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## The Charitable Contributions Deduction: Federal Tax Rules

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# The Charitable Contributions Deduction: Federal Tax Rules

HARVEY P. DALE & ROGER COLINVAUX\*

## Abstract

This Article provides a succinct overview of the main federal income tax law rules affecting charitable contributions. This Article covers all principal topics, including: eligibility to receive deductible contributions, eligible gifts, the amount allowed as a deduction, the specific rules for gifts of noncash property, contributions to certain split-interest trusts, substantiation rules, and valuation. This Article also touches on the estate and gift tax charitable deduction and provides a survey of select policy issues, including the rationale and form of the tax benefit, concerns about efficiency, the ability to deduct the appreciation in value of property, a nonitemizer deduction, and simplification.

## Table of Contents

I. Introduction .....	332
II. Eligible Donees of Deductible Contributions .....	333
III. Eligible Gifts .....	336
IV. Amount of Deduction .....	339
A. Quid Pro Quo .....	340
B. Percentage Limitations and Carryovers .....	341
V. Property Specific Rules.....	347
A. Clothing and Household Items.....	347
B. Vehicles .....	348
C. Qualified Conservation Contributions .....	348
VI. Contributions to Split-Interest Trusts .....	349

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VII. Substantiation.....	352
A. Contributions of Less than \$250 .....	354
B. Contributions of \$250 or More .....	354
C. Noncash Contributions of More than \$500 .....	355
D. Donee Obligations.....	356
VIII. Valuation .....	356
IX. Estate and Gift Tax Charitable Deductions.....	357
X. Policy Issues .....	358
A. Rationale and Form of the Tax Benefit.....	359
B. Efficiency Concerns .....	362
C. Deduction for the Appreciated Value of Property .....	364
D. Nonitemizer Deduction and Simplification.....	365
1. Nonitemizer Deduction .....	365
2. Simplification .....	366
XI. Conclusion.....	366

## I. Introduction

The United States has allowed an income tax deduction<sup>1</sup> to individual and corporate donors<sup>2</sup> for charitable contributions since 1917.<sup>3</sup> In the typical case—a donation of cash to a public charity—the donor may deduct the amount of cash donated.<sup>4</sup> The amount of the deduction generally may not exceed, in the case of an individual, 50% of the individual’s “contribution base,”<sup>5</sup> or in the case of a corporation, ten percent of its taxable income.<sup>6</sup>

Even slight deviations from the plain vanilla situation, however, may call into play a variety of complex rules with the potential to change the amount of, or even wholly to deny, the charitable contributions deduction. These rules depend on the form of the gift, whether the gift is of cash or property, the type of property donated, and the nature of the donee organization.

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<sup>1</sup>A charitable deduction also is allowed for estate and gift tax purposes. See I.R.C. §§ 2055, 2522. This Article focuses on the income tax deduction but also briefly describes the estate and gift tax rules. See *infra* text accompanying notes 185-197.

<sup>2</sup>Donations by partnerships, S corporations, and certain other pass-through entities are allowed to the partners, shareholders, etc., rather than being allowed to the entity. See, e.g., §§ 702(a)(4), 703(a)(2)(C), 1366(a)(1). Charitable donations by trusts or estates are subject to a different regime under section 642(c).

<sup>3</sup>War Revenue Act, Pub. L. No. 65-50, § 1201(2), 40 Stat. 300, 330 (1917). The federal income tax was enacted four years earlier.

<sup>4</sup>See I.R.C. § 170(a)(1).

<sup>5</sup>§ 170(b)(1)(A). An individual’s “contribution base” is his or her adjusted gross income computed without any net operating loss carrybacks. § 170(b)(1)(G).

<sup>6</sup>§ 170(b)(2); see *infra* note 82.

This Article provides a succinct overview of the main federal tax law rules affecting charitable contributions.<sup>7</sup> This Article covers all principal topics, including: eligibility to receive deductible contributions, eligible gifts, the amount allowed as a deduction, the specific rules for gifts of noncash property, contributions to split-interest trusts, substantiation rules, and valuation. This Article also touches on the estate and gift tax charitable deduction and provides a survey of select policy issues.

## II. Eligible Donees of Deductible Contributions

It is often said that gifts to organizations, as defined in section 501(c)(3), are eligible for the charitable contributions deduction.<sup>8</sup> That statement, however, is both over- and under-inclusive. It is over-inclusive because gifts to organizations that test for public safety are not eligible for the deduction even though such organizations are listed in section 501(c)(3).<sup>9</sup> It is under-inclusive because the section allowing the deduction—section 170(c)—mentions five types of eligible donee entities, only one of which is closely similar to those described in section 501(c)(3).

Nevertheless, by far the most important class of eligible donees is described in section 170(c)(2)(B), the words of which are closely similar to, but not identical to, the words of section 501(c)(3). This class comprises entities “organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition . . . , or for the prevention of cruelty to children or animals.”<sup>10</sup> For such entities to be eligible to receive tax-deductible gifts, additional statutory criteria must be satisfied:

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<sup>7</sup>A helpful publication is also available from the Service: IRS, IRS PUB. NO. 526, CHARITABLE CONTRIBUTIONS (2013), available at <http://www.irs.gov/uac/Publication-526,-Charitable-Contributions-1>.

<sup>8</sup>For example, in *Bob Jones University v. United States*, Justice Powell, concurring, wrote: “Federal taxes are not imposed on organizations ‘operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes . . . .’ 26 U.S.C. § 501(c)(3). The Code also permits a tax deduction for contributions made to these organizations. § 170(c).” 461 U.S. 574, 606 (1983); see also *Regan v. Taxation with Representation of Wash.*, 461 U.S. 540, 543 (1983) (“Taxpayers who contribute to § 501(c)(3) organizations are permitted by § 170(c)(2) to deduct the amount of their contributions on their federal income tax returns . . .”).

<sup>9</sup>Rev. Rul. 65-61, 1965-1 C.B. 234; G.C.M. 32,399 (Sept. 21, 1962), modified by G.C.M. 32,519 (Feb. 20, 1963); § 170(c)(2)(B) (omitting public safety organizations but including other organizations described in section 501(c)(3)).

<sup>10</sup>§ 170(c)(2)(B). The quoted language is identical to that in section 501(c)(3) with the exception that organizations that test for public safety are included in the latter but not in the former. See *supra* text accompanying note 8.

- The entity must be created or organized within the United States or its possessions,<sup>11</sup>
- The entity must not permit proscribed inurement of benefits to insiders,<sup>12</sup>
- The entity must not engage in political campaign activity,<sup>13</sup> and
- The entity must not engage in substantial lobbying.<sup>14</sup>

Further, although not an explicit statutory requirement, the entity must not violate fundamental public policy, per the United States Supreme Court's decision in *Bob Jones University*.<sup>15</sup>

No income tax charitable contributions deduction is allowed unless the charitable donee is organized within the United States.<sup>16</sup> This limitation is subject to two important qualifications. First, eligible U.S. charitable donees may use their funds abroad for charitable purposes.<sup>17</sup> Second, a donor may donate to a U.S. charity that, in turn, donates to a foreign charity.<sup>18</sup> However, the Service has denied deductions in such a case if the intermediate U.S. charity is a mere conduit, that is, if "the domestic organization is only nominally the donee," but "the real donee is the ultimate foreign recipient."<sup>19</sup> The

<sup>11</sup>Section 170(c)(2)(A) states that the donee must be "created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States." This restriction derives from 1935 legislation affecting corporate donations (section 102(c) of the Revenue Act of 1935, Pub. L. No. 74-407, 49 Stat. 1014, 1016 (1935), adding a new section 23(r) to the Revenue Act of 1934), and 1938 legislation affecting individual donations (section 23(o) of the Revenue Act of 1938, Pub. L. No. 75-554, 52 Stat. 447, 463 (1938)).

<sup>12</sup>§ 170(c)(2)(C). For a critique of conditioning the deduction on the nondistribution constraint see Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017 (2007). *But see* Brian Galle, *Keep Charity Charitable*, 88 TEX. L. REV. 1213 (2010) (refuting critique).

<sup>13</sup>§ 170(c)(2)(D); Reg. § 1.170A-1(j)(5)(ii).

<sup>14</sup>§ 170(c)(2)(D); Reg. § 1.170A-1(j)(5)(i).

<sup>15</sup>*Bob Jones Univ. v. United States*, 461 U.S. 574 (1983). For a discussion of the limitations of the public policy doctrine see Johnny Rex Buckles, *Reforming the Public Policy Doctrine*, 53 U. KAN. L. REV. 397 (2005). These and other rules relating to the charitable deduction and tax exemption are discussed in STAFF OF J. COMM. ON TAXATION, 109TH CONG., HISTORICAL DEVELOPMENT AND PRESENT LAW OF THE FEDERAL TAX EXEMPTION FOR CHARITIES AND OTHER TAX-EXEMPT ORGANIZATIONS (Comm. Print 2005).

<sup>16</sup>*See* § 170(c)(2)(A).

<sup>17</sup>The legislative history to the 1938 legislation (*see supra* note 11) explicitly confirmed this. H.R. REP. NO. 75-1860, at 19 (1938). Treasury regulations state that "all, or some portion, of the funds of the [donee] organization may be used in foreign countries for charitable or educational purposes." Reg. § 1.170A-8(a)(1). For inexplicable reasons, however, U.S. *corporate* donors are only allowed a deduction for donations to a U.S. *corporate* charity (as opposed to a noncorporate trust, community chest, or fund) if that domestic charity in turn uses its funds abroad. § 170(c)(2); Rev. Rul. 69-80, 1969-1 C.B. 65.

<sup>18</sup>*See* Rev. Rul. 63-252, 1963-2 C.B. 101 (examples 4 and 5); *see also* Rev. Rul. 66-79, 1966-1 C.B. 48; Rev. Rul. 69-80, 1969-1 C.B. 65; Rev. Rul. 75-65, 1975-1 C.B. 79.

<sup>19</sup>*See* Rev. Rul. 63-252, 1963-2 C.B. 101 (examples 1, 2, and 3).

deduction nevertheless may be allowed even if the intermediate U.S. donee gives funds only to a particular named foreign entity;<sup>20</sup> such U.S. intermediate entities are sometimes called “friends of” organizations because they are frequently so named.<sup>21</sup> The intermediate donee must not be bound, by any charter or bylaw provision, to deliver the funds to the foreign organization; gifts by the intermediate donee to the foreign organization must be within the mission and purpose of the U.S. intermediate entity; and the U.S. intermediate organization must exercise some appropriate level of scrutiny over the foreign donee to make sure that it qualifies as an eligible organization.<sup>22</sup>

The place-of-organization limitation does not apply for purposes of the gift tax or estate tax.<sup>23</sup> The Code, however, generally requires section 501(c)(3) organizations (other than certain religious groups or very small organizations) to notify the Service and to apply for a determination letter confirming their section 501(c)(3) status within 27 months of their organization.<sup>24</sup> This requirement applies to foreign organizations unless they derive less than 15% of their “support”<sup>25</sup> from U.S. sources.<sup>26</sup> A foreign organization that is not excused from this requirement but that fails to comply with it is not “treated as an organization described in section 501(c)(3),”<sup>27</sup> and donors to it may be denied gift tax and estate tax charitable contributions deductions for their gifts.<sup>28</sup>

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<sup>20</sup> Rev. Rul. 66-79, 1966-1 C.B. 48; *see also* Rev. Rul. 74-229, 1974-1 C.B. 142.

<sup>21</sup> *See, e.g.*, Judith S. Ballan, *How to Aid a Foreign Charity Through an “American Friends of” Organization*, 23 N.Y.U. CONF. TAX PLAN. FOR SECTION 501(c)(3) ORG’S ch. 4 (1994).

<sup>22</sup> *See generally* Harvey P. Dale, *Foreign Charities*, 48 TAX LAW. 657, 659-63 (1995); Kimberly S. Blanchard, *U.S. Taxation of Foreign Charities*, 8 EXEMPT ORG. TAX REV. 719, 726 (1993).

<sup>23</sup> Sections 2055(a)(2), 2055(a)(3), and 2522(a)(2) lack the restrictive language of section 170(c)(2)(A). The gift tax regulations confirm that “[t]he deduction is not limited to gifts for use within the United States, or to gifts to or for the use of domestic corporations, trusts, community chests, funds, or foundations . . .” Reg. § 25.2522(a)-1(a). The estate tax regulations, in almost identical language, agree. Reg. § 20.2055-1(a). The charitable contributions deduction allowed to estates and complex trusts, per section 642(c)(1), is also “determined without regard to [the place-of-formation limitation in] section 170(c)(2)(A).” The regulations again confirm this. Reg. § 1.642(c)-1(a)(2).

<sup>24</sup> Section 508(a) mandates the notice requirement. Regulation section 1.508-1(a)(2)(i) prescribes the use of Form 1023 and states that it must be filed within 15 months from the end of the month of organization. Section 4.01 of Revenue Procedure 92-85, 1992-2 C.B. 490, grants an automatic 12-month extension of this 15-month time period.

<sup>25</sup> For this purpose, “support” includes gifts, grants, contributions, membership fees, gross receipts from admissions or sales or furnishing facilities, and net income from unrelated business activities but does not include “gross investment income.” I.R.C. §§ 4948(b), 509(d), 509(e). Gifts, grants, contributions, and membership fees paid by U.S. persons are treated as from U.S. sources. Reg. § 53.4948-1(b).

<sup>26</sup> § 4948(b); Reg. § 53.4948-1(b). Under certain circumstances, even such excepted foreign charities may cease to be eligible to receive donations that are deductible for gift and estate tax purposes if they engage in a “prohibited transaction” and the Commissioner so notifies them. § 4948(c); Reg. § 53.4948-1(c)-(d).

<sup>27</sup> I.R.C. § 508(a).

<sup>28</sup> §§ 508(d)(2)(B), 2055(e)(1), 2522(c)(1).

Because it may be difficult for potential donors to ascertain whether a prospective donee satisfies all of these conditions for eligibility, the Service publishes online a list of eligible donees and updates it regularly.<sup>29</sup> Donors making gifts in reliance on that published list, as modified by occasional public announcements by the Service, are generally protected even if the donee organization ceases to qualify.<sup>30</sup>

Donees eligible to receive deductible contributions other than section 170(c)(2)(B) organizations are (1) states, possessions, political subdivisions, and the District of Columbia, (2) posts or organizations of war veterans, (3) domestic fraternal societies, and (4) cemetery companies. Further conditions on eligibility are imposed for each type.<sup>31</sup>

### III. Eligible Gifts

A deduction is allowed for a “charitable contribution.” A “charitable contribution” is defined as “a contribution or gift to or for the use of” an eligible organization.<sup>32</sup> There is no statutory definition of “contribution or gift.” Some early court decisions borrowed a definition from another part of the tax law,<sup>33</sup> following a United States Supreme Court decision that described a “gift” for those purposes as a transfer proceeding from “detached and disinterested generosity.”<sup>34</sup> This line of authority, however, fell into disfavor, in part because of its reliance on the subjective intent of the transferor–donor.<sup>35</sup> Preferring to focus on objective factors, the United States Supreme Court, in *United States v. American Bar Endowment*, articulated the test as follows: “The

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<sup>29</sup>IRS Publication 78, *Cumulative List of Organizations Described in Section 170(c) of the Internal Revenue Code*, lists all eligible charities on the Service Master File. The publication is available and may be searched on the Service’s website at <http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check>, but is not separately published as a paper version.

<sup>30</sup>See Rev. Proc. 2011-33, 2011-25 I.R.B. 887 for a general discussion of the extent to which such reliance will be protected. The Service reserves the right to challenge deductions, even if the donee organization was listed in IRS Publication 78, if the donor knew of the revocation of the charity’s exempt status, was aware that it was imminent, or was in part responsible for or aware of the actions giving rise to the revocation. *Id.* § 3.01.

<sup>31</sup>I.R.C. § 170(c).

<sup>32</sup>§ 170(c).

<sup>33</sup>§ 102.

<sup>34</sup>*Commissioner v. Duberstein*, 363 U.S. 278, 286 (1960); *see also DeJong v. Commissioner*, 309 F.2d 373 (9th Cir. 1962) (applying the subjective *Duberstein* test).

<sup>35</sup>*See, e.g., Singer Co. v. United States*, 449 F.2d 413 (Ct. Cl. 1971) (declining to apply the *Duberstein* test).

*sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration.”<sup>36</sup>

Treasury regulations adopted in 1996 now state that no transfer will be treated as “a contribution or gift” unless the donor “[i]ntends to make a payment in an amount that exceeds the fair market value of the goods or services [received in exchange for the payment]” and “makes a payment in an amount that exceeds the fair market value of the goods or services.”<sup>37</sup> The second leg of that test is purely objective; the first leg derives from a sentence in *American Bar Endowment* in which the United States Supreme Court said, “A payment of money generally cannot constitute a charitable contribution if the contributor *expects* a substantial benefit in return.”<sup>38</sup> However, because of the substantiation requirements discussed below,<sup>39</sup> the first leg of the test does not have much practical significance.

Charitable gifts must be made either “to” or “for the use of” an eligible donee; this distinction affects the deduction limitation for an individual donor and is discussed further below.<sup>40</sup> Gifts must be complete and unconditional to qualify for a deduction: retention of control by the donor, or the existence of conditions that might defeat the gift, may postpone or prevent deductibility.<sup>41</sup> The Treasury regulations state the test:

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<sup>36</sup> 477 U.S. 105, 118 (1986). Three years later, the Court commented approvingly on the *American Bar Endowment* objective test saying, “This practice has the advantage of obviating the need for the IRS to conduct imprecise inquiries into the motivations of individual taxpayers.” *Hernandez v. Commissioner*, 490 U.S. 680, 690-91 (1989); *see also* *Rolfs v. Commissioner*, 668 F.3d 888, 891 (7th Cir. 2012) (noting that “[t]he IRS and the courts look to the objective features of the transaction, not the subjective motives of the donor”). *See generally* Douglas A. Kahn & Jeffrey H. Kahn, “*Gifts, Gafis, and Gefis*”—*The Income Tax Definition and Treatment of Private and Charitable “Gifts” and a Principled Policy Justification for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441, 495-524 (2003).

<sup>37</sup> Reg. § 1.170A-1(h)(1), adopted by T.D. 8690, 1997-5 I.R.B. 5. The Service took this position in rulings prior to adoption of the regulations. *See, e.g.*, Rev. Rul. 67-246, 1967-2 C.B. 104; Rev. Rul. 68-432, 1968-2 C.B. 104.

<sup>38</sup> 477 U.S. at 116 (emphasis added).

<sup>39</sup> *See infra* text accompanying notes 144-164.

<sup>40</sup> *See infra* text accompanying notes 67-72.

<sup>41</sup> *See, e.g.*, *Briggs v. Commissioner*, 72 T.C. 646 (1979) (conditions on donated property not negligible; held: deduction denied), *aff’d without opinion*, 665 F.2d 1051 (9th Cir. 1981); 885 Inv. Co. v. Commissioner, 95 T.C. 156 (1990) (court found it “doubtful” that condition on use of donated property would be met; held: deduction denied); Rev. Rul. 73-1, 1973-1 C.B. 117 (donor’s retained option to require repayment of donated amounts fatal to deduction); Rev. Rul. 77-305, 1977-2 C.B. 72 (donor’s power to compel donee to sell donated property and accept cash instead fatal to deduction); *see also* *United States v. Dean*, 224 F.2d 26, 29 (1st Cir. 1955). *See generally* Johnny Rex Buckles, *The Case for the Taxpaying Good Samaritan: Deducting Earmarked Transfers to Charity Under Federal Income Tax Law, Theory and Policy*, 70 FORDHAM L. REV. 1243 (2002); John McGown, Jr., *Major Charitable Gift—How Much Control Can Donors Keep and Charities Give Up?*, 91 J. TAX’N 279 (1999); Ronald W. Blasi & Richard A. Denesha, *Avoiding Disallowance of Earmarked Charitable Contributions*, 9 REV. TAX’N INDIVIDUALS 160 (1985).

If as of the date of a gift a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.<sup>42</sup>

Designations of particular purposes for gifts or imposition of conditions that are extremely unlikely to interfere with the donee's interests are not fatal<sup>43</sup> but may affect valuation of the gift and so the amount of the deduction.<sup>44</sup>

Gifts of less than the donor's entire interest in the property donated do not qualify for a charitable contributions deduction.<sup>45</sup> There are five exceptions to this rule:

1. Gifts of remainder interests in charitable remainder trusts,<sup>46</sup>
2. Gifts of lead interests in charitable lead trusts,<sup>47</sup>

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<sup>42</sup>Reg. § 1.170A-1(e); *accord* Reg. § 1.170A-7(a)(3). The quoted language leaves room, however, for certain conditions so long as the likelihood of their occurrence is deemed "so remote as to be negligible." The Regulation goes on to confirm this:

If an interest in property passes to, or is vested in, charity on the date of the gift and the interest would be defeated by the subsequent performance of some act or the happening of some event, the possibility of occurrence of which appears on the date of the gift to be so remote as to be negligible, the deduction is allowable. For example, A transfers land to a city government for as long as the land is used by the city for a public park. If on the date of the gift the city does plan to use the land for a park and the possibility that the city will not use the land for a public park is so remote as to be negligible, A is entitled to a deduction under section 170 for his charitable contribution.

Reg. § 1.170A-1(e). Pre-1972, the regulations had used the phrase "highly improbable" instead of "so remote as to be negligible." T.D. 6285, 1958-1 C.B. 127. The change to the current language was made by T.D. 7207, 1972-2 C.B. 106.

<sup>43</sup>*See, e.g.*, Rev. Rul. 77-148, 1977-1 C.B. 63, supported by G.C.M. 36,980 (Jan. 11, 1977) (gift of timberland on condition that land would revert to donor if within 90 years donees attempted to sell land or remove trees; held: because donees were conservation organization and the United States, both accepting gift of land for use as wildlife preserve, possibility of reverter was so remote as to be negligible, so current deduction allowed).

<sup>44</sup>*See, e.g.*, Rev. Rul. 85-99, 1985-2 C.B. 83, supported by G.C.M. 39,380 (July 9, 1985) (gift of land to agricultural college on condition it was to be used only for agricultural purposes; held: deduction allowed, but land valued as agricultural even though worth more if free of that restriction); *accord* Deukmejian v. Commissioner, 41 T.C.M. (CCH) 738, 1981 T.C.M. (P-H) ¶ 81,024 (condition insisted on by donee); Fargason v. Commissioner, 21 B.T.A. 1032 (1930) (reviewed by the Board) (condition imposed by donor).

<sup>45</sup>I.R.C. § 170(f)(3); Reg. § 1.170A-7(a)(1); *see, e.g.*, Rev. Rul. 2003-28, 2003-1 C.B. 594.

<sup>46</sup>§ 170(f)(2)(A) (which includes pooled income funds as well as charitable remainder annuity trusts and charitable remainder unitrusts).

<sup>47</sup>§ 170(f)(2)(B).

3. Gifts of an undivided interest in the entire property owned by the donor,<sup>48</sup>
4. Gifts of remainder interests in a personal residence or farm,<sup>49</sup> and
5. Qualified conservation donations.<sup>50</sup>

Although a deduction for the gift of an undivided interest (*i.e.*, a fraction) of a donor's entire interest in property is allowed, this is so only if the donor (or the donor and donee in combination) owns the entire interest in the property immediately before the contribution and other requirements are met.<sup>51</sup> For example, a donor is allowed a deduction for donating a percentage interest in a painting to a museum if the donor owned the entire painting prior to the contribution. However, any deduction is later recaptured if the donor does not eventually give the entire interest in the painting to the donee museum and if the donee fails to exercise its percentage interest by, for example, not taking substantial physical possession of the painting or by failing to use the painting in a related use.<sup>52</sup> In addition, special valuation rules apply to each fractional gift (after the initial gift).<sup>53</sup>

Gifts of services are not eligible for a charitable contributions deduction.<sup>54</sup>

#### IV. Amount of Deduction

An eligible donee, the absence of a substantial return benefit, and a gift of the donor's entire interest are the main determinants of whether a charitable contributions deduction is allowed.<sup>55</sup> The amount allowed as a deduction, however, depends on a variety of factors and often requires application of complex rules.

An important factor determining the amount allowed as a deduction is whether the donee is classified either as a public charity or a private foundation, with a more generous allowance provided for donations to public

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<sup>48</sup> § 170(f)(3)(B)(ii); Reg. §§ 1.170A-5(a)(2), -7(b)(1)(i). If, however, the donor subdivides property for the purpose of avoiding this rule, no deduction is then allowed even for a donation of the entire subdivided property. Reg. § 1.170A-7(a)(2)(i).

<sup>49</sup> § 170(f)(3)(B)(i); Reg. § 1.170A-7(b)(3) (personal residence); Reg. § 1.170A-7(b)(4) (farm).

<sup>50</sup> § 170(f)(3)(B)(iii), (h); Reg. §§ 1.170A-7(b)(5), -14. These contributions are briefly discussed below.

<sup>51</sup> § 170(o). This rule was enacted as part of the Pension Protection Act of 2006, Pub. L. No. 109-280, § 1218(a), 120 Stat. 780.

<sup>52</sup> § 170(o)(3). The legislative history provides that the related use requirement would be satisfied if, for example, an art museum "includes the painting in an art exhibit sponsored by the museum." STAFF OF J. COMM. ON TAXATION, 109TH CONG., GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 109TH CONG. 603 (Comm. Print 2007).

<sup>53</sup> § 170(o)(2).

<sup>54</sup> Reg. § 1.170A-1(g). For a discussion of the nondeductibility of services, see Henry Ordower, *Charitable Contributions of Services: Charitable Gift Planning for Nonitemizers*, 67 TAX LAW. 517 (2014).

<sup>55</sup> See § 170(o)(1).

charities. The default classification is a private foundation.<sup>56</sup> Private foundations typically are founded and funded by a large donor who retains control over the organization. By contrast, to escape private foundation status, a public charity must show that a certain amount of its support derives from sufficiently public sources, through satisfaction of a detailed public support test.<sup>57</sup> Alternatively, a section 501(c)(3) organization may qualify as a public charity because of its function and role in the community; for example: hospitals, colleges and universities, and churches automatically are public charities.<sup>58</sup> Public charity status is also provided to supporting organizations, which receive such status derivatively through support of an established public charity.<sup>59</sup>

### A. *Quid Pro Quo*

As noted above, a charitable contributions deduction is allowed even if goods or services are received in exchange for a contribution so long as the payments to the charity exceed the value of the quid pro quo received by the donor. However, the amount of the deduction is reduced by the value of the return benefits.<sup>60</sup> The Treasury regulations provide a safe harbor for the donor to rely, in good faith, on a written statement provided by the donee setting forth the value of any goods or services received by the donor in exchange for the payment.<sup>61</sup> For these purposes, the value of certain small items provided to the donor may be ignored,<sup>62</sup> intangible religious benefits are not taken into account,<sup>63</sup> and recognition, praise, and even naming opportunities are disregarded.<sup>64</sup>

<sup>56</sup>I.R.C. § 509(a).

<sup>57</sup>§§ 170(b)(1)(A)(iv), (vi), 509(a)(1)-(2).

<sup>58</sup>§§ 170(b)(1)(A)(i)-(iii), 509(a)(1). For a discussion of the public charity-private foundation distinction, see Roger Colinvaux, *Charity in the 21st Century: Trending Toward Decay*, 11 FLA. TAX REV. 1, 53-64 (2011).

<sup>59</sup>§ 509(a)(3).

<sup>60</sup>Relatedly, if a deduction is allowed by reason of a sale for less than the fair market value of the property, the donor will recognize gain on the sale portion. I.R.C. § 1011(b).

<sup>61</sup>Reg. § 1.170A-1(h)(4).

<sup>62</sup>Reg. § 1.170A-13(f)(8)(i), referring to Rev. Proc. 90-12, 1990-1 C.B. 471, amplified by Rev. Proc. 92-49, 1992-1 C.B. 987, and modified by Rev. Proc. 92-102, 1992-2 C.B. 579.

<sup>63</sup>See I.R.C. § 6115(b). IRS, IRS PUB. NO. 1771, CHARITABLE CONTRIBUTIONS—SUBSTANTIATION AND DISCLOSURE REQUIREMENTS 7-8 (Rev. 2013), states:

What are “intangible religious benefits?” Generally, they are benefits provided by a tax exempt organization operated exclusively for religious purposes, and are not usually sold in commercial transactions outside a donative (gift) context. Examples include admission to a religious ceremony and a de minimis tangible benefit, such as wine used in a religious ceremony. Benefits that are not intangible religious benefits include education leading to a recognized degree, travel services, and consumer goods.

IRS PUB. NO. 1771, *supra*.

<sup>64</sup>*E.g.*, Rev. Rul. 68-432, 1968-2 C.B. 104; Rev. Rul. 73-407, 1973-2 C.B. 383; Rev. Rul. 77-367, 1977-2 C.B. 193; *see also* Reg. § 1.509(a)-3(f)(3), Ex. (2); Reg. §§ 53.4941(d)-2(f)(2), (4), Ex. (4).

A notable controversy about charitable contributions and return benefits involved the Church of Scientology. The Service initially ruled in 1978 that no deduction was available to a donor who received, in exchange for the donation, “auditing,” “training,” and “processing” courses, and other services.<sup>65</sup> After lengthy litigation, the Service’s position denying deductions to some donors was sustained by the United States Supreme Court.<sup>66</sup> At the same time, the Service separately determined that Scientology organizations were not tax exempt because they permitted personal inurement (to the benefit of founder L. Ron Hubbard), conducted extensive commercial activities, and contravened fundamental public policy by violating the law. Here, again, the Service was sustained by the courts.<sup>67</sup> Eventually, after the death of L. Ron Hubbard, the Service and the Scientologists announced a settlement under which the Scientology organizations would be recognized, once more, as tax exempt. Subsequently, the Service issued a ruling that “obsoleted” the 1978 ruling that had started the entire process.<sup>68</sup> Although the text of the closing agreement between the Scientology organizations and the Service was eventually made public, nothing in the closing agreement explains the Service’s change of stance in abandoning its prior ruling position that was sustained by the United States Supreme Court.<sup>69</sup>

### B. *Percentage Limitations and Carryovers*

The charitable contributions deduction is subject to a cap that is calculated as a percentage of a “contribution base.”<sup>70</sup> The applicable percentage depends on the type of donee, whether the donation is “to” or “for the use” of the donee, whether the contribution is cash or property, and whether the contribution is by an individual or corporation.

A 50% limitation is generally available for gifts made by individuals “to” a public charity.<sup>71</sup> Gifts “for the use of” public charities are deductible only up to 30% of the individual donor’s contribution base.<sup>72</sup> The United States

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<sup>65</sup>Rev. Rul. 78-189, 1978-1 C.B. 68.

<sup>66</sup>*Hernandez v. Commissioner*, 490 U.S. 680, 703 (1989) (a five-to-two decision with two Justices recusing).

<sup>67</sup>*E.g.*, *Church of Scientology of Cal. v. Commissioner*, 83 T.C. 381, 525-26 (1984), *aff’d on other grounds*, 823 F.2d 1310 (9th Cir. 1987), *cert. denied*, 486 U.S. 1015 (1988).

<sup>68</sup>Rev. Rul. 93-73, 1993-2 C.B. 75.

<sup>69</sup>*See* 19 EXEMPT ORG. TAX REV. 227, 227 (1998). In a later unrelated case, the Service denied claimed deductions for amounts paid for both secular and religious education. *Sklar v. Commissioner*, 282 F.3d 610, 622 (9th Cir. 2002) (affirming disallowance of the deduction on the ground that the donors had not shown that the value of the secular education received was less than the amount of the payments); *see also Sklar v. Commissioner*, 549 F.3d 1252, 1267 (9th Cir. 2008).

<sup>70</sup>I.R.C. § 170(b).

<sup>71</sup>§ 170(b)(1)(A). The 50% limitation also applies for gifts to government entities.

<sup>72</sup>§ 170(b)(1)(A), (B). The third sentence of Regulation section 1.170A-8(b) reads, “To qualify for the 50-percent limitation the contributions must be made ‘to’, and not merely ‘for the use of,’ one of the specified organizations.” Reg. § 1.170A-8(b).

Supreme Court has said that “a gift or contribution is ‘for the use of’ a qualified organization when it is held in a legally enforceable trust for the qualified organization or in a similar legal arrangement.”<sup>73</sup> Gifts of an income interest in property, whether or not in trust, are treated as made “for the use of” the charitable recipient,<sup>74</sup> but gifts of a qualified remainder interest are generally treated as made “to” the charitable recipient.<sup>75</sup> Unreimbursed expenses incurred in connection with rendering services to a charity are deductible and are treated as made “to” the charity<sup>76</sup> even though no deduction is permitted for a donation of services themselves.

Gifts of “capital gain property” made by an individual to a public charity qualify only for a 30%, rather than the usual 50%, limitation.<sup>77</sup> Capital gain property is any capital asset the sale of which by the donor at fair market value would give rise to long-term capital gain;<sup>78</sup> thus, gifts of appreciated stock or securities often fall under the 30% limitation. Donors may elect to reduce the amount of such gifts by the amount of any long-term capital gain, in which case the balance is deductible under the larger, 50% limitation.<sup>79</sup>

An individual’s gifts to private foundations generally may only be deducted up to 30% of the individual’s contribution base.<sup>80</sup> Furthermore, gifts of capital gain property to private foundations are subject to a still-smaller 20% limitation.<sup>81</sup>

Gifts by corporations are subject to a more straightforward, single ten percent limitation.<sup>82</sup> Corporations on the accrual basis of accounting may elect

<sup>73</sup> *Davis v. United States*, 495 U.S. 472, 485 (1990); *see also Rockefeller v. Commissioner*, 676 F.2d 35 (2d Cir. 1982), *acq.* 1984-2 C.B. 1.

<sup>74</sup> Reg. § 1.170A-8(a)(2).

<sup>75</sup> *Id.*

<sup>76</sup> Rev. Rul. 84-61, 1984-1 C.B. 39, accepting the result in *Rockefeller*. This position is now enshrined in the regulations. Reg. § 1.170A-1(g).

<sup>77</sup> § 170(b)(1)(C)(i).

<sup>78</sup> § 170(b)(1)(C)(iv).

<sup>79</sup> § 170(b)(1)(C)(iii). The election is made by attaching a statement to the donor’s tax return, referring to section 170(b)(1)(C)(iii) and Regulation section 1.170A-8(d)(2)(iii). It must cover all contributions of 30% property during the year, per Regulation section 1.170A-8(d)(2)(i)(a). It has been held generally to be irrevocable. *Woodbury v. Commissioner*, 900 F.2d 1457 (10th Cir. 1990); *Grynberg v. Commissioner*, 83 T.C. 255 (1984).

<sup>80</sup> § 170(b)(1)(B). Donations to certain subsets of private foundations, however—including private operating foundations and so-called pass-through or conduit foundations—qualify for the larger 50% limitation. § 170(b)(1)(A)(vii), (b)(1)(E); Reg. §§ 1.170A-9(f), -9(g), -9(h).

<sup>81</sup> § 170(b)(1)(D)(i).

<sup>82</sup> § 170(b)(2)(A). A corporation’s contribution base is its “taxable income.” Taxable income for this purpose is computed without regard to net operating loss carrybacks, deductions for dividends received, capital loss carrybacks, the charitable contributions deduction, and certain other deductions. § 170(b)(2)(C); Reg. § 1.170A-11(a). The limitation had been five percent; it was increased to ten percent by the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 263(a), 95 Stat. 172, 264. Efforts to increase the limitation to 15% were made but did not succeed. *See, e.g.*, STAFF OF J. COMM. ON TAXATION, 107TH CONG., DESCRIPTION OF AN AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 7, THE “COMMUNITY SOLUTIONS ACT OF 2001” (Comm. Print 2001).

to treat certain charitable gifts made after the close of a given taxable year, but before the 15th day of the third month thereafter, as having been made during the taxable year;<sup>83</sup> the election is not available to S corporations.<sup>84</sup>

Amounts disallowed by any of the limitations may be carried forward for five years and may be deducted in the future years to the extent to which the donor's gifts made in such years are less than the relevant limitations.<sup>85</sup> The computations may be complex, particularly if more than one of the relevant limitation percentages is involved.<sup>86</sup>

In recent years, Congress has enacted temporary special rules either increasing or waiving the percentage limitations. Contributions of conservation easements (technically, "qualified conservation contributions")<sup>87</sup> normally would be subject to the 30% limitation but under a special rule may be deducted up to 50% of the individual's contribution base.<sup>88</sup> If the taxpayer is a "qualified farmer or rancher," including a corporate taxpayer, then the limit is waived (*i.e.*, the limit is 100% of the contribution base).<sup>89</sup> Contributions in excess of any of these limits may be carried forward 15 years, instead of the usual five.<sup>90</sup> In addition, in the wake of devastating hurricanes that struck the Gulf Coast in the fall of 2005, Congress waived the percentage limitations on a temporary basis.<sup>91</sup> Congress also passed a special exclusion from income for distributions made by an individual from an individual retirement arrangement directly to a qualifying section 501(c)(3) organization.<sup>92</sup> Although not technically a waiver of the percentage limitations, the effect is to allow certain contributions to escape the percentage limitation cap.

The Tax Reform Act of 2014, a discussion draft released by Chairman of the Ways and Means Committee Dave Camp, proposes combining the 50%

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<sup>83</sup> § 170(a)(2). The election is made by attaching a written declaration to the corporation's tax return for the year. Reg. § 1.170A-11(b)(2). Prudence suggests careful compliance even though the courts and the Service have shown some flexibility in forgiving procedural foot-faults. *Columbia Iron & Metal Co. v. Commissioner*, 61 T.C. 5 (1973), *acq.* 1979-2 C.B. 1. The election may be made as to a portion as well as to all of the donations made during the 2.5 month window. Rev. Rul. 57-228, 1957-1 C.B. 506.

<sup>84</sup> Rev. Rul. 2000-43, 2000-2 C.B. 333.

<sup>85</sup> § 170(b)(1)(B), (C)(ii), (D)(ii), 170(d).

<sup>86</sup> See, e.g., Reg. § 1.170A-10 (for individuals); Reg. § 1.170A-11(c) (for corporations).

<sup>87</sup> § 170(h).

<sup>88</sup> § 170(b)(1)(E)(i). These special rules for conservation easements have expired and been extended multiple times since their enactment in 2006. As of this writing, the special rules terminated for contributions made in taxable years beginning after December 31, 2013. § 170(b)(1)(E)(vi), (2)(B)(iii).

<sup>89</sup> § 170(b)(2)(B)(i).

<sup>90</sup> § 170(b)(1)(E)(ii), (2)(B)(ii).

<sup>91</sup> Katrina Emergency Tax Relief Act of 2005; Pub. L. No. 109-73, § 301, 119 Stat. 2016; § 1400S(a).

<sup>92</sup> I.R.C. § 408(d)(8). The exclusion is available for distributions to a public charity but not to a donor advised fund or supporting organization. The provision was first enacted in 2006 and has since expired and been extended multiple times. As of this writing, the exclusion is not available for distributions made in taxable years beginning after December 31, 2013. § 408(d)(8)(F).

and 30% limitations applicable for gifts to public charities to a single limitation of 40% and also combining the 30% and 20% limitations applicable for gifts to nonoperating private foundations to a single limit of 25%.<sup>93</sup>

### C. *Reductions of Deduction Amount for Noncash Contributions*

For cash contributions, the amount of the deduction is equal to the amount of cash contributed (subject to all of the rules described above). For noncash contributions (property), the general approach is to allow a deduction equal to the fair market value of the property at the time it is contributed. However, there are numerous exceptions that result in a reduction (from fair market value) of the amount allowed as a deduction.

- Charitable donations of property must be reduced by the amount of any ordinary income that would have been recognized if the donor had sold the property for its fair market value.<sup>94</sup> Common examples are: (1) if an artist donates one of her own paintings, her deduction is limited to her basis in the painting, that is, the cost of the canvas, frame, paints, etc.;<sup>95</sup> (2) if a company donates inventory, the deduction is similarly limited to cost;<sup>96</sup> and (3) if a donor contributes stock held for less than one year, again the deduction is so limited.<sup>97</sup>
- Charitable donations of tangible personal property, if the donee puts the property to an unrelated use, must be reduced by the amount of any long-term capital gain that would have been recognized if the donor had sold the property for its fair market value.<sup>98</sup> Sale by the donee within three years of the contribution is an unrelated use, thus triggering the reduction either in the tax year of the donation or in a later year by

<sup>93</sup>Tax Reform Act of 2014 § 1403(d) (Discussion Draft 2014). The proposal would maintain the preference for gifts to public charities rather than private foundations but eliminate the preference for cash gifts over in kind giving.

<sup>94</sup>§ 170(e)(1)(A).

<sup>95</sup>Reg. §§ 1.170A-4(a)(1), (b)(1) (which specifically states that “a work of art created by the donor” is “ordinary income property”); accord *Maniscalco v. Commissioner*, 37 T.C.M. (CCH) 1174, 1978 T.C.M. (P-H) ¶ 78,274 (changes to this result are perennially proposed), *aff’d per curiam*, 632 F.2d 6 (6th Cir. 1980) (denying the taxpayer a charitable contributions deduction for a gift to charity of three portraits he painted); see, e.g., The Artist-Museum Partnership Act of 2013, H.R. 2482, 113th Cong. (2013); Art and Collectibles Capital Gains Tax Treatment Parity Act, S. 930, 112th Cong. (2011).

<sup>96</sup>§ 170(e)(3), (4), (6). Special rules exist for contributions of certain kinds of inventory and other ordinary income producing property, such as food, books, scientific property used for research, and computer technology and equipment. If various requirements are met, then the amount allowed as a deduction is the donor’s cost plus one half of the appreciation of the property (not to exceed twice the donor’s cost).

<sup>97</sup>§ 170.

<sup>98</sup>§ 170(e)(1)(B)(i).

recapture.<sup>99</sup> When the donated property is retained by the donee, the Service has opined that:

[A] direct and functional use test must be applied [for determining what is unrelated use]. Where a donee does not intend actually to use contributed appreciated personalty in carrying out its specific exempt purposes, we believe the Code requires the amount of the charitable contribution otherwise allowable to be reduced.<sup>100</sup>

Applying that standard, the Service held that display of donated art by a medical school does not constitute “related use,” and thus, the donor must reduce the amount of its gift under this rule. By contrast, “if a painting contributed to an educational institution is used by that organization for educational purposes by being placed in its library for display and study by *art* students, the use is not an unrelated use . . . .”<sup>101</sup> Because a donor may not always know the actual use to which donated property is put by the donee, some safe-harbor rules are provided in regulations.<sup>102</sup>

- Charitable donations of property to a private foundation must be reduced by the amount of any long-term capital gain that would have been recognized if the donor had sold the property for its fair market value.<sup>103</sup> An important exception permits gifts of certain “qualified appreciated stock” without any such reduction.<sup>104</sup> The stock must be quoted on an established securities market and not more than ten percent of the corporation’s outstanding stock may be so contributed.<sup>105</sup>
- Charitable donations of intellectual property (*e.g.*, a patent, copyright, or trademark) face a similar reduction from fair market value of any

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<sup>99</sup> § 170(e)(1)(B)(i)(II), (7). Section 6050L requires donees to report to the Service, with a copy to the donor, if any donated property is sold or disposed of within three years after its receipt. An appropriate certification by the donee regarding the use of the property avoids a reduction of the deduction (assuming a fair market value deduction was claimed) that would otherwise occur through recapture. § 170(e)(7)(D).

<sup>100</sup> G.C.M. 38,804 (Oct. 15, 1981).

<sup>101</sup> Reg. § 1.170A-4(b)(3)(i) (emphasis added).

<sup>102</sup> Reg. § 1.170A-4(b)(3)(ii).

<sup>103</sup> § 170(e)(1)(B)(ii). Some private foundations are exempt from this rule. § 170(b)(1)(F).

<sup>104</sup> § 170(e)(5).

<sup>105</sup> § 170(e)(5). This provision has had a stuttering history: it was enacted by the Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 301(b), 98 Stat. 494, 778; it expired at the end of 1994, but was reenacted, effective July 1, 1996, in section 1206(a) of the Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755, 1776, with a new “sunset” date of May 31, 1997. That 1997 sunset date, in turn, passed without legislative extension, but the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 602(a), 111 Stat. 788, 862, retroactively revived it and extended it to June 30, 1998. It again expired on June 30, 1998, but was once more retroactively resuscitated and this time made permanent by the Tax and Trade Relief Extension Act of 1998, § 1004(a), 112 Stat. 2681, 2681-888, which amended section 170(e)(5) by striking from it subparagraph D, which had contained the sunset provision. This last amendment was made effective for “contributions made after June 30, 1998.”

long-term capital gain.<sup>106</sup> However, if the contributed intellectual property generates net income to the donee for up to ten years after the contribution, additional charitable contribution deductions are allowed to the donor in an amount that is a percentage of such income.<sup>107</sup>

- Charitable donations of taxidermy are also subject to the long-term capital gain reduction rule.<sup>108</sup>

A reduction under these rules directly affects the amount allowed as a deduction, that is, no carryover is provided for the amount of the reduction.<sup>109</sup>

#### D. *Reduction Rules Affecting Itemized Deductions Generally (Including the Charitable Deduction)*

The charitable contributions deduction is an itemized deduction.<sup>110</sup> This means that the roughly two-thirds of taxpayers<sup>111</sup> who claim the standard deduction are not separately allowed a deduction for charitable contributions<sup>112</sup> but instead claim the simpler, and at least sometimes more generous, standard deduction.<sup>113</sup> Because the amount of the standard deduction does not vary with actual charitable donations and is in lieu of certain other deductions as well, it provides no incentive to make charitable gifts, and it treats equally those nonitemizers who donate to charity and those who do not. There is an unavoidable policy tension here between simplification of

<sup>106</sup> § 170(e)(1)(B)(iii).

<sup>107</sup> § 170(m). This rule was enacted as part of The American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 882, 18 Stat. 1418. The Tax Reform Act of 2014 would repeal this rule. The Tax Reform Act of 2014 § 1403(g) (Discussion Draft 2014).

<sup>108</sup> § 170(e)(1)(B)(iv).

<sup>109</sup> § 170(b)(1)(D)(ii).

<sup>110</sup> I.R.C. § 63(e).

<sup>111</sup> The Tax Policy Center reports that 66.5% of returns in 2011 claimed the standard deduction. *Types of Deduction 1999–2011*, TAX POLICY CENTER, Apr. 29, 2014, <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?DocID=392&Topic2id=30&Topic3id=34>.

<sup>112</sup> From 1982 to 1986, a nonitemizer charitable contributions deduction was allowed, phasing in during the earlier years until fully effective in 1986. The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 121(a), 95 Stat. 172, 196. It terminated after 1986 and later was completely repealed. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11801(a)(11), 104 Stat. 1388, 1388-520.

<sup>113</sup> For taxable years beginning in 2014, the standard deduction is \$6,200 (\$12,400 for a joint return of married individuals) for individuals who are less than 65 years old and are neither blind or heads of households. § 63(c); Rev. Proc. 2013-35, 2013-47 I.R.B. 537. Individuals or couples whose charitable contributions exceed those limits are likely to elect to itemize their deductions to claim those higher deductions. However, because the standard deduction is in lieu of certain other deductions as well as the charitable contributions deduction and because there is some cost in preparing the more-detailed tax return required to be filed by itemizers, there is not a one-to-one correspondence between the amounts given to charity and the decision whether to itemize.

taxpayer compliance burdens on the one hand and a desire for improved incentives and horizontal equity among taxpayers on the other.<sup>114</sup>

An individual's itemized income tax deductions, including those for charitable donations, must be reduced by the lesser of (1) three percent of the excess of adjusted gross income over the "applicable amount" or (2) 80% of itemized deductions.<sup>115</sup> The "applicable amount" was \$100,000 when the statutory provision was adopted in 1990<sup>116</sup> but was subject to inflation adjustments.<sup>117</sup> For the last calendar year in which that prior provision was in effect, 2009, the amount was \$166,800.<sup>118</sup> Under the currently effective section, the "floor" (or "applicable amount") for 2014 is \$305,050 for those filing joint returns, \$279,650 for heads of households, \$254,200 for individuals, and \$152,525 for married individuals filing separate returns.<sup>119</sup> Those amounts are subject to inflation adjustments.<sup>120</sup>

## V. Property Specific Rules

In addition to the rules described above for inventory, intellectual property, and taxidermy, Congress has enacted other, somewhat free-standing, property-specific deduction rules.

### A. *Clothing and Household Items*

No deduction is allowed for a contribution of clothing or household items (such as furniture, electronics, and appliances) unless the property is in good

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<sup>114</sup>For a thoughtful analysis of the history of and policy considerations affecting the non-itemizer charitable contributions deduction, see Ellen P. Aprill, *Churches, Politics, and the Charitable Contribution Deduction*, 42 B.C. L. REV. 843 (2001). See also STAFF OF J. COMM. ON TAXATION, 107TH CONG., DESCRIPTION AND ANALYSIS OF PRESENT LAW AND PROPOSALS TO EXPAND FEDERAL TAX INCENTIVES FOR CHARITABLE GIVING (Comm. Print 2001). Although a nonitemizer deduction was proposed in 2001, and over the course of several years passed both House and Senate in different forms, it was not enacted. See, e.g., Tax Relief Act of 2005, S. 2020, 109th Cong. § 301 (2005).

<sup>115</sup>I.R.C. § 68(a). This provision is often referred to as "Pease" after the Congressman—Donald J. Pease, D-Ohio, who served in Congress from 1977 until 1993—who authored its original version. Not all itemized deductions are included for this purpose: medical expenses, investment interest, and casualty or theft losses are excluded. § 68(c). Section 68 was added to the Code by the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11103, 104 Stat. 1388, 1388-406-07. It was extended by the Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, §§ 13201(b)(3)(e), 13204, 107 Stat. 312, 462. It was then phased out, partially starting in 2006 and completely by the end of calendar year 2009, by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 103(a), 115 Stat. 38, 44-45. Most recently, it was reinstated by the American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 101(b)(2)(A), 126 Stat. 2313, 2317 (2013).

<sup>116</sup>§ 68(b)(1).

<sup>117</sup>§ 68(b)(2).

<sup>118</sup>Rev. Proc. 2001-59, § 3.08, 2001-52 I.R.B. 623, 626.

<sup>119</sup>§ 68(b)(1); Rev. Proc. 2013-35, § 3.14, 2013-47 I.R.B. 537.

<sup>120</sup>§ 68(b)(2).

used condition or better.<sup>121</sup> This rule does not apply to a single item valued at more than \$500 if the donor includes an appraisal with the tax return.

### B. Vehicles

Concerns about abuse in the many car-donation programs run by section 501(c)(3) organizations<sup>122</sup> led to a special rule that limits the amount of the deduction to the sales price of the donated vehicle.<sup>123</sup> This rule does not apply to vehicles with a claimed value of \$500 or less or to vehicles that are used or substantially improved by the donee. Special substantiation rules apply.

### C. Qualified Conservation Contributions

A charitable deduction for a qualified conservation contribution (better known as the deduction for conservation easements) is allowed.<sup>124</sup> As noted above, this is an exception to the rule barring a deduction for contributions of a partial property interest.<sup>125</sup> The contribution must be exclusively for one of four broadly-defined conservation purposes, with special rules applicable to easements on buildings in historic districts.<sup>126</sup> Detailed regulations apply.<sup>127</sup> Also as noted above, qualified conservation contributions are preferred to other charitable contributions under the percentage limitation and carryover rules. Notwithstanding such preferred treatment, the deduction for easement contributions also has been criticized for abuses related to valuation and the nature of the public benefit derived.<sup>128</sup>

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<sup>121</sup> I.R.C. § 170(f)(16). This rule was enacted as part of the Pension Protection Act of 2006, Pub. L. No. 109-432, § 1216(a), 120 Stat. 780. See also Prop. Reg. § 1.170A-18, 73 Fed. Reg. 45,908 (Aug. 7, 2008). In 2005, the staff of the Joint Committee on Taxation proposed limiting the deduction for clothing and household items to no more than \$500 per taxable year, regardless of filing status. STAFF OF J. COMM. ON TAXATION, 109TH CONG., OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES 288-292 (Comm. Print 2005).

<sup>122</sup> See U.S. GEN. ACCOUNTING OFFICE, GAO-04-73, REP. TO S. COMM. ON FIN., VEHICLE DONATIONS: BENEFITS TO CHARITIES AND DONORS, BUT LIMITED PROGRAM OVERSIGHT (2003).

<sup>123</sup> § 170(f)(12). This rule was enacted as part of The American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 884(a), 118 Stat. 1418, 1632-34.

<sup>124</sup> § 170(h).

<sup>125</sup> § 170(f)(3)(B)(iii).

<sup>126</sup> § 170(h)(4)(B), (f)(13) (requiring a filing fee for such contributions).

<sup>127</sup> Reg. § 1.170A-14.

<sup>128</sup> See Daniel Halperin, *Incentives for Conservation Easements: The Charitable Deduction or a Better Way*, 74 LAW & CONTEMP. PROBS. 29 (2011); Roger Colinvaux, *The Conservation Easement Tax Expenditure: In Search of Conservation Value*, 37 COLUM. J. ENVTL. L. 1 (2012); Nancy A. McLaughlin, *Perpetual Conservation Easements in the 21st Century: What Have We Learned and Where Should We Go from Here?*, 2013 UTAH L. REV. 687 (2013); Roger Colinvaux, *Conservation Easements: Design Flaws, Enforcement Challenges, and Reform*, 2013 UTAH L. REV. 755 (2013); Wendy C. Gerzog, *Alms to the Rich: The Façade Easement Deduction*, VA. TAX REV. (forthcoming 2014).

## VI. Contributions to Split-Interest Trusts

Certain sophisticated transactions—involving split-interest gifts (*e.g.*, charitable remainder or charitable lead trusts), charitable gift annuities, pooled income funds, and the like—are subject to other detailed requirements that are generally beyond the scope of this overview to explore. Because of the substantial aggregate size of charitable remainder trusts, however, a brief description of the basic fiscal rules affecting them is set out below.

There are two broad categories of split-interest charitable trusts: charitable *lead* trusts (in which the charitable beneficiary's interest precedes the interest of noncharitable beneficiaries) and charitable *remainder* trusts (in which the reverse is true). Because the aggregate assets that have been donated to charitable remainder trusts (CRTs) are much greater than those in charitable lead trusts,<sup>129</sup> this discussion focuses only on CRTs. Pooled income funds, a special form of CRT, are not described.<sup>130</sup> As of 2012, the aggregate net assets of CRTs amounted to approximately \$92 billion.<sup>131</sup>

CRTs come in two flavors: charitable remainder annuity trusts (CRATs) and charitable remainder unitrusts (CRUTs).<sup>132</sup> Both have a charitable beneficiary that becomes entitled to the trust assets after the termination of a predecessor noncharitable beneficiary's interest.<sup>133</sup> The lead, noncharitable interest may either be for a fixed term (not to exceed 20 years) or for the life or lives of the noncharitable beneficiary(ies).<sup>134</sup> The value of the charitable remainder interest—determined on a present-value basis after subtracting the value of the lead, noncharitable interest—cannot be less than ten percent of the net fair market value of the donation to the trust.<sup>135</sup> In a CRAT, the lead interest is an annuity, that is, a fixed annual amount specified or calculable at the inception of the trust; the annuity amount cannot be less than five percent nor greater than 50% of the initial value of the trust.<sup>136</sup> In a CRUT, the lead interest is a fixed annual percentage (specified at the inception of the trust) of the trust assets valued at least once a year; the percentage cannot be

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<sup>129</sup>As of 2012, charitable remainder unitrusts, measured both by number of trusts and by net assets held, represented over 86% of remainder trusts; less than 14%, by number and net assets, were represented by charitable remainder annuity trusts. See Lisa S. Rosenmerkel, *Split-Interest Trusts, Filing Year 2012*, STATISTICS OF INCOME BULLETIN 51 (Winter 2014).

<sup>130</sup>See generally I.R.C. § 642(c)(5); Reg. § 1.642(c)-5. For further discussion of pooled income funds, see Lawrence P. Katzenstein, *Charitable Remainder Trusts: Charity Can Begin at Home*, AM. LAW ASSOC.-AM. BAR ASS'N COURSE OF STUDY, ST042 ALI-ABA 465 (June 2012).

<sup>131</sup>Rosenmerkel, *supra* note 129, at 53. These data were derived from more than 113,000 returns filed by split-interest trusts.

<sup>132</sup>Section 664(d)(1) and section 664(d)(2) respectively.

<sup>133</sup>§ 664(d)(1)(A), (1)(C), (2)(A), (2)(C).

<sup>134</sup>§ 664(d)(1)(A), (2)(A).

<sup>135</sup>§ 664(d)(1)(D), (2)(D).

<sup>136</sup>§ 664(d)(1)(A).

less than five percent nor greater than 50%.<sup>137</sup> Thus, the noncharitable beneficiary of a CRAT is entitled to receive the same amount every year regardless of the value of the trust, whereas the noncharitable beneficiary of a CRUT is entitled to receive an amount that varies from year to year depending on the value of the trust.

A donor to a CRT is allowed a charitable contributions deduction for a portion of the fair market value of the money and property donated to the trust.<sup>138</sup> No deduction is permitted unless the trust is either a CRAT or a CRUT;<sup>139</sup> thus, no deduction is permitted for a donation to a trust in which the interest of the lead noncharitable beneficiary is defined solely by reference to the trust's "income."<sup>140</sup> The amount of the deduction is calculated by apportioning the value of the donation to the CRT between the noncharitable lead interest and the charitable remainder interest<sup>141</sup> using an interest rate (or discount factor) that is fixed by the Service every month. The interest rate varies according to market interest rates on U.S. government mid-term

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<sup>137</sup> § 664(d)(2)(A). If the trust holds assets that do not have a readily ascertainable fair market value, they must be appraised either by an independent trustee or a qualified appraiser. Reg. § 1.664-1(a)(7).

<sup>138</sup> The income tax deduction is available under section 170(a)(1), section 170(c), and section 170(f)(2)(A). A gift tax deduction is available under sections 2522(a) and 2522(c)(2)(A). An estate tax deduction is available under sections 2055(a) and 2055(e)(2)(A). CRTs may be, and commonly are, created by testamentary gift as well as during a donor's life. It is often prudent, in drafting the CRT documents, to restrict the eligible charitable beneficiaries to organizations that meet *all* of the relevant definitions, *i.e.*, for income and gift and estate tax purposes; this insures eligibility for each of those tax regimes.

<sup>139</sup> Section 170(f)(2)(A) denies the income tax deduction. *See also* Reg. § 1.170A-6(b)(1). Section 2522(c)(2)(A) denies the gift tax deduction, and section 2055(e)(2)(A) denies the estate tax deduction. A deduction *is* allowed for donations to pooled income funds, as the above subparagraphs of the Code confirm, but (as mentioned above) pooled income funds are outside the scope of the current discussion.

<sup>140</sup> A deduction is permitted, however, for a contribution to a CRUT that either pays (1) the lesser of income or a fixed percentage of the value of its assets (§ 664(d)(3)(A)), or (2) that lesser amount with an extra payment out of income in a later year to make up for earlier year shortfalls when trust income was less than the unitrust amount (§ 664(d)(3)(B)). The former exception is sometimes referred to as a "net income CRUT" or "NICRUT;" the latter is sometimes referred to as "net income with make-up CRUT" or "NIMCRUT." The donor's charitable contribution deduction remains the same whether or not the make-up provision is included. § 664(e). The regulations approve a further variety of CRUT, a so-called "flip" CRUT, in which only income is paid to the lead, noncharitable beneficiary for a prescribed period, following which the trust changes to a standard, fixed percentage of value payout. Reg. § 1.664-3(a)(1)(i)(c), added by T.D. 8791, 1999-5 I.R.B. 7; *see also* the examples in Reg. § 1.664-3(a)(1)(i)(e). In all of these cases, however, the noncharitable beneficiary's interest is a unitrust interest, albeit modified by a trust-income limitation. As noted in the text, a pure income lead interest will not qualify the split-interest trust as a CRT and no deduction will be permitted to a donor to such a trust.

<sup>141</sup> This is not an effort to determine the present value of what the charitable remainderman will ultimately receive; indeed, it is highly unlikely that the amount of the permitted charitable contributions deduction will ever match, on a present-value basis, the amount actually turned over to the donee upon the termination of the lead noncharitable interest.

bonds.<sup>142</sup> The present value of the remainder interest is usually treated as paid “to,” rather than merely “for the use of” the charitable remainderman;<sup>143</sup> therefore, it may qualify for the higher, 50% limitation if the remainder beneficiary is a public charity.<sup>144</sup>

The CRT itself is exempt from income taxes so long as it does not generate unrelated business income.<sup>145</sup> Thus, gifts to CRTs of appreciated property may be advantageous as the donor is not taxed at the time of contribution on the unrealized gain, and the CRT is not taxed on the gain even when it is realized upon actual sale of the property by the CRT. A CRT is subject to some, but not all, of the private foundation excise tax rules. In all cases, the self-dealing prohibitions and the rules against expenditures for prohibited purposes apply;<sup>146</sup> in certain unusual situations, the excess-business-holdings and jeopardy-investment rules may also apply.<sup>147</sup>

A lead, noncharitable beneficiary is taxable on annuity or unitrust amounts paid by the CRT under a four-tier system of tracing income from the CRT to the beneficiary.<sup>148</sup> The details are beyond the scope of this Article.<sup>149</sup> CRTs

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<sup>142</sup>Section 7520(a)(2), by cross-reference to section 1274(d)(1), requires that the interest rate for any month is calculated: (1) by determining the average market yield during the prior month for U.S. obligations with a maturity of more than three but not more than nine years, (2) by multiplying that average yield by 120%, and (3) by rounding that result to the nearest two-tenths of one percent. The Service issues a monthly ruling setting the rate. A donor is permitted to elect to use the interest rate for the month in which the donation is made to a CRT or the rate for either of the prior two calendar months. I.R.C. § 7520(a); Reg. § 1.7520-2(a)(2).

<sup>143</sup>Reg. § 1.170A-8(a)(2). This adopts the result in *Tully v. Commissioner*, 48 T.C. 235 (1967). If, however, the remainder interest is not paid over outright to the charity but is instead held in continuing trust for the charity, the gift will be treated as “for the use of” the charity. Reg. § 1.170A-8(a)(2).

<sup>144</sup>Of course, the property donated must otherwise be eligible for the 50% limitation, so, e.g., capital gain property will not qualify. See *supra* text accompanying notes 77-79.

<sup>145</sup>§ 664(c)(1). Unrelated business taxable income, however, results in an excise tax equal to the amount of such income. § 664(c)(2). This rule, enacted in 2006, changed the prior rule under which the CRT’s tax exemption was lost on *all* of its income for a year in which it had unrelated business income. See, e.g., *Leila G. Newhall Unitrust v. Commissioner*, 104 T.C. 236 (1995), *aff’d*, 105 F.3d 482 (9th Cir. 1997).

<sup>146</sup>I.R.C. § 4947(a)(2), (b)(3)(B); Reg. § 53.4947-1(c)(1)(ii). The annuity or unitrust payments to any lead, noncharitable beneficiary do not violate the self-dealing prohibitions or the other private foundation rules. See Reg. § 53.4947-1(c)(2)(i).

<sup>147</sup>These latter rules apply if there is a charitable lead beneficiary in addition to one or more lead, noncharitable beneficiaries. § 4947(a)(2), (b)(3)(B).

<sup>148</sup>§ 664(b). Thus, gain realized by the trust upon sale of donated appreciated property may, under some circumstances, be taxed in whole or part to the lead, noncharitable beneficiary.

<sup>149</sup>Reg. §§ 1.664-1(d), (e). See generally MARTIN HALL & CAROLYN M. OSTEEN, *TAX ASPECTS OF CHARITABLE GIVING* § 1502.3 (3d ed. 2013); BRUCE R. HOPKINS, *THE TAX LAW OF CHARITABLE GIVING* § 12.2 (2010); Leo L. Schmolka, *Income Taxation of Charitable Remainder Trusts and Decedents’ Estates: Sixty-Six Years of Astigmatism*, 40 *TAX L. REV.* 1, 58-60 (1984).

are subject to other highly complex and technical rules that the Service tends to enforce with rigorous and remorseless rigidity.<sup>150</sup>

## VII. Substantiation

Under the Code, “[a] charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.”<sup>151</sup> Accordingly, lengthy and detailed regulations apply.<sup>152</sup> In addition, the Code imposes additional specific requirements, outlined below. Further, a doctrine of substantial compliance with the regulations is sometimes applied by the courts to allow deductions even if technical defects in satisfying the substantiation rules are present. In the words of Professor Ellen Aprill: “Substantial

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<sup>150</sup>The Service has provided considerable guidance on how to draft CRTs. The advice is of two kinds: mandatory and optional. The mandatory rules are in Revenue Ruling 72-395, 1972-2 C.B. 340. That ruling has been modified by three subsequent rulings—Revenue Ruling 80-123, 1980-1 C.B. 205; Revenue Ruling 82-128, 1982-2 C.B. 71; and Revenue Ruling 88-81, 1988-2 C.B. 127—and was also “clarified” by Revenue Ruling 82-165, 1982-2 C.B. 117. See also Rev. Rul. 92-57, 1992-2 C.B. 123. The optional rules, in the form of safe harbor provisions that the Service will automatically accept, are contained in numerous revenue procedures. For provisions to qualify trusts as CRATs, see, e.g., Rev. Proc. 2003-53, 2003-2 C.B. 230; Rev. Proc. 2003-55, 2003-2 C.B. 242; Rev. Proc. 2003-56, 2003-2 C.B. 249; Rev. Proc. 2003-57, 2003-2 C.B. 257; Rev. Proc. 2003-58, 2003-2 C.B. 262; Rev. Proc. 2003-59, 2003-2 C.B. 268; Rev. Proc. 2003-60, 2003-2 C.B. 274. For provisions to qualify trusts as CRUTs, see, for example, Rev. Proc. 2005-52, 2005-2 C.B. 326 (for CRUTs); Rev. Proc. 2005-53, 2005-34 I.R.B. 339; Rev. Proc. 2005-54, 2005-34 I.R.B. 353; Rev. Proc. 2005-55, 2005-34 I.R.B. 367; Rev. Proc. 2005-56, 2005-34 I.R.B. 383; Rev. Proc. 2005-57, 2005-34 I.R.B. 392; Rev. Proc. 2005-58, 2005-34 I.R.B. 402; Rev. Proc. 2005-59, 2005-2 C.B. 412. For additional discussion, see Martin Hall & Carolyn M. Osteen, *Areas for Reform: Split Interest and Partial Interest Gifts* (2012), in 24 N.Y.U. NAT’L CENTER ON PHILANTHROPY & L. CONF. SEC. E 41-45 (2012).

<sup>151</sup>I.R.C. § 170(a)(1).

<sup>152</sup>Reg. § 1.170A-13. This Regulation is captioned “Recordkeeping and return requirements for deductions for charitable contributions.” It is about 17 pages long. Some of the contents of the regulations were a result of an off-Code statutory directive. The Deficit Reduction Act of 1984 specifically required the Treasury to issue regulations under section 170(a)(1) to require taxpayers to secure a qualified appraisal and attach an appraisal summary to the donor’s tax return for property contributions with a claimed value of more than \$5,000. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 155, 98 Stat. 494, 691. Section 170(f)(11), enacted as part of The American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 883(a), 118 Stat. 1418, 1631, codified (and supplemented) many of the substantiation requirements previously found in the regulations. In 2008, the Treasury announced proposed regulations that modify and add to existing regulations. Prop. Reg. § 170(f)(11), 73 Fed. Reg. 45,908 (Aug. 7, 2008).

compliance excuses near misses.”<sup>153</sup> The scope of the substantial compliance doctrine is limited, however,<sup>154</sup> and donors are well advised to meet all of the precise substantiation requirements of the Code and regulations.<sup>155</sup> A general principle to be gleaned from the cases is that substantial compliance may be found if the errors in substantiation are few, and in large part, the donor obtained the required information but merely failed to report it properly—a substance over form approach. By contrast, if the (even technical) errors are many or if critical required information was not obtained, the deduction will be disallowed notwithstanding that the *only* defect was substantiation.

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<sup>153</sup>Ellen P. Aprill, *Reforming the Charitable Contribution Substantiation Rules*, 14 FLA. TAX REV. 275 (2013); see, e.g., *Bond v. Commissioner*, 100 T.C. 32, 40-42 (1993) (holding that attaching an appraisal summary but not the required actual appraisal was substantial compliance with the regulations in part because the essential required information had been provided in the summary itself); *Simmons v. Commissioner*, 98 T.C.M. (CCH) 211, 215, 2009 T.C.M. (RIA) ¶ 2009-208, at 1567 (holding that failure to include the contribution date in the appraisal was nonetheless substantial compliance because the Form 8283 attached to the return included such date); *Consol. Investors Grp. v. Commissioner*, 98 T.C.M. (CCH) 601, 614, 2009 T.C.M. (RIA) ¶ 2009-290, at 2140 (holding that an appraisal obtained three months too early nevertheless was in substantial compliance with the regulations and so a “qualified appraisal”). The most recent relevant decision is *RERI Holdings I, LLC, v. Commissioner*, 143 T.C. No. 3 (2014).

<sup>154</sup>The scope of the doctrine is uncertain because, as the cases indicate, it will not be clear in any given case whether substantial compliance is met. Further, the doctrine arose in the context of satisfaction of regulatory requirements not specific statutory directives. See, e.g., *Bond*, 100 T.C. at 40; *Hewitt v. Commissioner*, 109 T.C. 258, 263-64 (1997), *aff’d without opinion*, 166 F.3d 332 (4th Cir. 1998) (discussing whether the regulations are “directory” and “procedural” or “mandatory”). Congress’s adoption of statutory directives may have largely mooted this debate. See *Rothman v. Commissioner*, 103 T.C.M. (CCH) 1864, 1868, 2012 T.C.M. (RIA) ¶ 2012-163, at 1246 (“The substantial compliance doctrine has continuing but limited application in a post-section 170(f)(11) world.”). *But see* *Scheidelman v. Commissioner*, 682 F.3d 189, 198 (2d Cir. 2012) (relying in passing on substantial compliance doctrine to override technical defects of failure to include the date and manner of acquisition of property or the property’s cost basis). See also Aprill, *supra* note 153, at 298-306 (discussing these and other cases).

<sup>155</sup>See, e.g., *Hewitt*, 109 T.C. at 264 (holding that failure to obtain a qualified appraisal was grounds for denying a deduction even though the taxpayer’s own valuation was not contested); *Smith v. Commissioner*, 94 T.C.M. (CCH) 574, 586, 2007 T.C.M. (RIA) ¶ 2007-368, at 1982, *aff’d*, 364 F. App’x 317 (9th Cir. 2009) (holding that a “terse” appraisal lacking analysis, completed late by a person without clear expertise, combined with other errors was not substantial compliance); *Friedman v. Commissioner*, 99 T.C.M. (CCH) 1175, 1177, 2010 T.C.M. (RIA) ¶ 2010-045, at 258 (disallowing deduction where only “generic” descriptions of the property were provided leaving no basis to determine the valuation method used or the basis for the appraised values); *Mohamed v. Commissioner*, 103 T.C.M. (CCH) 1814, 1817, 2012 T.C.M. (RIA) ¶ 2012-152, at 1172 (denying deductions of more than \$18.5 million because the taxpayer, performing his own, largely accurate appraisals, was not a “qualified appraiser”).

In short, substantiation is a distinct condition of the charitable contributions deduction.<sup>156</sup>

### A. Contributions of Less than \$250

Under a rule enacted in the Pension Protection Act of 2006,<sup>157</sup> for contributions in the form of cash, check, or other monetary gift,<sup>158</sup> the donor must maintain a record of the contribution, such as a bank record (*e.g.*, in the case of a gift by check or credit card) or a written communication from the donee.<sup>159</sup> Any such written communication must show the name of the donee, and the date and amount of the contribution. Under proposed Treasury regulations, this substantiation requirement does not apply to contributions of less than \$250 to a charitable remainder trust or to unreimbursed expenses of less than \$250.<sup>160</sup> For noncash contributions, donors must either obtain a receipt from the donee or, if a receipt is impractical under the circumstances, keep reliable written records, as detailed in longstanding regulations.<sup>161</sup>

### B. Contributions of \$250 or More

For gifts of \$250 or more (cash or noncash), the Code requires donors to obtain a “contemporaneous written acknowledgement” from the donee.<sup>162</sup> The acknowledgement must provide: (1) the amount of cash and a description (but not the value) of any property contributed, (2) whether any quid pro quo was provided by the donee, and (3) a description and good faith

<sup>156</sup> See *Hewitt*, 109 T.C. at 264 (reason for the substantiation rules is to “alert [the Service] to potential overvaluations”); *Smith*, 94 T.C.M. (CCH) at 584, 2007 T.C.M. (RIA) ¶ 2007-368 at 1978 (explaining that the need to alert the Service “exists even though in a particular case . . . it turns out that the taxpayer’s deduction was in fact based on the fair market value of the property”); *Mohamed*, 103 T.C.M. (CCH) at 1820-21, 2012 T.C.M. (RIA) ¶ 2012-152 at 1178 (notwithstanding a “harsh” result, “the problems of misvalued property are so great that Congress was quite specific about what the charitably inclined have to do to defend their deductions”). Note that an alternative ground for failure to satisfy substantiation requirements is reasonable cause. § 170(f)(11)(A)(ii)(II).

<sup>157</sup> § 170(f)(17); Pension Protection Act of 2006, Pub. L. No. 109-280, § 1217(a), 120 Stat. 780.

<sup>158</sup> Proposed regulations provide that a monetary gift includes a gift card, payment by credit card, electronic fund transfer, online payment service, or payroll deduction. Prop. Reg. § 1.170A-15(b)(1), 73 Fed. Reg. 45,908 (Aug. 7, 2008).

<sup>159</sup> This general rule applies regardless of the amount of the contribution. However, other rules that apply for contributions of \$250 or more (described below) supplant the general rule.

<sup>160</sup> Prop. Reg. §§ 1.170A-15(e), (g), 73 Fed. Reg. 45,908 (Aug. 7, 2008).

<sup>161</sup> Reg. §§ 1.170A-13(b)(1), (2).

<sup>162</sup> § 170(f)(8)(A). To be “contemporaneous” the acknowledgment must be received by the date the donor’s tax return is filed or due to be filed. § 170(f)(8)(C); Reg. § 1.170A-13(f)(3). The legislative history makes clear that “[t]axpayers may not rely solely on a canceled check as substantiation for a donation” above the threshold amount. H.R. REP. NO. 103-111, at 785 (1993); H.R. REP. NO. 103-213, at 565 (1993) (Conf. Rep.). The older (and now obsolete) portion of the regulations continues to refer to cancelled checks, but the more recent portion requires the donee’s written acknowledgement. Compare Reg. § 1.170A-13(a)(1)(i), *with* Reg. § 1.170A-13(f)(1).

estimate of the value of any such quid pro quo.<sup>163</sup> Failure to obtain the required acknowledgement can result in disallowance of the deduction, notwithstanding other proof of the contribution.<sup>164</sup>

### C. *Noncash Contributions of More than \$500*

A donor contributing property with a claimed value of more than \$500 has additional requirements, including filing a Form 8283 with the Service.<sup>165</sup> Form 8283 requires a description of the property, name and address of the donee, the date of the contribution, and the value of the property.<sup>166</sup> If the contribution is more than \$5,000, the donor must obtain an appraisal<sup>167</sup> of the property and summarize information about the appraisal on the Form 8283. The regulations define a qualified appraisal in detail, but inevitably, disputes about the requisite content of an appraisal arise. Under court decisions, it seems clear that the failure to obtain an appraisal will result in denial of a charitable deduction, but issues of substantial compliance may emerge if an appraisal is technically deficient or cursory in analysis.<sup>168</sup> For some contributions, the appraisal itself must accompany the donor's tax return (*e.g.*, art valued at \$20,000 or more, clothing and household items not in good used condition, easements on buildings in historic districts, and property valued at more than \$500,000). Some exceptions to the requirement to obtain an appraisal apply, most notably, for nonpublicly traded stock valued at \$10,000 or less. A penalty, enacted in 2006 and assessed against appraisers, applies to valuations that result in substantial or gross misstatements of tax liability.<sup>169</sup>

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<sup>163</sup> § 170(f)(8)(B). If the quid pro quo takes the form of intangible religious services, no good faith estimate of value is required; rather a statement that such services was the quid pro quo is sufficient.

<sup>164</sup> See *Friedman v. Commissioner*, 99 T.C.M. (CCH) 1175, 2010 T.C.M. (RIA) ¶ 2010-045, at 258 (finding that the failure by the donee to state that no goods or services were provided meant that the donee acknowledgment was insufficient).

<sup>165</sup> § 170(f)(11).

<sup>166</sup> ROGER COLINVAUX, URBAN INST. CTR. ON NONPROFITS & PHILANTHROPY, ENFORCING THE ENHANCED CHARITABLE DEDUCTION: IMPROVED REPORTING ON THE FORM 8283 (2012), available at <http://www.urban.org/taxandcharities/upload/Enforcing-the-Enhanced-Charitable-Deduction.pdf>.

<sup>167</sup> § 170(f)(11)(C). The appraisal must be "qualified," including that it be conducted by a "qualified appraiser." § 170(f)(11)(E)(i). In general, the appraiser must be an active professional with verifiable education and experience in valuing the type of property in question. § 170(f)(11)(E)(ii)-(iii). Both terms are further explicated in the regulations. Reg. § 1.170A-13(c).

<sup>168</sup> Compare *Hewitt v. Commissioner*, 109 T.C. 258, 262-66 (1997) (failure to obtain an appraisal means no deduction), with *Bond v. Commissioner*, 100 T.C. 32, 40-42 (1993) (deduction allowed when an appraisal was conducted but reported only via the appraisal summary of Form 8283 and not by a distinct appraisal), and *Scheidelman v. Commissioner*, 682 F.3d 189, 194-98 (2d Cir. 2012) (appraisal of a façade easement that merely applied a percentage discount to the "before" value without analysis nonetheless satisfied regulatory requirements that the appraisal use a distinct "method" of appraisal and provide a "basis" for the decision).

<sup>169</sup> I.R.C. § 6695A.

Appraisers are required to sign Form 8283 to the effect that the appraiser meets the standards of a qualified appraiser.

#### D. *Donee Obligations*

For contributions of more than \$75 in which the donee provides goods or services in return (a quid pro quo), the donee must provide written notice of the existence and amount of any quid pro quo provided.<sup>170</sup> Donee organizations are required to sign Form 8283 acknowledging receipt of the property described. However, the Form states that the donee's signature "does not represent agreement with the claimed fair market value" of the contributed property.<sup>171</sup> Donee organizations must also affirm on Form 8283 that if the donee sells, exchanges, or otherwise disposes of the donated property within three years of receipt, it will file a Form 8282 with the Service. Form 8282 reports any amount received for the property<sup>172</sup> and allows the Service to compare such amount to the claimed value for deduction purposes.

### VIII. Valuation

The Code allows a charitable contributions deduction; it does not, however, specify the amount allowed as a deduction.<sup>173</sup> For cash gifts, there is little question—the amount allowed is the amount of cash contributed. In 1920, the Service ruled that for contributions of property the amount of the deduction was the donor's cost basis.<sup>174</sup> The Service later changed its mind, however, opting instead for fair market value.<sup>175</sup> Treasury regulations have thus long provided that for contributions of property, the amount allowed as a deduction is its fair market value<sup>176</sup> (subject to the reductions described above). The standard definition for this purpose reads:

The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.<sup>177</sup>

Because the determination of fair market value is fact specific, controversies continue to emerge regularly despite a large number of litigated cases. Indeed, valuation often is at the heart of abuses related to the charitable contributions

<sup>170</sup>I.R.C. §§ 6115, 6714.

<sup>171</sup>IRS, FORM 8283 (2013).

<sup>172</sup>I.R.C. § 6050L.

<sup>173</sup>I.R.C. § 170.

<sup>174</sup>Law Opinion 979, 2 C.B. 148 (1920).

<sup>175</sup>Law Opinion 1118, II-2 C.B. 148 (1923).

<sup>176</sup>Reg. § 1.170A-1(c)(1).

<sup>177</sup>Reg. § 1.170A-1(c)(2). Similar, if not identical, language appears in several other places in the regulations. *See, e.g.*, Reg. §§ 1.412(c)(2)-1(c)(1), 1.430(g)-1(c)(1)(ii), 1.611-1(d)(2), 1.631-1(d)(2), 1.897-1(o)(2)(ii), 1.1445-1(g)(7), 20.2031-1(b), 20.2031-6(a), 25.2702-2(c)(1).

deduction and has led to concerns voiced by administrators<sup>178</sup> and to proposals for change.<sup>179</sup> Valuation-related disputes also explain many of the special property-specific rules described above: for fractional contributions, vehicles, intellectual property, façade easements, penalties on appraisers, and taxidermy.<sup>180</sup>

The Service publishes a valuation guide for its appeals officers.<sup>181</sup> Special procedures apply to gifts of art,<sup>182</sup> and a Service Art Advisory Panel regularly meets in closed session in order to determine the authenticity and fair market value of works of art for income, estate, and gift tax purposes.<sup>183</sup> The meetings are closed in order to protect the confidentiality of taxpayer information presented to the Panel.<sup>184</sup>

## IX. Estate and Gift Tax Charitable Deductions

Charitable contributions are deductible for purposes of both the estate tax and the gift tax.<sup>185</sup> Although there are minor linguistic differences within and between the relevant sections,<sup>186</sup> those do not portend significant legal differences for most purposes. Under both the estate and the gift tax regimes:

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<sup>178</sup> See Letter from Mark W. Everson, Commissioner of Internal Revenue, to Sen. Charles E. Grassley, Chairman, Senate Comm. on Fin. (Mar. 30, 2005) (“We . . . have persistent problems in taxpayers’ valuation of deductions taken for non-cash charitable contributions.”).

<sup>179</sup> STAFF OF J. COMM. ON TAXATION, 109TH CONG., *supra* note 121, at 293-307 (proposing in most cases a deduction of the donor’s cost basis in lieu of fair market value); see also Roger Colinvaux, *Charitable Contributions of Property: A Broken System Reimagined*, 50 HARV. J. ON LEGIS. 263 (2013) (recommending that any deduction for charitable contributions of property be based on the ability to measure the benefit to the donee organization).

<sup>180</sup> For a summary of some of these abuses, see Colinvaux, *supra* note 58, at 23-27.

<sup>181</sup> The *Internal Revenue Service Valuation Guide for Income, Estate and Gift Taxes—Valuation Training for Appeals Officers*, published periodically by the Service, is available through various sources, including leading publishers of major loose-leaf tax services. See also IRS, IRS PUB. NO. 561, DETERMINING THE VALUE OF DONATED PROPERTY; Tim A. Thomas, Annotation, *Federal Income Tax Charitable Deductions: Property Fair-Market-Value Determinations*, 90 A.L.R. FED. 402 (1988).

<sup>182</sup> See Rev. Proc. 96-15, 1996-1 C.B. 627, *modified by* Announcement 2001-22, 2001-11 I.R.B. 895.

<sup>183</sup> Cases selected for audit that include an item of artwork valued at \$50,000 or more are referred to the panel. For fiscal year 2011, the Panel reviewed 344 items and recommended adjustments to 56% of the appraisals reviewed. ART ADVISORY PANEL OF THE COMM’R OF INTERNAL REVENUE, IRS, ANNUAL SUMMARY REPORT FOR FISCAL YEAR 2011, *available at* [www.irs.gov/pub/irs-utl/annrep2011.pdf](http://www.irs.gov/pub/irs-utl/annrep2011.pdf).

<sup>184</sup> Although the proceedings are confidential, notes taken at the meetings may be disclosed to the owners of the particular art being discussed. See *Bernardo v. Commissioner*, 104 T.C. 677, 694 (1995).

<sup>185</sup> I.R.C. §§ 2055(a), 2522(a). In addition, although there is no explicit charitable deduction provision in the Generation Skipping Transfer rules, charities are generally “assigned to the transferor’s generation.” I.R.C. § 2651(e)(3)(A)-(B). The statutory chain is a bit tedious, but the result is fairly clear: transfers to charities do not trigger the tax. See I.R.C. §§ 2601, 2611(a), 2612, 2613(a), 2651(e)(3).

<sup>186</sup> They are beyond the scope of this Article to explore. Some are cataloged at Harvey P. Dale, *supra* note 22, at 670 n.75.

- The deductions are unlimited (*i.e.*, no percentage limitations),<sup>187</sup> so there is no need for any carryover provisions;
- The special reduction rules that apply for income tax purposes<sup>188</sup> do not apply;
- The phaseout that has been applied for income tax purposes<sup>189</sup> does not apply;
- The special donation–substantiation rules that apply for income tax purposes<sup>190</sup> do not apply (although general substantiation-of-deduction requirements are applicable);<sup>191</sup> and
- As in the case of the income tax, no deduction is permitted for charitable gifts of partial interests,<sup>192</sup> except for: (1) donations in the form of charitable lead annuity trusts or unitrusts, charitable remainder annuity trusts or unitrusts, or pooled income funds;<sup>193</sup> (2) gifts of an undivided interest in the donor’s entire property;<sup>194</sup> (3) remainder interests in personal residences<sup>195</sup> and farms;<sup>196</sup> and (4) certain qualified conservation interests.<sup>197</sup>

A Venn diagram of the income tax, gift tax, and estate tax charitable deduction provisions would show a considerable overlap but also areas of each that differ from the others. It is often desirable to draft documents to focus on the intersection to ensure that the charitable donations qualify under each and all of the regimes. In almost all cases, inter vivos transfers should attempt to qualify for both income and gift tax purposes, lest an income tax deduction be allowed but a gift tax be imposed, or vice versa.

## X. Policy Issues

U.S. individuals, corporations, and foundations are generous donors. Total gifts in the United States were estimated at \$335.17 billion in 2013, of which

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<sup>187</sup> In the case of the estate tax, the deduction cannot exceed the entire gross estate. § 2055(d). In the case of the gift tax, the deduction is “allowed only to the extent that the gifts therein specified are included in the amount of gifts against which such deductions are applied.” I.R.C. § 2524; Reg. §§ 25.2522(a)-1(c), 25.2524-1.

<sup>188</sup> See *supra* text accompanying notes 94-109.

<sup>189</sup> See *supra* text accompanying notes 115-120.

<sup>190</sup> These special rules, under sections 170(f)(8), 6115, and 6714, are discussed in the text *supra* accompanying notes 157-172.

<sup>191</sup> Reg. §§ 20.2055-1(c), 25.2522(a)-1(c).

<sup>192</sup> §§ 2055(e)(2), 2522(c)(2).

<sup>193</sup> §§ 2055(e)(2)(A), 2522(c)(2)(A).

<sup>194</sup> Reg. §§ 20.2055-2(e)(2)(i), 25.2522(c)-3(c)(2)(i). The charitable deduction for gift tax purposes utilizes the income tax rule for fractional gifts. See *supra* text accompanying notes 51-53; see also § 2522(e).

<sup>195</sup> §§ 2055(f), 2522(d); Reg. §§ 20.2055-2(e)(2)(ii), 25.2522(c)-3(c)(2)(ii).

<sup>196</sup> Reg. §§ 20.2055-2(e)(2)(iii), 25.2522(c)-3(c)(2)(iii).

<sup>197</sup> Reg. §§ 20.2055-2(e)(2)(iv), 25.2522(c)-3(c)(2)(iv).

\$240.60 billion came from living individuals.<sup>198</sup> Of this amount, \$196.21 billion, or approximately 81.6%, was by individuals that itemize deductions and therefore claim the charitable contributions deduction.<sup>199</sup> Notably, a disproportionate amount of itemized contributions is made by wealthy individuals. For tax year 2011, for example, 21.7% of the amount of charitable contributions were by individuals earning \$1 million or more of adjusted gross income, representing just 0.747% of total returns.<sup>200</sup> In addition, a high percentage of gifts are not in cash. In 2011, for example, about 24% of charitable contributions were of noncash property. Of these contributions, 41% were made by individuals earning \$1 million or more of adjusted gross income (again, representing 0.747% of total returns).<sup>201</sup>

The high volume of annual giving highlights the importance of the charitable contributions deduction as a mainstay of the tax law and an important facilitator of funding for eligible organizations. Nevertheless, policy issues abound, including debate about the role of the deduction in the tax system, efficiency concerns, and the appropriateness of allowing a deduction for the appreciation in noncash property, among others.

#### A. *Rationale and Form of the Tax Benefit*

The charitable contributions deduction has been viewed as base-defining and as an incentive (or subsidy) for charitable giving (or both). The most widely-accepted definition of the proper tax base for an income tax—the Haig–Simons definition—states that income for any period is the sum of (1) amounts spent by the taxpayer on personal consumption during the period and (2) the change in the taxpayer’s net worth during the period.<sup>202</sup> Because amounts given to charity no longer appear in the taxpayer’s net worth, the question becomes whether such giving should be viewed as personal consumption. If not, the deduction for charitable gifts is an appropriate policy

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<sup>198</sup> GIVING USA FOUND., GIVING USA 2014: THE ANNUAL REPORT ON PHILANTHROPY FOR THE YEAR 2013, at 8 (2014). A further \$27.73 billion represented testamentary gifts, \$48.96 billion was given by private foundations, and approximately \$17.88 billion came from corporations.

<sup>199</sup> *Id.* at 216.

<sup>200</sup> IRS, STATISTICS OF INCOME DIVISION, *Table 2.1 Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2011*, SOI TAX STATS—INDIVIDUAL STATISTICAL TABLES BY SIZE OF ADJUSTED GROSS INCOME, Aug. 22, 2014, <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96981,00.html> (scroll down to “Individual Income Tax Returns with Exemptions and Itemized Deductions” red heading; then to “Individual Income Tax Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items” subheading; then to “Published as: Individual Complete Report (Publication 1304), Table 2.1,” and follow “2011” hyperlink for calculations derived from table).

<sup>201</sup> *Id.*

<sup>202</sup> See HENRY C. SIMONS, PERSONAL INCOME TAXATION 50 (1938).

response for defining net income subject to tax and should not be viewed as a subsidy.<sup>203</sup>

The base-defining rationale is a minority view. The more common view is that charitable contributions are a form of consumption by the donor, and the charitable contributions deduction is a federal subsidy intended to encourage giving.<sup>204</sup> Under a subsidy view, the deduction for charitable gifts can be viewed as a government matching program.<sup>205</sup> For example, if a donor who itemizes deductions and whose top marginal tax bracket is 35% makes a \$100 gift to charity and deducts that amount from his income, the net cost or “price” of the gift is \$65.<sup>206</sup> The government, from this viewpoint, is making a \$35 matching grant to the charity chosen by the donor. The size of the matching grant varies directly with the top tax bracket of the donor. Thus, the government offers a higher match to wealthier, higher-income taxpayers than to less-wealthy, lower-income taxpayers. This regressivity is objectionable to some on tax policy grounds; defenders support it as merely an appropriate base-defining rule.<sup>207</sup>

If it were thought desirable to eliminate this regressivity, a credit could be provided in lieu of the deduction.<sup>208</sup> The amount of the credit could be calculated, at least approximately, so as to involve any chosen amount of revenue loss and to simulate an equivalent deduction at any selected target rate. While this would eliminate the regressivity (because the government’s “matching grant” would then be the same at all income levels), it would not

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<sup>203</sup>The leading articulation of this view is William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 365-66 (1972). See also John K. McNulty, *Public Policy and Private Charity: A Tax Policy Perspective*, 3 VA. TAX REV. 229, 241 (1984); Peter J. Wiedenbeck, *Charitable Contributions: A Policy Perspective*, 50 MO. L. REV. 85, 94-95, 135 (1985). See generally Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393 (1988).

<sup>204</sup>See, e.g., Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an “Ideal” Income Tax and Why They Fit Worse in a Far From Ideal World*, 31 STAN. L. REV. 831, 834-35 (1979); Stanley A. Koppelman, *Personal Deductions Under an Ideal Income Tax*, 43 TAX L. REV. 679, 707 (1988). See generally Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501 (1990); Miranda Perry Fleischer, *Theorizing the Charitable Tax Subsidies: The Role of Distributive Justice*, 87 WASH. U. L. REV. 505 (2010).

<sup>205</sup>See Paul R. McDaniel, *Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction*, 27 TAX L. REV. 377 (1972).

<sup>206</sup>It is assumed for purposes of this simplified example that no special reduction rules, deduction floors, or other limitations or adjustments are applicable.

<sup>207</sup>For example, the same regressivity occurs when a sole proprietor deducts expenses, e.g., for salaries and rent, incurred in business: a higher income proprietor gets a greater benefit from those deductions than a lower income proprietor. For a summary of the policy implications of a base-defining or subsidy view, see Roger Colinvaux, *Rationale and Changing the Charitable Deduction*, 138 TAX NOTES (TA) 1453 (Feb. 25, 2013).

<sup>208</sup>The credit would probably have to be refundable if all taxpayers, even those with very low incomes, were to be treated equally.

be possible to justify a credit of this sort under a base-defining rationale.<sup>209</sup> Thus, the rationale of how charitable contributions fit within the tax system matters to the form of any tax benefit. In general, a base-defining rationale supports a full offset to tax for charitable contributions, that is, a deduction, whereas a subsidy rationale provides support for changes to the tax benefit perhaps in the form of additional caps or by changing to a credit.

There have been numerous proposals to change the charitable contributions deduction. Some proposals implicitly support the subsidy rationale. For example, the Obama Administration proposes capping the value of all itemized deductions, including the charitable contributions deduction, at 28% of the amount of the expense even if the taxpayer is in a marginal rate bracket higher than 28%.<sup>210</sup> Another is to switch to a credit or a system of matching grants. Two expert panels have recommended one or the other.<sup>211</sup>

Other proposals support a base-defining rationale. For example, the Tax Reform Act of 2014 proposed a substantial increase to the standard deduction in part to account for charitable contributions.<sup>212</sup> This would change the means for deducting charitable contributions from an itemized deduction to a component of the standard deduction. Although charitable contributions would remain outside the tax base, the incentive to make contributions would be largely eliminated. Under the proposal, the charitable deduction then would remain as an incentive (and subsidy) only for the small percentage of taxpayers who would continue to itemize deductions.

Some proposals are consistent with both a base-defining and a subsidy rationale. For example, deductions could be disallowed for amounts below a percentage-of-adjusted-gross-income floor.<sup>213</sup> Imposing a floor may be a cost-effective way to subsidize charitable contributions. A well-designed floor

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<sup>209</sup>For discussion and analysis of several proposals to reform the deduction, see Joseph J. Cordes, *Re-Thinking the Deduction for Charitable Contributions: Evaluating the Effects of Deficit-Reduction Proposals*, 64 NAT'L TAX J. 1001 (2011). See also ROGER COLINVAUX, BRAIN GALLE & EUGENE STEUERLE, URBAN INST. CTR. ON NONPROFITS & PHILANTHROPY, EVALUATING THE CHARITABLE DEDUCTION AND PROPOSED REFORMS 1, 11-18 (2012). For further discussions of a credit rather than a deduction for charitable giving, see CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING 44, 103-04 (1985). See also Gergen, *supra* note 203, at 1400-06; McNulty, *supra* note 203, at 245-47; Wiedenbeck, *supra* note 203, at 99-102.

<sup>210</sup>DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2015 REVENUE PROPOSALS 154-55 (2014).

<sup>211</sup>THE NAT'L COMM'N ON FISCAL RESPONSIBILITY & REFORM, THE MOMENT OF TRUTH 30-31 (2010) (recommending a charitable contribution credit with a two percent of adjusted gross income floor in lieu of the deduction); see also DEBT REDUCTION TASK FORCE, RESTORING AMERICA'S FUTURE: REVIVING THE ECONOMY, CUTTING SPENDING AND DEBT, AND CREATING A SIMPLE, PRO-GROWTH TAX SYSTEM 34 (2010). The staff of the Senate Finance Committee released a summary of options of reform of the charitable deduction. STAFF OF S. FIN. COMM., 113TH CONG., TAX EXEMPT ORGANIZATIONS AND CHARITABLE GIVING: SENATE FINANCE COMMITTEE STAFF TAX REFORM OPTIONS FOR DISCUSSION 4-9 (2013).

<sup>212</sup>Tax Reform Act of 2014 § 1403 (Discussion Draft 2014).

<sup>213</sup>*Id.* § 1403(a) (imposing a two percent of adjusted gross income floor on the itemized charitable deduction).

would eliminate the incentive for contributions that would occur with or without a deduction and preserve the incentive for contributions in the margin. A floor is also to a certain extent consistent with a base-defining rationale. Contributions disallowed by the floor may not affect the ability to pay taxes and can be said to represent the private-consumption component of some charitable contributions.

### B. *Efficiency Concerns*

There is uncertainty about how much the income tax deduction for charitable giving affects amounts given to charity.<sup>214</sup> Economists analyze this in terms of “price elasticity”: the extent (expressed as a decimal ratio) by which a reduction in the “price” of giving increases such giving.<sup>215</sup> The price of a \$1 donation for itemizers is one minus the donor’s top marginal tax rate.<sup>216</sup> If the price declines by ten percent (*e.g.*, because of an increase in the donor’s top marginal tax rate), and if donations, as a result, increase by the same ten percent, the price elasticity would be -1.0. If, however, a ten percent reduction in price produces only an eight percent increase in donations, the price elasticity would be -0.8. There is general agreement that the lower the price of giving, the more is given to charity, but quantifying the effect has proved to be extremely difficult.<sup>217</sup> The economic literature has produced estimates of price elasticity ranging from -0.5 to -1.75;<sup>218</sup> the former number suggests that a ten percent decline in the price of giving would increase long-run charitable

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<sup>214</sup>The estate tax, of course, exerts a price effect on bequests, even though it only reaches fairly large estates. Some simulations have suggested that repeal of the estate tax would reduce testamentary charitable gifts by between 24% and 44%. Charles T. Clotfelter & Richard L. Schmalbeck, *The Impact of Fundamental Tax Reform on Nonprofit Organizations*, in ECONOMIC EFFECTS OF FUNDAMENTAL TAX REFORM 211-43 (Henry J. Aaron & William G. Gale eds., 1996). Others disagree, believing that the wealth effect would overwhelm the price effect. For a more recent analysis, see JON BAKIJA, WILLIAM GALE & JOEL SLEMRD, NEW EVIDENCE ON THE EFFECTS OF TAXES ON CHARITABLE BEQUESTS (2005). See also ROBERT MCCLELLAND, CONG. BUDGET OFFICE, No. 2004-8, CHARITABLE BEQUESTS AND THE REPEAL OF THE ESTATE TAX (2004) (concluding that the decline in charitable giving as a result of estate tax repeal would be about 22%).

<sup>215</sup>See generally CLOTFELTER, *supra* note 209; Richard Steinberg, *Taxes and Giving: New Findings*, 1 VOLUNTAS: INT’L J. VOLUNTARY & NONPROFIT ORGS. 61 (1990).

<sup>216</sup>See *supra* example in text accompanying note 206.

<sup>217</sup>Dean Karlan & John A. List, *Does Price Matter in Charitable Giving? Evidence From a Large-Scale Natural Field Experiment*, 97 AM. ECON. REV. 1774 (2007); see also JOSEPH CORDES, URBAN INST. CTR. ON NONPROFITS & PHILANTHROPY, HAUSER CTR. FOR NONPROFIT ORGS., THE COST OF GIVING: HOW DO CHANGES IN TAX DEDUCTIONS AFFECT CHARITABLE CONTRIBUTIONS? (1999).

<sup>218</sup>See Charles T. Clotfelter, *The Economics of Giving*, in GIVING BETTER, GIVING SMARTER (John W. Barry & Bruno V. Manno eds., 1997).

giving by only five percent; the latter suggests that a price decline of ten percent would increase long-run charitable giving by 17.5%.<sup>219</sup>

Using newly available panel data,<sup>220</sup> several leading scholars have found differing price elasticities for “transitory,” as opposed to “permanent,” tax rate changes,<sup>221</sup> concluding that the former are significantly smaller in absolute terms than the latter, which fall in the range of -0.79 to -1.26.<sup>222</sup> The authors concede that their research is only a “first step” and that additional work has to be done with panel data “to address how changes in expectations of future tax policies . . . affect current individual [charitable] behavior.”<sup>223</sup> A more recent analysis suggests an elasticity of charitable giving in response to a persistent change in price that is in excess of -1 in absolute value.<sup>224</sup>

Price elasticities may differ for large donors and small donors. Many believe that the price elasticity is lower for lower-income donors, including those now generally electing to use the standard deduction in lieu of itemizing deductions.<sup>225</sup> If so, in estimating the impact of providing a deduction for nonitemizers, it is more likely that the revenue foregone would be greater than the additional donations stimulated; however, not all observers agree.<sup>226</sup>

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<sup>219</sup> Donors of money or property are also more likely to volunteer their time. Some empirical work suggests, therefore, that beyond the price elasticity (which only measures price impact on gifts of money or property), a reduced price for donations also tends to encourage more volunteering. Eleanor Brown & Hamilton Lankford, *Gifts of Money and Gifts of Time*, 47 J. PUB. ECON. 321 (1992); see also Aprill, *supra* note 114, at 862-64. Other work also considers whether increased subsidies are inefficient net of fundraising. See Brain Galle, *How Do Non-profit Firms Respond to Tax Policy?* (Boston College Law Sch. Legal Studies, Working Paper No. 320, 2014), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2443621](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2443621).

<sup>220</sup> Panel data are longitudinal as opposed to cross-sectional data, which are static.

<sup>221</sup> Gerald E. Auten, Holger Sieg & Charles T. Clotfelter, *Charitable Giving, Income, and Taxes: An Analysis of Panel Data*, 92 AM. ECON. REV. 371 (2002).

<sup>222</sup> *Id.* at 379.

<sup>223</sup> *Id.* at 381.

<sup>224</sup> Jon Bakija & Bradley T. Heim, *How Does Charitable Giving Respond to Incentives and Income? New Estimates from Panel Data*, 64 NAT'L TAX J. 615 (2011). Professor Bakija has also concluded “that tax incentives for charitable donations . . . succeed in causing donations to increase, probably by about as much or more than they cost in terms of tax revenue.” Jon Bakija, *Tax Policy and Philanthropy: A Primer on the Empirical Evidence for the United States and Its Implications*, 80 SOC. RES. 557, 581 (2013).

<sup>225</sup> Charles T. Clotfelter & C. Eugene Steuerle, *Charitable Contributions, in HOW TAXES AFFECT ECONOMIC BEHAVIOR* (Henry J. Aaron & Joseph A. Pechman eds., 1981); Christopher M. Duquette, *Is Charitable Giving by Nonitemizers Responsive to Tax Incentives? New Evidence*, 52 NAT'L TAX J. 195, 203-04 (1999); David H. Eaton, *Charitable Contributions and Tax Price Elasticities for Nonitemizing Taxpayers*, 7 INT'L ADVANCES ECON. RES. 431 (2001); see also CONG. BUDGET OFFICE, EFFECTS OF ALLOWING NONITEMIZERS TO DEDUCT CHARITABLE CONTRIBUTIONS 9-11 (2002), available at <http://www.cbo.gov/publication/14230>. But see Amy E. Dunbar & John Phillips, *The Effect of Tax Policy on Charitable Contributions: The Case of Nonitemizing Taxpayers*, 19 J. AM. TAX'N ASS'N 1 (1997).

<sup>226</sup> Independent Sector argues that “the nonitemizer deduction included in the Charity Aid, Recovery, and Empowerment Act of 2002 would likely stimulate at least \$1.15 of charitable giving for every \$1.00 it costs.” *Fact Sheet, Giving In America*, INDEPENDENTSECTOR.ORG (2002). For a useful analysis of these issues, see Aprill, *supra* note 114, at 857-59.

### C. *Deduction for the Appreciated Value of Property*

If the base-defining rationale is accepted, allowing a deduction for the appreciation in value of property donated to charity without including that increase in the income of the donor cannot be justified.<sup>227</sup> To that extent, it must be supported, if at all, on the grounds that it is an incentive or subsidy for giving. If it were thought desirable to preserve the deduction generally, but eliminate the harder-to-justify deduction for appreciation in value of property donated, three routes to achieve that could be followed:

1. The deduction could be limited to the adjusted basis of the property donated, that is, the deduction for the unrealized appreciation in value could be denied, or
2. The deduction could be allowed for the full fair market value of the property donated but the gain inherent in the property could be included in the donor's income at the time of the gift, or
3. A deduction could be permitted for the full fair market value of the property donated but the charitable donee could be required to pay tax on the unrealized appreciation in value at any later time when it sells or disposes of the property.

The first route is similar to some already in the Code for many gifts to public charities<sup>228</sup> and already is the general rule for gifts to private foundations.<sup>229</sup> This approach was recommended by the Joint Committee on Taxation staff in 2005<sup>230</sup> and followed in the Tax Reform Act of 2014 but with numerous exceptions.<sup>231</sup> The second and third approaches would be novel in that context.<sup>232</sup> The second requires donors to pay tax even though they do not receive any cash or property in exchange for the donated property. Nonetheless, because the deduction for the appreciated value is widely viewed as

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<sup>227</sup> As Professor Andrews puts it:

Whatever its origin, the fair market value rule must now be viewed as a subsidy or artificial inducement, above and beyond mere tax exemption, for philanthropic giving. The magnitude of the subsidy is a function of the amount of unrealized appreciation in relation to the basis of the property and the taxpayer's rates of tax, being greatest for taxpayers in highest brackets and with most appreciation.

Andrews, *supra* note 203, at 372.

<sup>228</sup> For example, the special reduction rules discussed in the text accompanying notes 95-98, *supra*, tend to limit the deduction to the adjusted basis of the donated property.

<sup>229</sup> I.R.C. § 170(e)(1)(B)(ii).

<sup>230</sup> STAFF OF J. COMM. ON TAXATION, 109TH CONG., *supra* note 121, at 293-307.

<sup>231</sup> Tax Reform Act of 2014 § 1403(c) (Discussion Draft 2014).

<sup>232</sup> In other contexts, charitable gifts sometimes trigger gain to the donor. For example, charitable donations of installment obligations accelerate gain to the donor. Rev. Rul. 60-352, 1960-2 C.B. 208; Rev. Rul. 55-157, 1955-1 C.B. 293. Charitable donations of property subject to indebtedness also trigger gain to the donor. Rev. Rul. 81-163, 1981-1 C.B. 443.

problematic, this approach has been advocated in recent years.<sup>233</sup> The third route not only defers, perhaps indefinitely, the imposition of any tax on the unrealized appreciation in value but would subject it to tax upon later disposition of the property at the then-applicable tax rates of the donee rather than those of the donor. Consideration might be given to making the first route the default rule but allowing donors to elect to apply the second or, with the consent of the donee, the third route in lieu of the first.

## D. *Nonitemizer Deduction and Simplification*

### 1. *Nonitemizer Deduction*

A charitable deduction for nonitemizers has long been a priority for some in the charitable sector. Designing a sound nonitemizer deduction<sup>234</sup> requires confronting and balancing conflicting policies:

- The standard deduction is intended to provide nonitemizers an implicit deduction in an amount sufficient to substitute for itemized deductions, including the charitable contributions deduction. Permitting nonitemizers to deduct charitable contributions thus raises two concerns: (1) would this erode the simplification of compliance burden fostered by the standard deduction, and (2) if a nonitemizer charitable deduction is permitted, should the amount of the standard deduction be reduced to take that into account and prevent “double dipping”?
- Because the amounts covered by a nonitemizer deduction are relatively modest but the number of people claiming it would likely be large, the already lean Service resources might not be able to audit those returns effectively, thus giving rise to the perception, if not the reality, of more tax fraud.<sup>235</sup>

These concerns could be ameliorated, albeit not eliminated, by permitting a nonitemizer deduction only above a certain floor amount.<sup>236</sup>

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<sup>233</sup> See Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-In Gains*, 56 TAX L. REV. 1 (2002); David S. Miller, *Reforming the Taxation of Exempt Organizations and Their Patrons*, 67 TAX LAW. 451, 498-500 (2014).

<sup>234</sup> For a very thoughtful series of articles on how best to design a nonitemizer deduction, see C. Eugene Steuerle, *Charity Deduction for Nonitemizers: Where Do You Draw the Line?*, 86 TAX NOTES (TA) 1773 (Mar. 20, 2000); C. Eugene Steuerle, *Nonitemizers Charitable Deduction: The Administration's Floor Plan*, 86 TAX NOTES (TA) 1625 (Mar. 13, 2000); C. Eugene Steuerle, *The Right Way to Extend Charitable Deductions to Nonitemizers*, 86 TAX NOTES (TA) 1297 (Feb. 28, 2000). See also CONG. BUDGET OFFICE, *supra* note 225; C. Eugene Steuerle, *Allowing Charitable Deductions for Those Who Don't Itemize*, 48 TAX NOTES (TA) 633 (July 30, 1990); JOSEPH CORDES, JOHN O'HARE & C. EUGENE STEUERLE, URBAN INST. CTR. ON NONPROFITS & PHILANTHROPY, *EXTENDING THE CHARITABLE DEDUCTION TO NONITEMIZERS: POLICY ISSUES AND OPTIONS* (2000), available at <http://www.urban.org/publications/310338.html>.

<sup>235</sup> See Aprill, *supra* note 114, at 859-62 (discussing these administrative concerns).

<sup>236</sup> The imposition of a ceiling, rather than a floor, on such deductions appears unwise: although a ceiling would mitigate the expected adverse tax revenue impact, it fails to respond to the other policy considerations mentioned in the text.

## 2. *Simplification*

The charitable contributions deduction has become one of the most complex sections of a complex revenue code. The fact of the deduction's complexity may undermine its incentive effects, as donors are unable easily to calculate the amount of the tax benefit and the true cost of giving. Even absent any significant change in policy or approach to the deduction, a simplification project could improve the effectiveness of the incentive at little cost.<sup>237</sup>

## **XI. Conclusion**

This Article surveys the main federal tax law rules and policies relating to the deduction for charitable contributions. The charitable deduction is a mainstay of the federal income tax. Given the considerable complexity of the rules, however, careful planning for and understanding of the many legal intricacies is often required to realize the benefits of the deduction fully.

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<sup>237</sup>See DANIEL HALPERIN, URBAN INST. CTR. ON NONPROFITS & PHILANTHROPY, THE CHARITABLE CONTRIBUTION DEDUCTION: SECTION 170 REORGANIZED (2012), *available at* <http://www.urban.org/publications/412771.html> (outlining a reorganized charitable deduction).