foreign taxable corporation is generally subject to U.S. withholding tax on U.S.-source FDAP (other than portfolio interest), a foreign tax-exempt organization can escape tax on U.S.-source FDAP that is not debt-financed and qualifies for an exception from UBTI.[61] Finally, a foreign tax-exempt organization can escape tax on FIRPTA gain that is not debt-financed and qualifies for an exemption from UBTI.[62]

Conversely, while tax-exempt organizations are taxable on UBTI and unrelated debt-financed income ("UDFI"), foreign corporations (including foreign tax-exempt organizations) are exempt from tax on portfolio interest income (even if it is debt-financed) and foreign-source non-ECI income that is debt-financed or does not qualify for an exemption from UBTI.[63]



Thus, while a foreign taxable corporation would be subject to a thirty percent U.S. withholding on U.S.-source dividends, so long as the underlying stock is not debt-financed, a tax-exempt foreign investor generally would not be subject to tax on U.S.-source dividends.[64] Likewise, while a foreign taxable corporation would generally be sub-

ble income are subject to withholding under § 1.1441-1, 1.1441-4, 1.1441-6, and 1.1446-1 through 1.1446-6 . . . .").

60. *See* I.R.C. § 512(a)(2).
61. *See id.* § 512(b).
62. *Id.* § 512(b)(5).
63. *Id.* §§ 881(c)(1), 864(c)(4)(A).
64. *See id.* § 512(b)(1).

ject to corporate tax on the sale of an interest in a United States real property holding company (a "USPHC"),[65] a tax-exempt foreign investor would not (assuming, again, that the USPHC is not debt-financed). But, because tax-exempt investors need not rely on their tax exemption, they benefit from the portfolio interest exemption and escape tax even if the investment is debt-financed. For that reason, a foreign social welfare organization is more tax efficient than a domestic one.

Finally, organizing a new social welfare organization outside the United States helps to avoid the risk of a change in U.S. tax law. Thus, a U.S. donor who is concerned that Congress might impose a tax on domestic tax-exempt entities could organize a social welfare organization outside the United States. In a pinch, the social welfare organization could cause its tax-exempt status to be revoked by failing to file a return for three years.

B. Qualifying a Foreign Social Welfare Organizations for Tax-Exempt Status

Social welfare organizations are not required to file a Form 1024. Some practitioners take the position that a foreign tax-exempt organization also need not file annual Forms 990, regardless of the amount of its U.S.-source income.[66] However, as discussed below, the overwhelming weight of authority requires that a foreign social welfare organization file an annual Form 990 to maintain its tax-exempt status, unless it qualifies for one of the specific exemptions provided in § 6033 and Revenue Procedure 2011-15.

First, § 6033(a)(1) generally provides that *every* organization exempt from tax under § 501(c) must file an annual return. Section 6033(a)(3) provides three specific exemptions from this rule for (i) churches, (ii) organizations whose annual gross receipts are less than $5,000 (increased under Revenue Procedure 2011-15 to $50,000), and (iii) the exclusively religious activities of any religious order. Very few social welfare organizations qualify for any of them. Section 6033(a)(3)(B) provides that the IRS may relieve tax-exempt organizations from the annual filing requirement if the filings are not necessary to the efficient administration of the tax laws.[67]

65. *Id.* § 897.

66. *See* Kimberly S. Blanchard, *When Must a Foreign Charity File a Form 990?*, 45 Tax Mgmt. Int'l J. 553 (2016).

67. *See* Treas. Reg. § 1.6033-2(g)(6) (as amended in 2017) (delegating authority to the Commissioner of the IRS).

In Revenue Procedure 2011-15, the IRS very specifically provided that all organizations (including foreign organizations) are required to file an annual IRS Form 990 unless the organization is exempted under Revenue Procedure 2011-15.[68] Revenue Procedure 2011-15 provides an exemption for a foreign organization that (i) is not a private foundation or a supporting organization, (ii) normally does not receive more than $50,000 in annual gross receipts from sources within the United States, and (iii) has no significant activity (including lobbying and political activity and the operation of a trade or business, but excluding investment income activity) in the United States.[69] However, even these organizations must file the postcard return on Form 990-N.[70]

Second, in 2016, following the enactment of § 506,[71] the New York State Bar Association's Tax Section sent a letter to the IRS requesting that foreign organizations described in § 501(c)(4) with no significant activities in the United States be exempted from the notice requirements.[72] The IRS denied this request and, in the Preamble to Temp. Treas. Reg. § 1.506-1T, confirmed that foreign § 501(c)(4) organizations generally are required to file an annual information return or notice under § 6033. The IRS also specifically required foreign organizations to file the notice under § 506, although it did provide that a foreign organization would generally be exempt from penalties for failing to file the notice if it filed the notice promptly after first commencing activities or receiving income that would cause it to have a notification requirement under § 6033.[73]

Thus, Revenue Procedure 2011-15 and the preamble to Temp. Treas. Reg. § 1.506-1T together clearly require foreign § 501(c)(4) organizations to file annual returns on Form 990 unless they qualify for an exemption.

Some commentators believe that a foreign tax-exempt organization cannot lose its exemption even if it fails to file an IRS Form 990

68. 2011-3 I.R.B. 322.

69. *Id.*

70. *Id.*

71. Section 506 generally requires an organization that is described in § 501(c)(4) to notify the IRS of its intent to operate as a § 501(c)(4) organization within sixty days after the organization is established.

72. New York State Bar Association, Tax Section, Letter Regarding New Section 506 (April 11, 2016), http://www.nysba.org/Sections/Tax/Tax_Section_Reports/Tax_Reports_2016/Tax_Section_Letter_1341.html. I was the principal draftsperson of the letter.

73. *See* Rev. Proc. 2016-41, 2016-30 I.R.B. 8.03.

or 990-N for three consecutive years.[74] Why would this be the case? Section 6033(j) provides simply that any organization described in § 6033(a) that fails to file Form 990 or 990-N for three consecutive years loses its exemption.[75] There is no exception for foreign tax-exempt organizations and no evident policy that would exempt them. Also, the stakes are relatively low for a foreign organization. Loss of exemption means only withholding tax on U.S.-source FDAP (other than portfolio interest), net income tax on ECI that is not UBTI, and net income tax on gain from the sale of U.S. real property interests that are not UBTI. The price for exemption from tax is disclosure. This is a small price.

C. Practical Aspects of Operating a Tax-Exempt Foreign Social Welfare Organization

1. FATCA

The Foreign Account Tax Compliance Act ("FATCA") generally requires that foreign financial institutions ("FFIs") register with the IRS unless an intergovernmental agreement (an "IGA") entered into between the United States and the country in which the FFI is a resident provides otherwise.

The regulations define an FFI to include a foreign entity (1) the gross income of which is primarily attributable to investing and trading in financial investments; and (2) that is managed by another entity that is a professional investment manager.[76] The description includes many foreign grantmaking social welfare organizations. However, the regulations also provide that such an entity is not an FFI if it is described in § 501(c)(4).[77] Nevertheless, the regulations state that if a foreign entity is resident in a country with a Model 1 or Model 2 IGA, for purposes of determining whether the entity is an FFI, the definition of financial institution in the IGA controls.[78]

Neither the US-Bermuda IGA nor the US-Cayman Islands IGA (as two examples) have an exception to the FFI definition for non-

74. Blanchard, *supra* note 66, at 2 ("Moreover, any foreign charity that had been in existence for more than three years but had not filed a Form 990 would have had its exemption auto-revoked under § 6033(j). It seems obvious that this cannot be the rule; among other things, it would vitiate the exemption from FDAP, a result nowhere hinted at in the § 1441 regulations.").

75. I.R.C. § 6033(j).

76. Treas. Reg. § 1.1471-5(e)(4)(i)(B) (as amended in 2017).

77. Treas. Reg. § 1.1471-5(e)(5)(v) (as amended in 2017).

78. *Id.*; Treas. Reg. § 1.1471-5(d) (as amended in 2017).

profits.[79] Therefore, social welfare organizations organized under the laws of the Cayman Islands and Bermuda do not appear to qualify for an exemption by reason of being tax-exempt.

Both the U.S.-Bermuda IGA and the U.S.-Cayman Islands IGA do provide that, notwithstanding the IGA, Bermuda or the Cayman Islands (as the case may be), may permit financial institutions to use the U.S. regulations definition of FFI in lieu of the corresponding definition in the IGA so long as the definition in the regulations would not frustrate the purposes of the IGA.[80] Neither Bermuda nor the Cayman Islands has exercised this authority.

Therefore, a foreign social welfare organization organized in the Cayman Islands or Bermuda whose assets are managed by a professional investment manager is an FFI and must obtain a global intermediary identification number (a "GIIN") under FATCA.

2. *U.S. Withholding Tax*

In order for a foreign social welfare organization to claim exemption from withholding, it must provide the withholding agent with an IRS Form W-8EXP and either certify that the IRS has issued a favorable determination letter (and the date), or provide (i) an opinion from a U.S. counsel concluding that the organization is described in § 501(c) and (ii) an affidavit of the organization setting forth sufficient facts concerning its operations for the IRS to determine that it would likely qualify under § 501(c)(4).[81] In my experience, these documents cause withholding agents angst, as they are not used to facing foreign nonprofits and are uncomfortable reviewing the determination letter or the opinion and affidavit.

To avoid these issues, I propose that a foreign social welfare organization organize a second foreign social welfare organization and, in turn, have the two organizations form a Delaware partnership. The Delaware partnership would hold any investments of the foreign social

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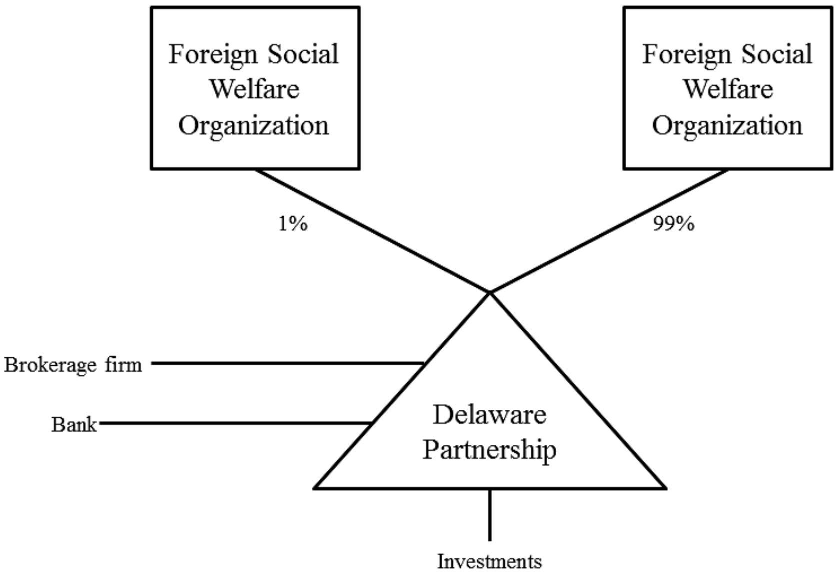
79. Agreement Between the Government of the United States of America and the Government of Bermuda for Cooperation to Facilitate the Implementation of FATCA, Berm.-U.S., Dec. 19, 2013 [hereinafter U.S.-Bermuda IGA], https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-Bermuda-12-19-2013.pdf; Agreement Between the Government of the Cayman Islands and the Government of the United States of America to Improve International Tax Compliance and to Implement FATCA, Cayman Is.-U.S., Nov. 29, 2013 [hereinafter U.S.-Cayman Islands IGA], https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FINAL%20US%20-%20Cayman%20Islands%20-%20Cayman%20alternat.pdf.

80. U.S.-Bermuda IGA, *supra* note 79, art. II, ¶ 6; U.S.-Cayman Island IGA, *supra* note 79, art. IV, ¶ 7.

81. Treas. Reg. § 1.1441-9(b)(2) (as amended in 2000).

welfare organizations and face any counterparties. The Delaware partnership would simply provide these counterparties with an IRS Form W-9. The partnership would still be required to receive the IRS Forms W-8EXP along with any determination letter, or opinion and affidavit, from the two social welfare organization partners, but these documents would not have to be shared with third parties. The partnership would also have responsibility for withholding any U.S. tax and remitting it to the IRS, but the partnership could also ensure that there is no over-withholding. Grants could be made from the partnership directly to a grantee or, to avoid any concern of the recipient about receiving funds from an unknown partnership, the partnership could make its grants to a separate domestic private foundation managed by the same people who manage the social welfare organizations. The separate domestic private foundation would, in turn, make grants to the ultimate grantees. Although this private foundation would have to file a Form 990, it would have no assets and would report a single donor: the Delaware partnership.



D. Taxable Foreign Social Welfare Organizations

1. In General

As mentioned above, tax exemption for a social welfare organization (i.e., relief from U.S. withholding and income tax) requires the filing of an annual IRS Form 990 (or 990-N).[82] The IRS periodically releases the Forms 990 for these organizations in a searchable form.[83] This disclosure prevents donors from giving anonymously and also serving as officers or directors of the social welfare organization they founded. These donors are often willing to forgo tax exemption (after they make their donations) in order to preserve their anonymity. Therefore, some donors do not file Forms 990 for their social welfare organizations. As mentioned above, if a social welfare organization fails to file its Form 990 for three consecutive years, it loses its exempt status.[84]

However, there is potentially a much more serious penalty for failing to file a Form 990. Under § 6652(c)(1)(A)(i), a social welfare organization is subject to penalty of $20 for each day its return is late (not to exceed the lesser of $10,000 or 5% of the gross receipts of the organization for the year), or if the organization's gross receipts exceed $1 million for any year, the lesser of $100 a day or 5% of the gross receipts of the organization (not to exceed $50,000). Nevertheless, the 1992 IRS Exempt Organizations CPE Technical Instruction Program Textbook provides that the penalty is normally not imposed on a foreign organization until after (i) the IRS requests a return, (ii) the request is refused, and (iii) no reasonable cause is provided.[85] A foreign social welfare organization that seeks to be taxable might intentionally fail to file an IRS Form 990 and hope that the IRS would follow this procedure, allowing the organization to only file a return upon request.

Once a tax-exempt organization loses its tax-exempt status for failure to file a Form 990, it would be taxable as a foreign corporation for U.S. federal income tax purposes.[86] This begs the question: Could a U.S. donor organize a nonstock foreign organization whose organizational documents limit its purposes to those specified in § 501(c)(4), except that the organization would be permitted to participate in political campaigns in furtherance of its purposes to an unlimited extent, and donate to that organization? The organization would qualify as a

82. *See supra* Section I.B.

83. Press Release, Internal Revenue Serv., IRS Makes Electronically Filed form 990 Data Available in New Format (June 16, 2016), https://www.irs.gov/uac/newsroom/irs-makes-electronically-filed-form-990-data-available-in-new-format.

84. *See supra* Section I.B.

85. James F. Bloom et al., *K. Foreign Activities of Domestic Charities and Foreign Charities, in* IRS Exempt Organizations Continuing Professional Education (1992), https://www.irs.gov/pub/irs-tege/eotopick92.pdf.

86. I.R.S. Gen. Couns. Mem. 38,840 (Apr. 22, 1982), 1982 WL 204279; *see* Harvey P. Dale, *Foreign Charities*, 48 TAX LAW. 655, 694 & n.237 (1995).

social welfare organization for three years, but thereafter, the organization would fail to qualify as a social welfare organization (i.e., it would be a "defective SWO"). Under the reasoning of General Counsel Memorandum 38,840,[87] the defective SWO would be taxable as a foreign corporation; but so long as it avoids ECI, FIRPTA, and U.S.-source FDAP (other than portfolio interest), it could avoid U.S. federal tax.

2. *The Risk of Beneficial Ownership*

In my experience, the risk for a donor who establishes and runs a foreign social welfare organization but does not file an IRS Form 1024 and then fails to file IRS Form 990 (thereby causing the organization to become a defective SWO) is that the IRS would deem the organization to be owned by the donor for federal income and/or estate tax purposes. In this case, the IRS would most likely treat the organization as a "controlled foreign corporation" (a "CFC") or worse, a "passive foreign investment company" (a "PFIC"), and the donor would have current or future income tax liability.

As a substantive matter, these concerns should be avoided if the organization's constituent documents provide explicitly that the organization's purposes are limited to those permitted by § 501(c)(4), and in practice the organization follows these rules. However, in the absence of a ruling, the question is an evidentiary one. A § 501(c)(4) ruling, even if the organization subsequently fails to file tax returns and loses its tax-exempt status, may go far towards convincing an IRS agent who asserts that the donor is the beneficial owner of the organization. On the other hand, if local law permits the organization to amend its articles at the effective direction of a founder, and the organization does not have a ruling, the IRS would have significant incentive to argue that the taxpayer is the beneficial owner.

3. *FATCA*

A social welfare organization that fails to file a Form 990 for three consecutive years would also fail to qualify for the exemption from FFI status under Treas. Reg. § 1.1471-5(e)(5)(v).[88] Another exemption exists in Treas. Reg. § 1.1471-5(e)(5)(vi) for an entity that is established and maintained in its country of residence exclusively for religious, charitable, scientific, artistic, cultural, or educational pur-

87. *See* I.R.S. Gen. Couns. Mem. 38,840, *supra* note 86.
88. Treas. Reg. § 1.1471-5(e)(5)(v) (as amended in 2017).

poses and certain other requirements are satisfied.[89] That exemption is based upon § 501(c)(3).[90] It is possible that a foreign social welfare organization that is taxable for U.S. tax purposes could satisfy this exception. However, if a social welfare organization fails to qualify under § 501(c)(3) because it may substantially benefit private interests or because it is permitted to lobby substantially, then it may also fail to qualify under this exception. In addition, as mentioned above, Cayman Islands and Bermuda organizations are not exempted from FFI status under the IGA, which takes precedence over the regulations. Thus, social welfare organizations that are taxable for U.S. federal income tax purposes generally obtain a GIIN under FATCA.

III.
CASE STUDIES

A. South American Entrepreneur

In this Part, I examine a number of hypothetical case studies. First, assume the client is a wealthy and philanthropic South American entrepreneur. He wishes to organize a tax-exempt organization to make grants to charities in the United States and his home country. He would prefer to organize a U.S. organization so that U.S. grantees do not raise issues about receiving funds from a South American entity.

For this client, a domestic social welfare organization is ideal. The client is not a U.S. resident or engaged in a U.S. trade or business, and therefore would not be able to use a charitable deduction (and is not subject to U.S. estate tax). A § 501(c)(3) organization would be subject to private foundation rules and would offer less flexibility than a social welfare organization. Anonymity is not an issue. This organization would submit a Form 1024 and file Form 990 annually. The staff of the social welfare organization (which is managed in the cli-

89. These additional requirements are: (i) The entity is exempt from income tax in its country of residence; (ii) the entity has no shareholders or members who have a proprietary or beneficial interest in its income or assets; (iii) neither the laws of the entity's country of residence nor the entity's formation documents permit any income or assets of the entity to be distributed to, or applied for the benefit of, an individual or noncharitable entity other than pursuant to the conduct of the entity's charitable activities, or as payment of reasonable compensation for services rendered or the use of property, or as payment representing the fair market value of property that the entity has purchased; and (iv) the laws of the entity's country of residence or the entity's formation documents require that, upon the entity's liquidation or dissolution, all of its assets be distributed to a foreign government or another organization that meets the requirements of this paragraph or escheat to the government of the entity's country of residence or any political subdivision thereof. Treas. Reg. § 1.1471-5(e)(5)(vi) (as amended in 2017) .

90. I.R.C. § 501(c)(3).

ent's home jurisdiction) would send an email to tax counsel describing proposed grants to ensure they are for valid social welfare purposes and do not raise inurement or other issues.

B. U.S. Private Equity Fund Manager

Second, consider a situation in which the client is an individual private equity fund manager with carried interests in a series of funds who wishes to contribute these carried interests to a charity. The individual cannot use a charitable deduction but the interests have appreciated considerably.

For this client, a social welfare organization organized outside the United States is more ideal. The organization would file an IRS Form 1024 and receive exemption. The carried interests would be contributed to the social welfare organization. The organization would deliver a form W-8EXP, with a copy of the exemption letter, to the private equity funds. To avoid the possible inclusion of the social welfare organization in the individual's estate under § 2036(a)(2), the individual's children would serve as the officers and directors of the social welfare organization. Alternatively, upon the death of the individual, the organization could be required to transfer all of its assets to § 501(c)(3) organizations.

However, the IRS will eventually publicly release the organization's Form 990. If the donor wishes anonymity, he or she could fail to file Form 990 for the organization, in which case after three years, the organization will become a foreign taxable corporation.

IV.
Why Not Use a Social Welfare Organization As a Grantmaker?

This Article explains the many benefits of a social welfare organization as a grantmaker, particularly for a wealthy individual like Jeff Bezos or a C corporation that is not able to use a charitable deduction. So what are the reasons such an individual or corporation would *not* want to use a social welfare organization as a grantmaker? I list here three reasons: (1) public relations, (2) the prohibition under § 2036(a)(2) against donor management, and (3) the absence of the discipline typically imposed by the private foundation rules.

First, social welfare organizations are most widely associated with lobbying and campaigning activity.[91] Were a wealthy individual

91. *See, e.g.*, *Explainer: 501(c)(4)s and Political Activity*, BolderAdvocacy: Blog (May 13, 2013, 4:55 PM), https://bolderadvocacy.org/blog/explainer-501c4s-

to donate a large amount of publicly-traded stock to a social welfare organization (not to mention a foreign one), the donation would immediately be public and the assumption would be that the organization would engage in lobbying and campaigning, and not grantmaking. This alone may dissuade the use of a social welfare organization.

Second, as discussed above in Section I.D., § 2036(a)(2) will effectively prevent the donor from managing the social welfare organization or require it to grant its assets to a § 501(c)(3) organization upon the donor's death.[92]

Third, some potential donors see value in the five percent distribution requirement and other rules imposed on private foundations. These rules impose discipline on future generations that is not imposed on social welfare organizations. Sometimes too much freedom is a bad thing.

V.
Tax Policy Implications

If one assumes that the charitable deduction is the most important tax benefit of a charitable contribution, and the exclusion of capital gains tax on the donation of appreciated property a distant second, then most of the tax consequences described in this Article make sense. They reflect a hierarchy of tax benefits that inversely match the donor's control over the donated funds following the donation. Thus, the greatest tax benefits—an income tax deduction, avoidance of capital gains tax, and exemption of tax on most investment income of the entity—are available for § 501(c)(3) organizations.[93] These organizations are also subject to the greatest restrictions. Public charities are limited as to the amount of lobbying they may conduct and are prohibited from political campaigning (and subject to a number of other restrictions).[94] Private foundations are prohibited from lobbying and political campaigning.[95]

However, if the donor is willing to forgo the charitable deduction, limiting the donor's subsidy to exemption of tax on the built-in gain in the donated property, the restrictions are limited as well. In

and-political-activity ("Social welfare organizations may conduct unlimited lobbying and may engage in partisan political campaign work, but only as a *secondary activity*.")

92. *See supra* Section I.D.

93. *See* I.R.C. § 501(c)(3).

94. *See* Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii), (iii) (as amended in 2017).

95. *See* I.R.C. § 4945(d)(1)-(2) (imposing punitive excise tax on any private foundation that engages in lobbying or political campaigning).

such a situation, a social welfare organization may engage in unlimited lobbying and some political campaigning.

Finally, § 527 political organizations are not entitled to subsidies—donors are not entitled to charitable deductions for donations to them, donations of appreciated property are treated as if the property had been sold, and the organizations themselves are subject to tax on their investment income.[96] Section 527 organizations may participate in political campaigning.

However, the crucial assumption underlying the different treatment between § 501(c)(3) charitable organizations and § 501(c)(4) social welfare organizations is that the charitable deduction is more valuable to taxpayers than the capital gains exclusion. For most taxpayers, this assumption is correct. For super-wealthy people, this assumption is not.

Thus, assume a wealthy (but not super-wealthy) taxpayer earns $1 million annually and donates appreciated publicly-traded stock to a private foundation with a value of $1 million and a basis of zero.[97] At a 37% federal rate, the $1 million donation provides the taxpayer with a tax deduction benefit of $74,000 a year (20% x 37% x $1 million), or $370,000 total in five years. At a 23.8% capital gains rate, the exclusion of capital gains is worth $238,000.

Assume instead that a super-wealthy taxpayer donates $1 billion of appreciated publicly-traded stock (zero basis). At a 37% federal rate, the $1 billion donation to a private foundation provides the taxpayer with the same $74,000 a year charitable deduction benefit (20% x 37% x $1 million), or $370,000 following the five-year carry forward period. However, at a 23.8% capital gains rate, the exclusion of the tax on the appreciation is worth $238 million. For this taxpayer, the exclusion of capital gains tax is hundreds of times more valuable than the income deduction.[98] In fact, this super-wealthy taxpayer would maximize his or her deduction and flexibility by donating $1 million of stock to a public charity and the rest to a social welfare organization.

96. *See* I.R.C. § 527(c).

97. *See* I.R.C. § 170(e)(5).

98. This taxpayer is not so different than Warren Buffett. In 2015, Warren Buffett had adjusted gross income of $11.5 million, Warren Buffett, *Some Tax Facts for Donald Trump*, BUS. WIRE (Oct. 16, 2016, 12:00 PM), https://www.businesswire.com/news/home/20161010005859/en/Tax-Facts-Donald-Trump, and gave away $2.8 billion of Berkshire Hathaway stock. Jackie Wattles, *Warren Buffett Gives Away Another $2.8 Billion*, CNN MONEY (July 6, 2015, 3:36 PM), http://money.cnn.com/2015/07/06/news/warren-buffett-charity/index.html.

To recalibrate the tax subsidy, the donation of appreciated property to any § 501(c) organization should be treated as a sale for income tax purposes.[99] This change would restore most-favored tax treatment to § 501(c)(3) organizations and eliminate a tax subsidy that is far more valuable to wealthy donors than to others.[100] Donors to § 501(c)(3) organizations alone would enjoy a charitable deduction, and § 501(c)(3) organizations would be exempt from tax on most investment income. Section 501(c)(4) organizations would be exempt from tax on most investment income, but their donors would not be entitled to any tax subsidy.[101] And § 527 organizations would remain at the bottom of the pile. Neither they nor their donors would enjoy any tax benefit.

Treating donations of appreciated property to § 501(c) organizations as taxable sales would also dent income inequality. Only if death and donations of appreciated property are treated as taxable events will Warren Buffett ever pay a penny of tax on his $75.8 billion of appreciated Berkshire Hathaway stock.

Conclusion

This Article responds to Jeff Bezos's request for philanthropic ideas with a suggestion for the structure of his grantmaking. Gifts of appreciated stock should be made to § 501(c)(3) organizations only to the extent that Bezos will be able to use the charitable deduction that the donation generates before it expires. A social welfare organization should receive all other gifts of appreciated stock.

For taxpayers who cannot use a charitable deduction, or are willing to forgo the deduction for significantly greater flexibility, social welfare organizations are the ideal vehicle for grantmaking. Gifts of appreciated property to them are exempt from tax on the built-in gain and, for super wealthy taxpayers, this exemption may be hundreds of times more valuable than an income tax deduction. Social welfare organizations also are not subject to the private foundation rules and may engage in unlimited amounts of lobbying and limited amounts of political activity. Donors to social welfare organizations are not subject to gift tax and, with some planning, can avoid estate tax on the donations.

99. *See* David S. Miller, *Reforming the Taxation of Exempt Organizations and Their Patrons*, 67 TAX LAW. 451, 498-500 (2014).

100. *Id.*

101. Any donor to a § 501(c)(3) or § 501(c)(4) organization that engaged in significant lobbying or campaigning and did not disclose the name of the donor would be subject to gift tax on the donation.

Foreign social welfare organizations can be used to avoid UBTI and, for donors seeking anonymity, failure to file a Form 990 for three years will convert a foreign social welfare organization into a foreign corporation that, while technically taxable, can avoid all U.S. federal income tax.

Social welfare organizations are thus much better vehicles for the super-wealthy than § 501(c)(3) organizations because the exemption of capital gains tax on the donation of appreciated property is a far more valuable tax benefit than the charitable deduction. Ending that exemption for donations to § 501(c) organizations would restore the traditional hierarchy to § 501(c) and help address income inequality.