

## CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 398

August 9, 1976

### DIVERSION OF CAMPAIGN FUNDS

Syllabus:

Advice has been requested as to the taxability of political contributions raised by one candidate or committee and subsequently donated to the campaign of another.

Campaign contributions, to be taxable, must be considered "income" to the candidate. The United States Supreme Court, in Eisner v. Macomber, 252 U.S. 189 (1919) defined income as "the gain derived from capital, from labor, or from both combined." Gain does not include an item which is not an accession to wealth.

Commencing in 1939 and continuing thereafter, the Internal Revenue Service has not considered campaign funds to be within the foregoing definition if utilized for generally recognized campaign purposes, transferred to a candidate's national, state, or local political party committees, or used to reimburse the candidate for out of pocket expenses of a current or prior campaign. (I.T. 3276, 1939-1 Cum.Bull. 108; Rev. Proc. 68-19, 1968-1 Cum.Bull. 810.)

In Rev.Rul. 71-449, 1971-2 Cum.Bull. 77, it was determined political funds were not taxable to a candidate by or for whom they were collected if used for expenses of a political campaign or some similar purpose. Any amount, however, diverted from the channel of campaign activity and used by a candidate for any personal purpose was income taxable to such candidate for the year in which the funds were so diverted.

For purposes of state taxation and in concert with the above reasoning, campaign funds collected by or for one candidate and subsequently donated to the campaign of another is sufficient "similar purpose" to avoid taxability to the donor. Further, funds donated to a second candidate or supporting committee have sufficiently remained in the "channel of campaign activity" to avoid classification as a diversion of income to the personal use of the donor-candidate.

An opposite result would be dictated by circumstances inclusive of any type of payment to a political campaign in exchange for a candidate's promise or action which is not of a traditional and legitimate political nature. For example, if candidate A or his controlled committee contributed campaign funds

to candidate B, in exchange for B's promise to perform a personal service for A, a taxable event would have transpired for both as: (1) A has diverted campaign funds for personal use and (2) B's command and dominion over the payment stemmed from the fact that his promise to act for A's personal benefit was knowingly given in exchange for and in fact produced the payment. It is irrelevant the payment was made to B's political campaign as the substance of the transaction will control over its form.

This example is not intended to be exhaustive but rather serve to demonstrate that it is necessary to ascertain the circumstances under which contributions are made. If indicia are present that a payment was not made as a result of traditional and legitimate political motivation, a complete factual development may warrant a finding of a taxable diversion of campaign funds by the involved candidate.