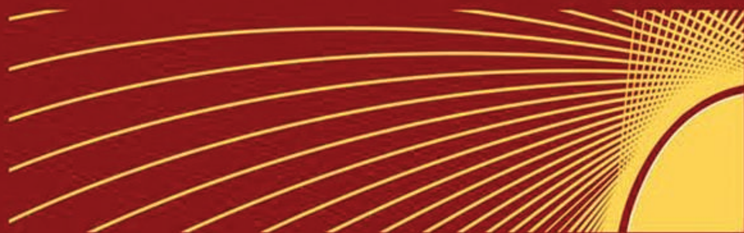
THE TAX LAW OF CHARITABLE GIVING

FOURTH EDITION



BRUCE R. HOPKINS

The Tax Law of Charitable Giving

Fourth Edition

Bruce R. Hopkins

John Wiley & Sons, Inc.

Copyright © 2010 by John Wiley & Sons, Inc. All rights reserved.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.

Published simultaneously in Canada.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, (978) 750-8400, fax (978) 750-4470, or on the web at www.copyright.com. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, or online at www.wiley.com/go/permissions.

Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor author shall be liable for any loss of profit or any other commercial damages, including but not limited to special, incidental, consequential, or other damages.

For general information on our other products and services or for technical support, please contact our Customer Care Department within the United States at (800) 762-2974, outside the United States at (317) 572-3993 or fax (317) 572-4002.

Wiley also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic books. For more information about Wiley products, visit our web site at www.wiley.com.

ISBN: 978-0-470-56060-0

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

The fourth edition of this book is dedicated to three individuals
who are reshaping my life:
Patrick Oliver Hopkins, Isabel Marie Ash, and Sadie Helen Ash.

The first edition of this book was dedicated to John J. Schwartz,
because of his tireless and selfless work in the realm
of philanthropy and charitable giving for the good of others.

BECOME A SUBSCRIBER!

Did you purchase this product from a bookstore?

If you did, it's important for you to become a subscriber. John Wiley & Sons, Inc. may publish, on a periodic basis, supplements and new editions to reflect the latest changes in the subject matter that you ***need to know*** in order to stay competitive in this ever-changing industry. By contacting the Wiley office nearest you, you'll receive any current update at no additional charge. In addition, you'll receive future updates and revised or related volumes on a 30-day examination review.

If you purchased this product directly from John Wiley & Sons, Inc., we have already recorded your subscription for this update service.

To become a subscriber, please call **1-877-762-2974** or send your name, company name (if applicable), address, and the title of the product to:

mailing address: Supplement Department
John Wiley & Sons, Inc.
One Wiley Drive
Somerset, NJ 08875

e-mail: subscriber@wiley.com
fax: 1-732-302-2300
online: www.wiley.com

For customers outside the United States, please contact the Wiley office nearest you:

Professional & Reference Division
John Wiley & Sons Canada, Ltd.
22 Worcester Road
Etobicoke, Ontario M9W 1L1
CANADA
Phone: 416-236-4433
Phone: 1-800-567-4797
Fax: 416-236-4447
Email: canada@wiley.com

John Wiley & Sons, Ltd.
The Atrium
Southern Gate, Chichester
West Sussex PO 19 8SQ
ENGLAND
Phone: 44-1243-779777
Fax: 44-1243-775878
Email: customer@wiley.co.uk

John Wiley & Sons Australia, Ltd.
33 Park Road
P.O. Box 1226
Milton, Queensland 4064
AUSTRALIA
Phone: 61-7-3859-9755
Fax: 61-7-3859-9715
Email: brisbane@johnwiley.com.au

John Wiley & Sons (Asia) Pte., Ltd.
2 Clementi Loop #02-01
SINGAPORE 129809
Phone: 65-64632400
Fax: 65-64634604/5/6
Customer Service: 65-64604280
Email: enquiry@wiley.com.sg

About the Author

Bruce R. Hopkins is a senior partner in the law firm of Polsinelli Shughart PC, practicing in the firm's Kansas City, Missouri, and Washington, D.C., offices. He specializes in the representation of charitable and other nonprofit organizations. His practice ranges over the entirety of law matters involving tax-exempt organizations, with emphasis on charitable giving (including planned giving), the formation of nonprofit organizations, acquisition of recognition of tax-exempt status for them, the private inurement and private benefit doctrines, the intermediate sanctions rules, legislative and political campaign activities issues, public charity and private foundation rules, unrelated business planning, use of exempt and for-profit subsidiaries, joint venture planning, tax shelter involvement, review of annual information returns, fundraising law issues, and Internet communications developments.

Mr. Hopkins served as chair of the Committee on Exempt Organizations, Tax Section, American Bar Association; chair, Section Taxation, National Association of College and University Attorneys; and president, Planned Giving Study Group of Greater Washington, D.C.

Mr. Hopkins is the series editor of Wiley's Nonprofit Law, Finance, and Management Series. In addition to *The Tax Law of Charitable Giving, Fourth Edition*, he is the author of *The Law of Fundraising, Fourth Edition; The Law of Tax-Exempt Organizations, Ninth Edition; Planning Guide for the Law of Tax-Exempt Organizations: Strategies and Commentaries; IRS Audits of Tax-Exempt Organizations: Policies, Practices, and Procedures; The Tax Law of Associations; The Tax Law of Unrelated Business for Nonprofit Organizations; The Nonprofits' Guide to Internet Communications Law; The Law of Intermediate Sanctions: A Guide for Nonprofits; Starting and Managing a Nonprofit Organization: A Legal Guide, Fifth Edition; Nonprofit Law Made Easy; Charitable Giving Law Made Easy; Private Foundation Law Made Easy; Fundraising Law Made Easy; 650 Essential Nonprofit Law Questions Answered; The First Legal Answer Book for Fund-Raisers; The Second Legal Answer Book for Fund-Raisers; The Legal Answer Book for Nonprofit Organizations; The Second Legal Answer Book for Nonprofit Organizations*; and *The Nonprofit Law Dictionary*; and is the coauthor, with Jody Blazek, of *Private Foundations: Tax Law and Compliance, Third Edition*; also with Mr. Blazek, *The Legal Answer Book for Private Foundations*; with Thomas K. Hyatt, of *The Law of Tax-Exempt Healthcare Organizations, Third Edition*; with David O. Middlebrook, of *Nonprofit Law for Religious Organizations: Essential Questions and Answers*; with Douglas K. Anning, Virginia C. Gross, and Thomas J. Schenkelberg, of *The New Form 990: Law, Policy, and Preparations*; and also with Ms. Gross, *Nonprofit*

Governance: Law, Practice, and Trends. He also writes *Bruce R. Hopkins' Nonprofit Counsel*, a monthly newsletter, published by John Wiley & Sons.

Mr. Hopkins earned his JD and LLM degrees at George Washington University National Law Center, and his BA at the University of Michigan. He is a member of the bars of the District of Columbia and the state of Missouri.

Mr. Hopkins received the 2007 Outstanding Nonprofit Lawyer Award (Vanguard Lifetime Achievement Award) from the American Bar Association, Section of Business Law, Committee on Nonprofit Corporations. He is listed in *The Best Lawyers in America, Nonprofit Organizations/Charities Law,* 2007–2010.

Contents

Preface xvii

Book Citations xxii

PART ONE INTRODUCTION TO THE TAX LAW OF CHARITABLE GIVING

Chapter One Charitable Giving Law: Basic Concepts 3

1.1 Introduction to the Charitable Contribution Deduction 3
1.2 Defining *Tax-Exempt Organizations* 4
1.3 Principles of Charitable Organizations Law Philosophy 7
1.4 Statistical Profile of Charitable Sector 20
1.5 Categories of Tax-Exempt Organizations 24

Chapter Two The United States Tax System: An Overview 27

2.1 Concept of Income 28
2.2 Gross Income 30
2.3 Exclusions from Income 31
2.4 Concept of *Adjusted Gross Income* 31
2.5 Deductions 32
2.6 Standard Deduction 34
2.7 Concept of Taxable Income 34
2.8 Taxable and Nontaxable Entities 35
2.9 Annual Accounting Period 37
2.10 Accounting Methods 37
2.11 Timing 38
2.12 Property 38
2.13 Inventory 40
2.14 Gain 41
2.15 Taxation of Income 46

Because of the rapidly changing nature of information in this field, this product will be updated with annual supplements or with future editions. Please call 1-877-762-2974 or e-mail us at *subscriber@wiley.com* to receive any current update at no additional charge. We will send on approval any future supplements or new editions when they become available. If you purchased this product directly from John Wiley & Sons, Inc., we have already recorded your subscription for this update service.

2.16 Capital Assets, Gains, and Losses 50
2.17 Carryovers and Carrybacks 52
2.18 Alternative Minimum Tax 53
2.19 Depreciation 55
2.20 Capital Gains and Dividends Rates 56
2.21 Taxation of Corporate Distributions 56
2.22 Accumulated Earnings and Personal Holding Company Taxes 57
2.23 Tax Credits 57
2.24 Foreign Tax Credits 58

PART TWO BASICS OF CHARITABLE GIVING LAW

Chapter Three Fundamental Concepts **61**

3.1 Meaning of *Gift* 61
3.2 Meaning of *Donor* 98
3.3 Meaning of *Charitable Organization* 98
3.4 Public Charities and Private Foundations 108
3.5 Unrelated Business Rules 120
3.6 Factors Affecting Income Tax Deductibility of Charitable Gifts 126
3.7 Grantor Trust Rules 127

Chapter Four Gifts of Money and Property **131**

4.1 Gifts of Money 131
4.2 Gifts of Property in General 132
4.3 Gifts of Long-Term Capital Gain Property in General 134
4.4 Gifts of Ordinary Income Property 134
4.5 Certain Gifts of Capital Gain Property 138
4.6 Gifts of Property for Unrelated Use 141
4.7 Variations in Applying Property Rules 144
4.8 Step Transaction Doctrine 145
4.9 Charitable Pledges 150

Chapter Five Fundamentals of Planned Giving **153**

5.1 Introduction 154
5.2 Appreciated Property Gifts 154
5.3 Planned Gifts: Core Concepts 155
5.4 Charitable Remainder Trusts 157
5.5 Pooled Income Funds 164
5.6 Charitable Gift Annuities 170
5.7 Charitable Lead Trusts 170

5.8 Planned Giving: Other Forms 174
5.9 Planned Giving and Securities Laws 174

PART THREE CHARITABLE GIVING IN GENERAL

Chapter Six Timing of Charitable Deductions 179

6.1 Gifts of Money in General 181
6.2 Gifts of Money by Check 181
6.3 Gifts of Money by Credit Card 183
6.4 Gifts of Money by Telephone 184
6.5 Gifts of Securities 184
6.6 Gifts of Copyright Interest 186
6.7 Gifts by Means of Notes 187
6.8 Gifts by Letters of Credit 187
6.9 Gifts of Property Subject to Option 188
6.10 Gifts of Stock Options 189
6.11 Gifts of Credit Card Rebates 190
6.12 Gifts of Tangible Personal Property 191
6.13 Gifts of Real Property 191
6.14 Gifts by C Corporations 192
6.15 Gifts by S Corporations 193
6.16 Gifts by Partnerships 194
6.17 Gifts by Means of Internet 196

Chapter Seven Percentage Limitations 197

7.1 Introduction 198
7.2 Individual's Contribution Base 200
7.3 Corporation's Taxable Income 201
7.4 Percentage Limitations: An Overview 201
7.5 Fifty Percent Limitation 203
7.6 Thirty Percent Limitation for Gifts of Certain Property 208
7.7 Electable 50 Percent Limitation 211
7.8 General 30 Percent Limitation 216
7.9 Interplay of 50 Percent/Special 30 Percent Limitations 218
7.10 Interplay of 50 Percent/General 30 Percent Limitations 219
7.11 Interplay of Special 30 Percent/General 30 Percent Limitations 220
7.12 Twenty Percent Limitation 220
7.13 Gifts for the Use of Charity 221
7.14 Blending Percentage Limitations 222

7.15 Individuals' Net Operating Loss Carryovers and Carrybacks 223
7.16 Rules for Spouses 226
7.17 Information Requirements 228
7.18 Percentage Limitation for Corporations 229
7.19 Corporations' Net Operating Loss Carryovers and Carrybacks 231

Chapter Eight Estate and Gift Tax Considerations **235**

8.1 Introduction 236
8.2 Federal Gift Tax 237
8.3 Federal Estate Tax 247
8.4 Unification of Taxes 258
8.5 Generation-Skipping Transfer Tax 259
8.6 Estate Planning Principles 261
8.7 Remainder Interests 267
8.8 Ascertainability 276

Chapter Nine Special Gift Situations **279**

9.1 Works of Art 280
9.2 Gems 284
9.3 Inventory 285
9.4 Scientific Research Property 294
9.5 Computer Technology or Equipment 295
9.6 License to Use Patent 297
9.7 Conservation Property 298
9.8 S Corporation Stock 312
9.9 Section 306 Stock 320
9.10 Retirement Plan Accounts 321
9.11 Commodity Futures Contracts 329
9.12 Donors' Creations 331
9.13 Charity Auctions 332
9.14 Services 338
9.15 Unreimbursed Expenses 339
9.16 Limitation on Deduction for Expenses Due to Pleasure 343
9.17 Automobile Expenses 346
9.18 Use of Property 347
9.19 Bargain Sales 347
9.20 Property Subject to Debt 351
9.21 Future Interests in Tangible Personal Property 354
9.22 Contributions by Trusts 357

9.23 Partial Interests 363
9.24 Taxidermy 365
9.25 Clothing and Household Items 366
9.26 Charitable Family Limited Partnerships 366
9.27 Motor and Other Vehicles 368
9.28 Intellectual Property 374
9.29 Foreign Tax Credit 378
9.30 Subsistence Whaling Expenses 378
9.31 Public Policy Considerations 379

Chapter Ten Other Aspects of Deductible Giving 383

10.1 Valuation of Property 383
10.2 Contributions by Means of an Agent 402
10.3 Gifts for the *Use* of Charity 403
10.4 Conditional Gifts 405
10.5 Earmarking of Gifts for Individuals 408
10.6 Alternative Minimum Tax Considerations 411
10.7 Interrelationship with Business Expense Deduction 412
10.8 Denial of Deduction for Lobbying Activities 412
10.9 Deductible Gifts to Noncharitable Organizations 413
10.10 Reallocation of Deductions 416
10.11 Charitable Giving and Funding of Terrorism 416
10.12 Statute of Limitations 417
10.13 Concept of Trust Income 417
10.14 Penalties 420
10.15 Transactions of Interest 427

PART FOUR PLANNED GIVING

Chapter Eleven Valuation of Partial Interests 435

11.1 Overview of Statutory Law 435
11.2 Standard Actuarial Factors 436
11.3 General Actuarial Valuations 437
11.4 Nonstandard Actuarial Factors 440

Chapter Twelve Charitable Remainder Trusts 445

12.1 Definitions 446
12.2 Charitable Remainder Annuity Trust Rules 457
12.3 Charitable Remainder Unitrust Rules 469

12.4 Issues 483
12.5 Tax Treatment of Distributions 497
12.6 Division of Charitable Remainder Trusts 507
12.7 Early Terminations of Charitable Remainder Trusts 511
12.8 Taxation of Charitable Remainder Trusts 512
12.9 Mandatory Provisions 514
12.10 Private Foundation Rules 514
12.11 Wealth Replacement Trusts 516
12.12 Calculation of Charitable Deduction 520

Chapter Thirteen Pooled Income Funds 525

13.1 Definitions 526
13.2 Qualifying Pooled Income Funds 527
13.3 Allocation of Income 531
13.4 Recognition of Gain or Loss on Transfers 535
13.5 Mandatory Provisions 535
13.6 Private Foundation Rules 536
13.7 Pass-Through of Depreciation 536
13.8 Tax Status of Fund and Beneficiaries 538
13.9 Multiorganization Pooled Income Funds 538
13.10 Comparison with Charitable Remainder Trusts 541
13.11 Charitable Contribution Deduction 542

Chapter Fourteen Charitable Gift Annuities 545

14.1 Contract as Vehicle Form 545
14.2 Tax Treatment to Donor 546
14.3 Deferred Payment Gift Annuities 547
14.4 Estate and Gift Tax Consequences 548
14.5 Unrelated Business Income Implications 548
14.6 Unrelated Debt-Financed Income Implications 549
14.7 Contrast with Other Planned Gift Methods 550
14.8 Gift Annuities and Antitrust Laws 550
14.9 Gift Annuities and Securities Laws 552
14.10 Charitable Contribution Deduction 552

Chapter Fifteen Other Gifts of Remainder Interests 553

15.1 Overview 553
15.2 Contributions of Remainder Interests in Personal Residence or Farm 554
15.3 Undivided Portions of Entire Interests in Property 557

Chapter Sixteen Charitable Lead Trusts 565

16.1 General Rules 565
16.2 Income Interest 566
16.3 Income Tax Charitable Deduction 567
16.4 Tax Treatment of Charitable Lead Trusts 568
16.5 Testamentary Use of Charitable Lead Trusts 570
16.6 Percentage Limitation Rules 570
16.7 Private Foundation Rules 571
16.8 Anti-Abuse Rule Concerning Income Interests 572
16.9 Charitable Income Trusts 574
16.10 Comparison with Charitable Remainder Trusts 575
16.11 Valuing Charitable Deduction 575

Chapter Seventeen Gifts of and Using Life Insurance 577

17.1 Introduction 577
17.2 Life Insurance Concepts 578
17.3 Charitable Giving and Insurance 580
17.4 Insurable Interest 585
17.5 Unrelated Debt-Financed Income Considerations 588
17.6 Charitable Split-Dollar Insurance Plans 588
17.7 Applicable Insurance Contract Reporting Requirements 594

PART FIVE INTERNATIONAL CHARITABLE GIVING

Chapter Eighteen International Giving by Individuals during Lifetime 599

18.1 Introduction 599
18.2 Background 600
18.3 Earmarking and Conduit Restrictions 602
18.4 Control over Foreign Donees 605
18.5 Summary 608
18.6 Income Tax Treaties 608

Chapter Nineteen International Giving by Individuals through Estates 611

19.1 Introduction 611
19.2 Estate Tax Rules 612
19.3 Gift Tax Rules 617
19.4 Charitable Giving by Noncitizen Nonresidents 617

Chapter Twenty International Giving by Corporations 619

20.1 Corporate Gifts to U.S. Charity for Overseas Use 619
20.2 Gifts of Money from Foreign Affiliate of U.S. Parent to Overseas Charity 620
20.3 Gift of Goods or Services to Benefit Foreign Charity 621
20.4 Grants of Funds from U.S. Corporation-Related Foundation to Foreign Charity 622

PART SIX ADMINISTRATION OF CHARITABLE GIVING PROGRAMS

Chapter Twenty-one Substantiation and Appraisal Requirements 633

21.1 Introduction 633
21.2 Substantiation Requirements for Gifts of Money 634
21.3 Substantiation Requirements for Gifts of $250 or More 635
21.4 Substantiation Requirements for Noncash Gifts 643
21.5 Appraisal Requirements 645
21.6 Appraisals and Penalties 651
21.7 Appraisals of Clothing and Household Items 653
21.8 Burden of Proof Rules 653

Chapter Twenty-two Disclosure Requirements 655

22.1 Disclosure by Charitable Organizations in General 655
22.2 *Quid Pro Quo* Contribution Rules 659
22.3 Disclosure by Noncharitable Organizations 663

Chapter Twenty-three Special Events, Corporate Sponsorships, and Donor-Advised Funds 667

23.1 IRS Audit Guidelines 668
23.2 Special Events 671
23.3 Corporate Sponsorship Rules 673
23.4 Donor-Advised Funds 676

Chapter Twenty-four Reporting Requirements 679

24.1 Gift Reporting by Individuals 679
24.2 Gift Reporting by C Corporations 680
24.3 Gift Reporting by S Corporations 680
24.4 Gift Reporting by Partnerships 680
24.5 Gift Reporting by Donees in General 680
24.6 Gift Reporting in Unrelated Business Context 686

24.7 Reporting of Noncash Gifts in General 688
24.8 Reporting of Gifts of Vehicles 703
24.9 Reporting of Gifts of Intellectual Property 704
24.10 Reporting on Dispositions of Contributed Property 705
24.11 Applicable Insurance Contract Reporting Requirements 708
24.12 Personal Benefit Contract Reporting Requirements 709
24.13 Split-Interest Trust Filing Requirements 710

Chapter Twenty-five State Fundraising Regulation 711

25.1 State Regulation in General 711
25.2 Historical Perspective 712
25.3 States' Police Power 714
25.4 Basic Definitions 714
25.5 Registration Requirements 715
25.6 Reporting Requirements 716
25.7 Exemptions from Regulation 716
25.8 Fundraising Cost Limitations 717
25.9 Prohibited Acts 718
25.10 Contractual Requirements 719
25.11 Disclosure Requirements 720

PART SEVEN APPENDICES

Appendix A Sources of the Law 725

Appendix B Internal Revenue Code Sections 739

Appendix C Form 8283—Noncash Charitable Contributions 741

Appendix D Form 8282—Donee Information Return 743

Appendix E Inflation-Adjusted Insubstantiality Threshold— $50 Test 745

Appendix F Inflation-Adjusted Insubstantiality Threshold— $25 Test 747

Appendix G Inflation-Adjusted Low-Cost Article Definition 749

Appendix H Monthly Federal Interest Rates Used in Valuing Partial Interests (IRC § 7520) 751

Appendix I Deemed Rates of Return for Transfers to New Pooled Income Funds 757

Appendix J Form 1098—C 759

Appendix K Selected Bibliography 763

Tables

Table of Cases 777

Table of IRS Revenue Rulings and Revenue Procedures 785

Table of IRS Private Determinations Cited in Text 788

Table of IRS Private Letter Rulings, Technical Advice Memoranda, and General Counsel Memoranda 791

Table of Cases Discussed in *Bruce R. Hopkins' Nonprofit Counsel* 800

Table of Revenue Rulings Discussed in *Bruce R. Hopkins' Nonprofit Counsel* 803

Table of Private Letter Rulings and Technical Advice Memoranda Discussed in *Bruce R. Hopkins' Nonprofit Counsel* 804

Index 807

Preface

Although this sounds like a horrendous conceit, I marvel at this book. More accurately, I marvel at the *size* of this book. The very title suggests a subject that ought to be summarized in a pamphlet: *The Tax Law of Charitable Giving*. The principal reason for my amazement: How can something as simple and innocent as *charitable giving* generate so much law? It is, I suppose, a hallmark of our society; matters of law are quite complicated in the United States, and this includes the matter of transferring money and property to charitable organizations.

There is another reason for my wonder, one that is personal. By the early 1990s, this book had been on my mind for a long time. It had been written, in fits and starts, on many occasions over the years, with the manuscript pages ending up accumulating in this storage box and that file. It took some gentle prodding by the wonderful people at John Wiley & Sons—specifically, for the initiation of this project, Jeffrey Brown (long since promoted to Wiley's higher echelons) and Marla Bobowick (now a consultant in the charitable sector)—to get me going on completion of the book. The first edition appeared in 1993. Martha Cooley skillfully continued in the fashion of her predecessors; the second edition arrived in 1997. Susan McDermott provided the impetus for the third edition (2005) and now this, the fourth edition of the book.

It is not that I did not want to write this book; that is certainly not the case. In fact, I long dreamed of—it seems rather immodest to say it—a trilogy. This idea reflects what is now more than 40 years of law practice entirely in the realm of nonprofit organizations. I see the law uniquely affecting these organizations as falling into three general fields: the law of tax-exempt organizations, the law of fundraising, and the law of charitable giving.

By the time the pressure was mounting to write a book on charitable giving, the books on tax-exempt organizations law and fundraising law had been published (by Wiley, of course). Certainly, the time had come to begin (or re-begin) the writing of the third book. But I found my writing time diverted to other subjects (such as other books, book supplements, and my monthly newsletter); postponement of the charitable giving book had become the order of my days.

I have been writing books, published by Wiley, for more than 30 years. (The first book, the third edition of *The Law of Tax-Exempt Organizations*, was published in 1979. The predecessor to *The Law of Fundraising* was published in 1980.) These and other Wiley books I have been involved with entail the writing of annual supplements. As the 1980s unfolded, I discovered something unusual: I enjoy writing supplements. (There is something perversely challenging about

simultaneously correcting prior mistakes, and capturing and integrating subsequent developments.)

Thus, while writing supplements to the tax-exempt organizations and fundraising books, I found myself wanting to write supplements for a book on the law of charitable giving. This was (and is) because of the immense swirl of developments in the law taking place in all three arenas. The problem, however, was obvious: One cannot supplement a book that does not exist—or exists only in the realm of the author's mind.

So I set about to finish what became the first edition of this book. This is not to imply that I wrote it just so I could justify the writing of supplements for it (although a case can be made that that was a partial reason). I wrote the book because I was impressed with the volume of law being generated in the field; I wanted readers to have a book that explains the basics and new developments concerning the law of charitable giving in a comprehensive manner.

The law on the subject of charitable giving has become intricate; there is no let-up in sight. Those who need to keep up with the law in this area deserve a single place to go to find both the fundamentals and recent developments. With the trilogy now firmly in place (all three books being annually supplemented), the federal tax law of charitable giving can be placed in its appropriate context.

The first edition of this book captured the state of the law of charitable giving as of the close of 1992. Not surprisingly, the field exploded into new realms even as the book was being published. The Omnibus Budget Reconciliation Act of 1993 introduced law that significantly added to the administrative burdens of charitable organizations: more stringent substantiation rules and disclosure rules in the case of quid pro quo gifts. This legislation brought other revisions of the law of charitable giving, as did the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, and the IRS Restructuring and Reform Act of 1998. In these years, Congress also revised the antitrust and securities laws in the context of charitable giving.

The second edition was influenced only slightly by new legislation, the Tax Relief Extension Act of 1999. That edition would have been considerably different (and a bit thicker) had the Taxpayer Refund and Relief Act of 1999 not been vetoed.

The third edition took into account enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001, the Victims of Terrorism Tax Relief Act of 2001, the Jobs and Growth Tax Relief Reconciliation Act of 2003, the Military Family Tax Relief Act of 2003, the American Jobs Creation Act of 2004, and the Working Families Tax Relief Act of 2004.

The two major enactments that were introduced by the American Jobs Creation Act—concerning charitable gifts of intellectual property and motor vehicles—have since been augmented by guidance from the IRS. These two provisions, bred of Congress's concern about abuses (read: overvaluations), are complex, discouraging of charitable giving, and otherwise troublesome. While the concept is understandable (given Congress's concerns), this matter of confining the federal income tax charitable contribution deduction to the amount the charity actually receives from holding or disposition of the property is terrible precedent. If that concept were extended to all charitable gifts of property (such

as taking into account fundraising costs), the result would be disaster and chaos in the realm of charitable giving. More laws like this may be forthcoming unless something can be done about the underlying problem, which is standards and compliance as to gift property valuation.

This fourth edition summarizes all of the applicable components of the Pension Protection Act of 2006, including the (temporary) rules pertaining to the exclusion from gross income for certain distributions from individual retirement arrangements, enhancements to the rules concerning contributions of inventory, the new law pertaining to recapture of tax benefits derived from certain gifts of tangible personal property, changes in the law concerning contributions for conservation purposes, new rules as to gifts of fractional interests, changes in the law concerning appraisals and appraisers, and, yes, the rules governing charitable contributions of taxidermy.

The case can be made that gift property valuation is the core issue, in the charitable giving law context, facing the charitable sector. This subject was, as noted, visited again when Congress enacted revised and new appraisal and appraiser rules in 2006. In advance of that, the House Ways and Means and Senate Finance Committees held hearings on the law pertaining to façade and conservation easements. The Commissioner of Internal Revenue at the time said that the IRS has discovered instances where the tax benefits resulting from these types of gifts (for the preservation of open space and historic buildings) have been "twisted for inappropriate individual benefit." The Commissioner, Tax Exempt and Governmental Entities, thereafter expressed the IRS's concern with the "misuse of our regulated tax-exempt community to generate unwarranted or hyperinflated deductions" or other forms of participation in "tax abusive transactions." The IRS launched what the TE/GE Commissioner termed a "robust examination program," investigating promoters, appraisers, contributors, and charitable organizations; "most often," he said, the agency is finding "real valuation problems." Law that may dramatically affect the conservation easement community may also be indicative of more law on the subject of property gifts and valuation that directly impacts the entire charitable sector. Matters become even more dire as, increasingly, charitable deduction manipulation schemes become identified as abusive tax shelters.

This edition also includes references to the various provisions of charitable giving tax law that were extended (through 2009) by enactment of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, which is Division C of the financial markets stabilization legislation.

The Treasury Department and the IRS are also quite busy in the charitable giving field, promulgating much in the way of regulations, notices, announcements, forms, private letter rulings, and technical advice memoranda. Issues and subjects in the realm of the tax law of charitable giving that the IRS has addressed in recent months include the timing of the charitable deduction in connection with gifts of stock options, gifts where the donor retains the ability to manage the gift property, regulations concerning the charitable remainder trust characterization and ordering rules, a controversial (and withdrawn) proposal concerning the impact of spousal elective share laws on the qualification of charitable remainder

trusts, regulations concerning the taxation of charitable remainder trusts with unrelated taxable income, proposed recordkeeping and substantiation rules imposed in connection with cash and noncash contributions, proposed regulations concerning new rules pertaining to qualified appraisals and appraisers, and guidance issued by the IRS as to the federal tax consequences of division of charitable remainder trusts.

The IRS is engaged in a massive audit effort, targeting organizations such as credit counseling and down payment assistance organizations. While most of the law involved is that concerning tax-exempt organizations, some principles pertaining to charitable giving law are emerging. One in particular is the matter of the ''mandatory contribution,'' evidenced in some of the factual situations concerning down payment assistance entities. This development is also referenced in this edition.

Still another IRS initiative discussed in this edition is the agency's' examination program pertaining to charitable contributions of certain so-called successor member interests in certain limited liability companies, launched by means of a prototype letter and information document request. This IDR asks some pointed questions that charitable organizations should ponder, particularly when formulating a gift acceptance policy.

The most momentous IRS initiative of all, however, is promulgation of the revamped Form 990, the annual information return filed by most charitable organizations. Of the many resulting ramifications of this new return, one of the most significant is the reporting requirements concerning noncash contributions (reflected in Schedule M accompanying the return). The contents of this schedule and other relevant aspects of this new annual information return are discussed in this edition.

The courts continue to churn out opinions that shape and reshape the law of charitable giving. For example, two court opinions were issued concerning the deductibility of contributions of conservation easements. Several recent opinions apply the accuracy related and overvaluation penalties. The biggest disappointment was the Supreme Court's decision to not review the *Addis* case. These charitable giving tax law developments are summarized in this edition.

Overall, then, much more law concerning charitable giving is on the way, keeping this field alive, fascinating, and sometimes confusing.

This book is offered as a vehicle to survey the law and minimize the confusion as to the federal tax law of charitable giving. This time around, I am generally satisfied that nearly everything relevant through the first two-thirds of 2009 has been captured. Yet, I am probably fooling myself. For example, at this writing, final regulations concerning appraisals and appraisers are in the wings, as are proposed regulations concerning donor-advised funds. Proposed regulations pertaining to supporting organizations have been issued. Also, regrettably, there are developments in the tax shelter realm that are beginning to impact the law of charitable giving.

If readers suspect that my using the writing of prefaces to praise the outstanding folks at John Wiley & Sons, Inc., is simply a routine courtesy, please believe otherwise. These people have been marvelously supportive (and adept at

enforcing deadlines). The publisher's devotion to the production of quality publications in the nonprofit field warrants unstinting praise. The Nonprofit Law, Finance, and Management Series is an unparalleled collection of books in the area. I am honored to be among those who have been and are contributing to this substantial body of knowledge.

Thus, my sincere thanks go to my senior editor, Susan McDermott, and to Chris Gage, production editor, for their assistance and support in connection with this project.

BRUCE R. HOPKINS

Book Citations

Throughout this book, four books by the author (in some instances, as co-author), all published by John Wiley & Sons, are referenced as follows:

1. *The Law of Fundraising, Fourth Edition (2009): cited as Fundraising.*
2. *The Law of Tax-Exempt Organizations, Ninth Edition (2007): Tax-Exempt Organizations.*
3. *The New Form 990: Law, Policy, and Preparation (2009): New Form 990.*
4. *Private Foundations: Tax Law and Compliance, Third Edition (2008): Private Foundations.*

The first, second, and fourth of these books are annually supplemented. Also, updates on all of the foregoing subjects (plus *The Tax Law of Charitable Giving*) are available in *Bruce R. Hopkins' Nonprofit Counsel*, the author's monthly newsletter, also published by Wiley.

PART ONE

Introduction to the Tax Law of Charitable Giving

CHAPTER ONE

Charitable Giving Law: Basic Concepts

§ 1.1 Introduction to the Charitable Contribution Deduction 3

§ 1.2 Defining *Tax-Exempt Organizations* 4

§ 1.3 Principles of Charitable Organizations Law Philosophy 7

(a) Public Policy and National Heritage 9

(b) Other Rationales 16

(c) Freedom of Association 19

§ 1.4 Statistical Profile of Charitable Sector 20

§ 1.5 Categories of Tax-Exempt Organizations 24

The purpose of this book is to summarize and analyze the law of charitable giving. For the most part, this law consists of federal tax law requirements, although state law can be implicated. The law of charitable giving frequently interrelates with the laws concerning tax-exempt status and public charity/private foundation classification of charitable organizations.

§ 1.1 INTRODUCTION TO THE CHARITABLE CONTRIBUTION DEDUCTION

The *charitable contribution* is the subject of extensive law. On the face of it, a charitable gift is a rather simple matter, requiring merely a *gift* and a *charitable* recipient. Though these elements are crucial (and are discussed throughout these pages), they by no means constitute the whole of the subject. Far more is involved in determining the availability and amount of the charitable contribution deduction.

There are, in fact, several charitable contribution deductions in American law, including three at the federal level: one for the income tax, one for the estate tax, and one for the gift tax. Most states have at least one form of charitable deduction, as do many counties and cities.

The principal charitable contribution deduction is the one that is part of the federal income tax system. A charitable contribution paid during a tax year

generally is allowable as a deduction in computing taxable income for federal income tax purposes. This deduction is allowable irrespective of either the method of accounting employed or the date on which the contribution may have been pledged.

The federal income tax charitable contribution deduction is available to both individuals and corporations. In both instances, the amount deductible may depend on a variety of conditions and limitations. These elements of the law of charitable giving are the subject of much of this book. The federal gift and estate tax charitable contribution deductions are also discussed.

An income tax charitable deduction may be available for gifts of money and of property. This deduction can also be available with respect to outright transfers of money or property to charity, as well as to transfers of partial interests in property.[1] A gift of a partial interest in property is often known as *planned giving*.[2]

Aside from the law underlying the charitable deduction itself, several other aspects of law can bear on the availability of the deduction. These elements of law include receipt, recordkeeping, reporting, and disclosure requirements.[3] Also involved is the battery of laws regulating the fundraising process.[4]

There is much additional law that relates to charitable giving but is outside the scope of this book. This book is part of a series on nonprofit organizations, however; the series includes books on the law governing charitable organizations as such, the law comprising regulation of the charitable fundraising process, tax and financial planning for charitable organizations, the fundraising process itself, and the accounting rules for charitable organizations.[5]

Prior to review of the laws specifically applicable to charitable giving, it is necessary to understand the fundamentals of the body of federal tax law concerning tax exemption for charitable organizations and the history underlying this jurisprudence.

§ 1.2 DEFINING *TAX-EXEMPT ORGANIZATIONS*

A *tax-exempt organization* is a unique entity. Almost always, it is a nonprofit organization.[6] The concept of a *nonprofit organization* is usually a matter of state law,

---

[1] See Part Three.
[2] See Part Four.
[3] See Part Six.
[4] See, e.g., ch. 25.
[5] Companion books by the author provide a summary of the law concerning tax-exempt organizations as such (*Tax-Exempt Organizations*), planning considerations for tax-exempt organizations (*Planning Guide*), IRS examinations of tax-exempt organizations (*IRS Audits*), and regulation of the charitable fundraising process (*Fundraising*). Governance of tax-exempt organizations is the subject of Hopkins & Gross, *Nonprofit Governance: Law, Practices & Trends* (Hoboken, NJ: John Wiley & Sons, 2009). These bodies of law are reviewed in less technical detail in Hopkins, *Starting and Managing a Nonprofit Organization: A Legal Guide, Fifth Edition* (Hoboken, NJ: John Wiley & Sons, 2009). Coverage of these areas of the law (including the charitable giving rules) in even less technical detail is in these books by the author: *Nonprofit Law Made Easy* (Hoboken, NJ: John Wiley & Sons, 2005), *Charitable Giving Law Made Easy* (Hoboken, NJ: John Wiley & Sons, 2007), and *Fundraising Law Made Easy* (Hoboken, NJ: John Wiley & Sons, 2009).
[6] The term *nonprofit organization* is used throughout, rather than the term *not-for-profit*. The latter term is used, such as in the federal tax setting, to describe activities (rather than organizations) the expenses of which do not qualify for the business expense deduction. Internal Revenue Code of 1986, as amended, section 183. Throughout this book, the Internal Revenue Code is cited as the "IRC." The IRC is also published as Title 26 of the United States Code.

while the concept of a tax-exempt organization is principally a matter of the federal tax law.

The nonprofit sector of United States society has never been totally comfortable with this name. Over the years, it has been called, among other titles, the *philanthropic sector*, *private sector*, *voluntary sector*, *third sector*, and *independent sector*. In a sense, none of these appellations is appropriate.[7]

The idea of sectors of United States society has bred the thought that, in the largest sense, there are three of them. The institutions of society within the United States are generally classified as governmental, for-profit, or nonprofit entities. These three sectors of society are seen as critical for a democratic state—or, as it is sometimes termed, a civil society. *Governmental entities* are the branches, departments, agencies, and bureaus of the federal, state, and local governments. *For-profit entities* constitute the business sector of this society. *Nonprofit organizations*, as noted, constitute what is frequently termed the third sector, the voluntary sector, the private sector, or the independent sector of U.S. society. These terms are sometimes confusing; for example, the term *private sector* has been applied to both the for-profit and nonprofit sectors.

The rules concerning the creation of nonprofit organizations are essentially a subject for state law. Although a few nonprofit organizations are chartered by the U.S. Congress, most are incorporated or otherwise formed under state law. There is a substantive difference between nonprofit and tax-exempt organizations. While almost all tax-exempt organizations are nonprofit organizations, there are types of nonprofit organizations that are not tax-exempt. There is considerable confusion as to what the term *nonprofit* means—but it certainly does not mean that the organization cannot earn a profit (excess of revenue over expenses). The essential difference between a nonprofit organization and a for-profit organization is found in the *private inurement doctrine*.[8]

The concept of a nonprofit organization is best understood through a comparison with a for-profit organization. In many respects, the characteristics of the two categories of organizations are identical; both require a legal form, have a board of directors and officers, pay compensation, face essentially the same expenses, make investments, produce goods and/or services, and are able to receive a profit.

A for-profit entity, however, has owners: those who hold the equity in the enterprise, such as stockholders of a corporation. The for-profit organization is operated for the benefit of its owners; the profits of the enterprise are passed through to them, such as the payment of dividends on shares of stock. This is what is meant by the term *for-profit organization*; it is one that is intended to generate a profit for its owners. The transfer of the profits from the organization to its owners is considered the inurement of net earnings to the owners in their private capacity.

---

[7] A discussion of these sectors appears in Ferris & Graddy, *Fading Distinctions among the Nonprofit, Government, and For-Profit Sectors*, in Hodgkinson, Lyman, & Associates, "The Future of the Nonprofit Sector," ch. 8 (San Francisco: Jossey-Bass, 1989). An argument that the sector should be called the first sector is advanced in Young, "Beyond Tax Exemption: A Focus on Organizational Performance versus Legal Status," in *id*. ch. 11.

[8] See § 3.3(b), text accompanied by note 281. See also *Tax-Exempt Organizations* ch. 20.

Unlike the for-profit entity, the nonprofit organization generally is not permitted to distribute its profits (net earnings) to those who control and/or financially support it; a nonprofit organization usually does not have any owners (equity holders).[9] Consequently, the private inurement doctrine is the substantive dividing line that differentiates, for law purposes, nonprofit organizations and for-profit organizations.

Thus, both nonprofit organizations and for-profit organizations are able to generate a profit. The distinction between the two entities pivots on what is done with this profit.[10] The for-profit organization endeavors to produce a profit for what one commentator called its "residual claimants."[11] The nonprofit organization usually seeks to make that profit work for some end that is beneficial to society.

The private inurement doctrine is applicable to many types of tax-exempt organizations. It is, however, most pronounced with respect to charitable organizations.[12] By contrast, in some types of nonprofit (and tax-exempt) organizations, the provision of forms of private benefit is the exempt purpose and function. This is the case, for example, with employee benefit trusts, social clubs, and, to an extent, political committees.[13]

As this chapter has indicated thus far, there are subsets and sub-subsets within the nonprofit sector. Tax-exempt organizations are subsets of nonprofit organizations. Charitable organizations (using the broad definition of that term[14]) are subsets of tax-exempt organizations. Charitable organizations (in the narrow sense) are subsets of charitable organizations (in the broader sense of that term).[15]

These elements of the nonprofit sector may be visualized as a series of concentric circles, as shown on the following page.

---

[9] The Supreme Court wrote that a "nonprofit entity is ordinarily understood to differ from a for-profit corporation principally because it 'is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees.' " *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 585 (1997), quoting from Hansmann, "The Role of Nonprofit Enterprise," 89 *Yale L.J.* 835, 838 (1980).

[10] One commentator stated that charitable and other nonprofit organizations "are not restricted in the amount of profit they may make; restrictions apply only to what they may do with the profits." Weisbrod, "The Complexities of Income Generation for Nonprofits," in Hodgkinson, ch. 7.

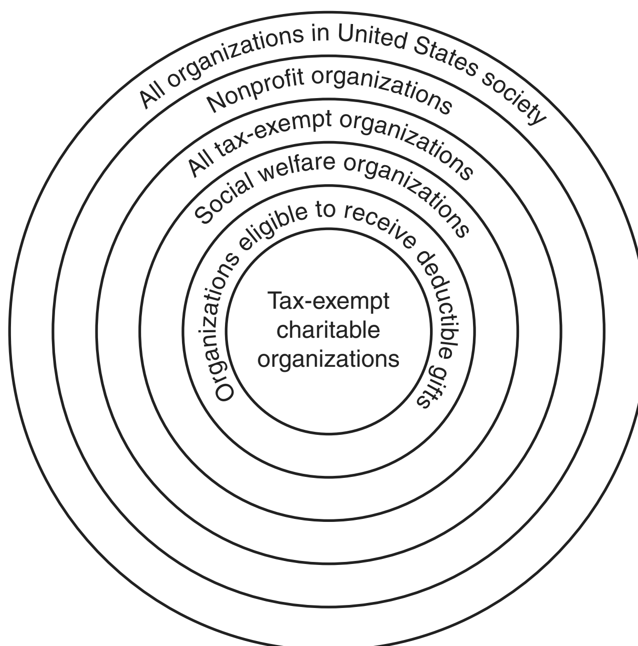
[11] Norwitz, "The Metaphysics of Time: A Radical Corporate Vision," 46 *Bus. Law.* (no. 2) 377 (Feb. 1991).

[12] The federal law of tax exemption for charitable organizations requires that each of these entities be organized and operated so that "no part of . . . [its] net earnings . . . inures to the benefit of any private shareholder or individual." IRC § 501(c)(3).

[13] IRC §§ 501(c)(9), (17), and (21) (employee benefit trusts), and IRC § 501(c)(7) (social clubs). The various categories of tax-exempt organizations and the accompanying Internal Revenue Code sections are summarized in § 1.5.

[14] This broad definition carries with it the connotation of *philanthropy*. *See, e.g.*, Van Til, "Defining Philanthropy," in Van Til & Associates, *Critical Issues in American Philanthropy*, ch. 2 (San Francisco: Jossey-Bass, 1990). See also Payton, *Philanthropy: Voluntary Action for the Public Good* (New York: Macmillan, 1988); O'Connell, *Philanthropy in Action* (New York: The Foundation Center, 1987).

[15] The complexity of the federal tax law is such that the charitable sector (using the term in its broadest sense) is also divided into two segments: charitable organizations that are considered *private* (private foundations) and charitable organizations that are considered *public* (all charitable organizations other than those that are considered private); these nonprivate charities are frequently referred to as *public charities*. See § 3.4.



For a variety of reasons, the organizations constituting the nation's independent sector have been granted exemption from federal and state taxation; in some instances, they have been accorded the status of entities contributions to which are tax-deductible under federal and state tax law. Federal, state, and usually local law provide exemptions from income tax for (and, where appropriate, deductibility of contributions to) a wide variety of organizations, including churches, colleges, universities, health care providers, various charities, civic leagues, labor unions, trade associations, social clubs, political organizations, veterans' groups, fraternal organizations, and certain cooperatives. Yet, despite the longevity of most of these exemptions, the underlying rationale for them is vague and varying. Nonetheless, the rationales for exemption appear to be long-standing public policy, inherent tax theory, and unique and specific reasons giving rise to a particular tax provision.

§ 1.3 PRINCIPLES OF CHARITABLE ORGANIZATIONS LAW PHILOSOPHY

The definition in the law of the term *nonprofit organization*, and the concept of the nonprofit sector as critical to the creation and functioning of a civil society, do not distinguish nonprofit organizations that are tax-exempt from those that are not. This is because the tax aspect of nonprofit organizations is not relevant to either subject. Indeed, rather than defining either the term *nonprofit organization* or its societal role, the federal tax law principles respecting tax exemption of these entities reflect and flow out of the essence of these subjects.

This is somewhat unusual; most tax laws are based on some form of rationale that is inherent in tax policy. The law of charitable and other tax-exempt

organizations, however, has very little to do with any underlying tax policy. Rather, this aspect of the tax law is grounded in a body of thought quite distant from tax policy: political philosophy as to the proper construct of a democratic society.

This raises, then, the matter of the rationale for tax-exemption eligibility of nonprofit organizations. That is, what is the fundamental characteristic—or characteristics—that enables a nonprofit organization to qualify as a tax-exempt organization? In fact, there is no single qualifying feature. This circumstance mirrors the fact that the present-day statutory tax exemption rules are not the product of a carefully formulated plan. Rather, they are a hodgepodge of federal statutory law that has evolved over nearly 100 years, as various Congresses have deleted from (infrequently) and added to (frequently) the roster of exempt entities, causing it to grow substantially over the decades. One observer wrote that the various categories of tax-exempt organizations ''are not the result of any planned legislative scheme'' but were enacted over the decades ''by a variety of legislators for a variety of reasons.''[16]

There are six basic rationales underlying qualification for tax-exempt status for nonprofit organizations. On a simplistic plane, a nonprofit entity is tax-exempt because Congress wrote a provision in the Internal Revenue Code according tax exemption to it. Thus, some organizations are tax-exempt for no more engaging reason than that Congress said so. Certainly, as to this type of exemption, there is no grand philosophical principle buttressing the exemption.

Some of the federal income tax exemptions were enacted in the spirit of being merely declaratory of, or furthering, then-existing law. The House Committee on Ways and Means, in legislating a forerunner to the provision that exempts certain voluntary employees' beneficiary associations, commented that ''these associations are common today [1928] and it appears desirable to provide specifically for their exemption from ordinary corporation tax.''[17] The exemption for nonprofit cemetery companies was enacted to parallel then-existing state and local property tax exemptions.[18] The exemption for farmers' cooperatives has been characterized as part of the federal government's posture of supporting agriculture.[19] The provision exempting certain U.S. corporate instrumentalities from tax was deemed declaratory of the exemption simultaneously provided by the particular enabling statute.[20] The provision according tax exemption to multiparent title-holding corporations was derived from the IRS's refusal to recognize exempt status for title-holding corporations serving more than one unrelated parent entity.

Tax exemption for categories of nonprofit organizations can arise as a byproduct of enactment of other legislation. In these instances, tax exemption is granted to facilitate accomplishment of the purpose of another legislative end. Thus, tax-exempt status has been approved for funds underlying employee

[16] McGovern, ''The Exemption Provisions of Subchapter F,'' 29 *Tax Law*. 523 (1976). Other overviews of the various tax exemption provisions are in Hansmann, ''The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation,'' 91 *Yale L.J.* 69 (1981); Bittker & Rahdert, ''The Exemption of Nonprofit Organizations from Federal Income Taxation,'' 85 *Yale L.J.* 299 (1976).

[17] H. Rep. No. 72, 78th Cong., 1st Sess. 17 (1928).

[18] Lapin, ''The Golden Hills and Meadows of the Tax-Exempt Cemetery,'' 44 *Taxes* 744 (1966).

[19] ''Comment,'' 27 *Iowa L. Rev*. 128, 151–55 (1941).

[20] H. Rep. No. 704, 73d Cong., 2d Sess. 21–25 (1934).

benefit programs. Other examples include tax exemption for professional football leagues that emanated out of the merger of the National Football League and the American Football League, and for state-sponsored providers of health care to the needy, which was required to accommodate the goals of Congress in creating health care delivery legislation.

There is a pure tax rationale for some tax-exempt organizations. Social clubs stand out as an illustration of this category.

The fourth rationale for tax-exempt status is a policy one—not tax policy, but policy with regard to less essential elements of the structure of a civil society. This is why, for example, tax-exempt status has been granted to entities as diverse as fraternal organizations, title-holding companies, farmers' cooperatives, certain insurance companies, and prepaid tuition plans.

The fifth rationale for tax-exempt status rests solidly on a philosophical principle. Yet, there are degrees of scale here; some principles are less majestic than others. Thus, there are nonprofit organizations that are tax-exempt because their objectives are of direct importance to a significant segment of society and indirectly of consequence to all of society. Within this frame lies the rationale for tax exemption for entities such as labor organizations, trade and business associations, and veterans' organizations.

The sixth rationale for tax-exempt status for nonprofit organizations is predicated on the view that exemption is required to facilitate achievement of an end of significance to the entirety of society. Most organizations that are generally thought of as *charitable* in nature[21] are entities that are meaningful to the structure and functioning of society in the United States. At least to some degree, this rationale embraces social welfare organizations. This rationale may be termed the *public policy* rationale.[22]

(a) Public Policy and National Heritage

The public policy rationale is one involving political philosophy rather than tax policy. The key concept underlying this philosophy is *pluralism*; more accurately, the pluralism of institutions, which is a function of competition between various institutions within the three sectors of society. In this context, the competition is between the nonprofit and governmental sectors. This element is particularly critical in the United States, whose history originates in distrust of government. (When the issue is unrelated business income taxation, the matter is one of competition between the nonprofit and for-profit sectors.) Here, the nonprofit sector serves as an alternative to the governmental sector as a means of addressing society's problems.

One of the greatest exponents of pluralism was John Stuart Mill. He wrote in *On Liberty*, published in 1859:

> In many cases, though individuals may not do the particular thing so well, on the average, as officers of government, it is nevertheless desirable that it should be done by them, rather than by the government, as a means to their own mental education—a mode of strengthening their active faculties,

[21] These are the charitable, educational, religious, scientific, and like organizations referenced in IRC § 501(c)(3).

[22] See *Tax-Exempt Organizations* § 1.3.

> exercising their judgment, and giving them a familiar knowledge of the subjects with which they are thus left to deal. This is a principal, though not the sole, recommendation of . . . the conduct of industrial and philanthropic enterprises by voluntary associations.

Following a discussion of the importance of ''individuality of development, and diversity of modes of action,'' Mill wrote:

> Government operations tend to be everywhere alike. With individuals and voluntary associations, on the contrary, there are varied experiments, and endless diversity of experience. What the State can usefully do is to make itself a central depository, and active circulator and diffuser, of the experience resulting from many trials. Its business is to enable each experimentalist to benefit by the experiments of others; instead of tolerating no experiments but its own.

This conflict among the sectors—a sorting out of the appropriate role of governments and nonprofit organizations—is, in a healthy society, a never-ending process, ebbing and flowing with the politics of the day. A Congress may work to reduce the scope of the federal government and a president may proclaim that the ''era of big government is over,'' while a preceding and/or succeeding generation may celebrate strong central government.

One of the greatest commentators on the impulse and tendency in the United States to utilize nonprofit organizations was Alexis de Tocqueville. Writing in 1835, in *Democracy in America*, he observed:

> Feelings and opinions are recruited, the heart is enlarged, and the human mind is developed only by the reciprocal influence of men upon one another. I have shown that these influences are almost null in democratic countries; they must therefore be artificially created, and this can only be accomplished by associations.

De Tocqueville's classic formulation on this subject came in his portrayal of Americans' use of ''public associations'' as a critical element of the societal structure:

> Americans of all ages, all conditions, and all dispositions constantly form associations. They have not only commercial and manufacturing companies, in which all take part, but associations of a thousand other kinds, religious, moral, serious, futile, general or restricted, enormous or diminutive. The Americans make associations to give entertainments, to found seminaries, to build inns, to construct churches, to diffuse books, to send missionaries to the antipodes; in this manner they found hospitals, prisons, and schools. If it is proposed to inculcate some truth or to foster some feeling by the encouragement of a great example, they form a society. Wherever at the head of some new undertaking you see the government in France, or a man of rank in England, in the United States you will be sure to find an association.

This was the political philosophical climate concerning nonprofit organizations in place when Congress, toward the close of the 19th century, began considering enactment of an income tax. Although courts would subsequently articulate policy rationales for tax exemption, one of the failures of American jurisprudence is that the Supreme Court and the lower courts have never adequately articulated the public policy doctrine.

Contemporary Congresses legislate by writing far more intricate statutes than their forebears, and in doing so usually leave in their wake rich deposits in the form of extensive legislative histories. Thus, it is far easier to ascertain what a

recent Congress meant when creating a law than is the case with respect to an enactment ushered in decades ago.

At the time a constitutional income tax was coming into existence (the first was enacted in 1913[23]), Congress legislated in spare language and rarely embellished upon its statutory handiwork with legislative histories. Therefore, there is no contemporary record, in the form of legislative history, of what members of Congress had in mind when they first started creating categories of charitable and other tax-exempt organizations. Congress, it is generally assumed, saw itself doing what other legislative bodies have done over the centuries. One observer stated that the ''history of mankind reflects that our early legislators were not setting precedent by exempting religious or charitable organizations'' from income tax.[24] That is, the political philosophical policy considerations pertaining to nonprofit organizations were such that taxation of these entities—considering their contributions to the well-being and functioning of society—was unthinkable.

Thus, in the process of writing the Revenue Act of 1913, Congress viewed tax exemption for charitable organizations as the only way to consistently correlate tax policy to political theory on the point, and saw the exemption of charities in the federal tax statutes as an extension of comparable practice throughout the whole of history. No legislative history enlarges upon the point. Presumably, Congress simply believed that these organizations ought not to be taxed and found the proposition sufficiently obvious that extensive explanation of its actions was not required.

Some clues are found in the definition of *charitable activities* in the income tax regulations,[25] which are thought to reflect congressional intent. The regulations refer to purposes such as relief of the poor, advancement of education and science, erection and maintenance of public buildings, and lessening of the burdens of government. These definitions of charitable undertakings clearly derive from the Preamble to the Statute of Charitable Uses,[26] written in England in 1601. Reference is there made to certain ''charitable'' purposes:

> some for relief of aged, impotent and poor people, some for maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in universities, some for repair of bridges, ports, havens, cause-ways, churches, seabanks and highways, some for education and preferment of orphans, some for or towards relief, stock or maintenance for houses of correction, some for marriages of poor maids, some for supportation, aid and help of young tradesmen, handicraftsmen and persons decayed, and others for relief of redemption of prisoners or captives. . . .

As this indicates, a subset of the public policy doctrine implies that tax exemption for charitable organizations derives from the concept that they

[23] In 1894, Congress imposed a tax on corporate income. This was the first time Congress was required to define the appropriate subjects of tax exemption (inasmuch as prior tax schemes specified the entities subject to taxation). The Tariff Act of 1894 provided exemption for nonprofit charitable, religious, and educational organizations; fraternal beneficiary societies; certain mutual savings banks; and certain mutual insurance companies. The 1894 legislation succumbed to a constitutional law challenge. *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895), *overruled on other grounds sub nom. South Carolina v. Baker*, 485 U.S. 505 (1988). The Sixteenth Amendment was subsequently ratified, and the Revenue Act of 1913 was enacted.

[24] McGovern, ''The Exemption Provisions of Subchapter F,'' 29 *Tax Law.* 523, 524 (1976).

[25] Income Tax Regulations (Reg.) § 1.501(c)(3)-1(d)(2).

[26] Statute of Charitable Uses, 43 *Eliz.*, c.4.

perform functions that, in the absence of these organizations, government would have to perform. This view leads to the conclusion that government is willing to forgo the tax revenues it would otherwise receive in return for the public interest services rendered by charitable organizations.

Since the founding of the United States and beforehand in the colonial period, tax exemption—particularly with respect to religious organizations—was common.[27] Churches were uniformly spared taxation.[28] This practice has been sustained throughout the history of the nation—not only at the federal level, but also at the state and local levels of government, which grant property tax exemptions, as an example.

The Supreme Court concluded, soon after enactment of the income tax, that the foregoing rationalization was the basis for the federal tax exemption for charitable entities (although in doing so it reflected a degree of uncertainty in the strength of its reasoning, undoubtedly based on the paucity of legislative history). In 1924, the Court stated that ''[e]vidently the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named, and is intended to aid them when [they are] not conducted for private gain.''[29] Nearly 50 years later, in upholding the constitutionality of income tax exemption for religious organizations, the Court observed that the ''State has an affirmative policy that considers these groups as beneficial and stabilizing influences in community life and finds this classification [tax exemption] useful, desirable, and in the public interest.''[30] Subsequently, the Court wrote that, for most categories of nonprofit organizations, ''exemption from federal income tax is intended to encourage the provision of services that are deemed socially beneficial.''[31]

A few other courts have taken up this theme. One federal court of appeals wrote that the ''reason underlying the exemption granted'' to charitable organizations is that ''the exempted taxpayer performs a public service.''[32] This court continued:

> The common element of charitable purposes within the meaning of the . . . [federal tax law] is the relief of the public of a burden which otherwise belongs to it. Charitable purposes are those which benefit the community by relieving it pro tanto from an obligation which it owes to the objects of the charity as members of the community.[33]

This federal appellate court subsequently observed, as respects the exemption for charitable organizations, that ''[o]ne stated reason for a deduction or exemption of this kind is that the favored entity performs a public service and benefits the public or relieves it of a burden which otherwise belongs to it.''[34] Another federal court opined that the justification of the charitable contribution deduction was ''historically . . . that by doing so, the Government relieves itself of the burden of

---

[27] Cobb, *The Rise of Religious Liberty in America*, 482–528 (1902).
[28] Torpey, *Judicial Doctrines of Religious Rights in America* 171 (1948).
[29] *Trinidad v. Sagrada Orden de Predicadores de la Provincia del Santisimo Rosario de Filipinas*, 263 U.S. 578, 581 (1924).
[30] *Walz v. Tax Commission*, 397 U.S. 664, 673 (1970).
[31] *Portland Golf Club v. Commissioner*, 497 U.S. 154, 161 (1990).
[32] *Duffy v. Birmingham*, 190 F.2d 738, 740 (8th Cir. 1951).
[33] *Id.*
[34] *St. Louis Union Trust Co. v. United States*, 374 F.2d 427, 432 (8th Cir. 1967).

meeting public needs which in the absence of charitable activity would fall on the shoulders of the Government."[35]

Only one federal court has fully articulated the public policy doctrine, even there noting that the "very purpose" of the charitable contribution deduction "is rooted in helping institutions because they serve the public good."[36] The doctrine was explained as follows:

> [A]s to private philanthropy, the promotion of a healthy pluralism is often viewed as a prime social benefit of general significance. In other words, society can be seen as benefiting not only from the application of private wealth to specific purposes in the public interest but also from the variety of choices made by individual philanthropists as to which activities to subsidize. This decentralized choice-making is arguably more efficient and responsive to public needs than the cumbersome and less flexible allocation process of government administration.[37]

Occasionally, Congress issues a pronouncement on this subject. One of these rare instances occurred in 1939, when the report of the House Committee on Ways and Means, part of the legislative history of the Revenue Act of 1938, stated:

> The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare.[38]

The doctrine also is referenced from time to time in testimony before a congressional committee. For example, the Secretary of the Treasury testified before the House Committee on Ways and Means in 1973, observing:

> These organizations [which he termed "voluntary charities, which depend heavily on gifts and bequests"] are an important influence for diversity and a bulwark against over-reliance on big government. The tax privileges extended to these institutions were purged of abuse in 1969 and we believe the existing deductions for charitable gifts and bequests are an appropriate way to encourage those institutions. We believe the public accepts them as fair.[39]

The literature on this subject is extensive. The contemporary versions of it are traceable to 1975, when the public policy rationale was reexamined and reaffirmed by the Commission on Private Philanthropy and Public Needs (informally known as the Filer Commission). The Commission observed:

> Few aspects of American society are more characteristically, more famously American than the nation's array of voluntary organizations, and the support in both time and money that is given to them by its citizens. Our country has been decisively different in this regard, historian Daniel Boorstin observes, "from the beginning." As the country was settled, "communities existed before governments were there to care for public needs." The result, Boorstin says, was that "voluntary collaborative activities" were set up to provide basic social services. Government followed later.

---

[35] *McGlotten v. Connally*, 338 F. Supp. 448, 456 (D.D.C. 1972).
[36] *Green v. Connally*, 330 F. Supp. 1150, 1162 (D.D.C. 1971), *aff'd sub nom. Coit v. Green*, 404 U.S. 997 (1971).
[37] *Id.*, 330 F. Supp. at 1162.
[38] H. Rep. No. 1860, 75th Cong., 3d Sess. 19 (1939).
[39] Department of the Treasury, *Proposals for Tax Change*, Apr. 30, 1973.

> The practice of attending to community needs outside of government has profoundly shaped American society and its institutional framework. While in most other countries, major social institutions such as universities, hospitals, schools, libraries, museums and social welfare agencies are state-run and state-funded, in the United States many of the same organizations are privately controlled and voluntarily supported. The institutional landscape of America is, in fact, teeming with nongovernmental, noncommercial organizations, all the way from some of the world's leading educational and cultural institutions to local garden clubs, from politically powerful national associations to block associations—literally millions of groups in all. This vast and varied array is, and has long been widely recognized as, part of the very fabric of American life. It reflects a national belief in the philosophy of pluralism and in the profound importance to society of individual initiative.
>
> Underpinning the virtual omnipresence of voluntary organizations, and a form of individual initiative in its own right, is the practice—in the case of many Americans, the deeply ingrained habit—of philanthropy, of private giving, which provides the resource base for voluntary organizations.
>
> These two interrelated elements, then, are sizable forces in American society, far larger than in any other country. And they have contributed immeasurably to this country's social and scientific progress. On the ledger of recent contributions are such diverse advances as the creation of noncommercial "public" television, the development of environmental, consumerist and demographic consciousness, community-oriented museum programs, the protecting of land and landmarks from the often heedless rush of "progress." The list is endless and still growing; both the number and deeds of voluntary organizations are increasing. "Americans are forever forming associations," wrote de Tocqueville. They still are: tens of thousands of environmental organizations have sprung up in the last few years alone. Private giving is growing, too, at least in current dollar amounts.[40]

Here, the concept of *philanthropy* enters, with the view that charitable organizations, maintained by tax exemption and nurtured by an ongoing flow of deductible contributions, reflect the American philosophy that not all policy-making and problem-solving should be reposed in the governmental sector. Earlier, a jurist wrote, in a frequently cited article, that philanthropy

> is the very possibility of doing something different than government can do, of creating an institution free to make choices government cannot—even seemingly arbitrary ones—without having to provide a justification that will be examined in a court of law, which stimulates much private giving and interest.[41]

A component part of the public policy doctrine is its emphasis on *voluntarism*. This principle was expressed as follows:

> Voluntarism has been responsible for the creation and maintenance of churches, schools, colleges, universities, laboratories, hospitals, libraries, museums, and the performing arts; voluntarism has given rise to the public and private health and welfare systems and many other functions and services that are now an integral part of the American civilization. In no other country has private philanthropy become so vital a part of the national culture or so effective an instrument in prodding government to closer attention to social needs.[42]

---

[40] *Report of the Commission on Private Philanthropy and Public Needs: Giving in America—Toward a Stronger Voluntary Sector*, at 9–10 (1975).

[41] Friendly, "The *Dartmouth College* Case and the Public-Private Penumbra," 12 *Tex. Q.* (2d Supp.) 141, 171 (1969). Two other prominent sources are Rabin, "Charitable Trusts and Charitable Deductions," 41 *N.Y.U. L. Rev.* 912 (1966); Saks, "The Role of Philanthropy: An Institutional View," 46 *Va. L. Rev.* 516 (1960).

[42] Fink, "Taxation and Philanthropy—A 1976 Perspective," 3 *J. Coll. & Univ. L.* 1, 6–7 (1975).

One of the modern-day advocates of the role and value of the independent sector in the United States was John W. Gardner, former Secretary of Health, Education, and Welfare, founder of Common Cause, and one of the founders of Independent Sector. Mr. Gardner wrote extensively on the subject of the necessity for and significance of the nation's nonprofit sector. He stated that the ''area of our national life encompassed by the deduction for religious, scientific, educational, and charitable organizations lies at the very heart of our intellectual and spiritual striving as a people, at the very heart of our feeling about one another and about our joint life.''[43] He added that the ''private pursuit of public purpose is an honored tradition in American life''[44] and believed that ''[a]ll elements in the private sector should unite to maintain a tax policy that preserves our pluralism.''[45] Likewise, Robert J. Henle, formerly president of Georgetown University, wrote of how the ''not-for-profit, private sector promotes the free initiative of citizens and gives them an opportunity on a nonpolitical basis to join together to promote the welfare of their fellow citizens or the public purpose to which they are attracted.''[46]

It is not possible, in a book of this nature, to fully capture the philosophical underpinnings of the nonprofit sector. This task has been accomplished, however, by Brian O'Connell, while president of Independent Sector.[47] In a foreword to Mr. O'Connell's work, John W. Gardner stated this basic truth: ''All Americans interact with voluntary or nonprofit agencies and activities regularly, although they are often unaware of this fact.''[48] Still, the educational process must continue, for, as Mr. Gardner wrote, ''The sector enhances our creativity, enlivens our communities, nurtures individual responsibility, stirs life at the grassroots, and reminds us that we were born free.''[49] Mr. O'Connell's collection includes thoughts from sources as diverse as Max Lerner (''the associative impulse is strong in American life; no other civilization can show as many secret fraternal orders, businessmen's 'service clubs,' trade and occupational associations, social clubs, garden clubs, women's clubs, church clubs, theater groups, political and reform associations, veterans' groups, ethnic societies, and other clusterings of trivial or substantial importance''[50]), Daniel J. Boorstin (''in America, even in modern times, communities existed before governments were here to care for public needs''[51]), Merle Curti (''voluntary association with others in common causes has been thought to be strikingly characteristic of American life''[52]), John W. Gardner (''For many countries . . . monolithic central support of all educational, scientific, and charitable activities would be regarded as normal . . . [b]ut for the United States it would mean the end of a great tradition''[53]), Richard C. Cornuelle (''We have been unique because another sector, clearly distinct from

---

[43] Gardner, ''Bureaucracy vs. The Private Sector,'' 212 *Current* 17–18 (May 1979).
[44] *Id*. at 17.
[45] *Id*. at 18.
[46] Henle, ''The Survival of Not-For-Profit, Private Institutions,'' *America*, Oct. 23, 1976, at 252.
[47] O'Connell, *America's Voluntary Spirit* (New York: The Foundation Center, 1983).
[48] *Id*. at xi.
[49] *Id*. at xv.
[50] *Id*. at 81.
[51] *Id*. at 131.
[52] *Id*. at 162.
[53] *Id*. at 256.

the other two, has, in the past, borne a heavy load of public responsibility''[54]), John D. Rockefeller III (''The third sector is . . . the seedbed for organized efforts to deal with social problems''[55]), Waldemar A. Neilsen (''the ultimate contribution of the Third Sector to our national life—namely what it does to ensure the continuing responsiveness, creativity and self-renewal of our democratic society''[56]), Richard W. Lyman (''an array of its [the independent sector's] virtues that is by now fairly familiar: its contributions to pluralism and diversity, its tendency to enable individuals to participate in civic life in ways that make sense to them and help to combat that corrosive feeling of powerlessness that is among the dread social diseases of our era, its encouragement of innovation and its capacity to act as a check on the inadequacies of government''[57]), and himself (''The problems of contemporary society are more complex, the solutions more involved and the satisfactions more obscure, but the basic ingredients are still the caring and the resolve to make things better'').[58]

Consequently, it is erroneous to regard the charitable contribution deduction and tax exemption as anything other than a reflection of this larger doctrine. Congress is not merely ''giving'' eligible nonprofit organizations any ''benefits''; the charitable deduction or exemption from taxation is not a ''loophole,'' a ''preference,'' or a ''subsidy''—it is not really an ''indirect appropriation.''[59] Rather, the various Internal Revenue Code provisions that establish the tax exemption system exist as a reflection of the affirmative policy of American government to refrain from inhibiting by taxation the beneficial activities of qualified tax-exempt organizations acting in community and other public interests.[60]

(b) Other Rationales

There are, as noted, other rationales for tax exemption that pertain to charitable organizations. One of these, somewhat less lofty than that accorded charitable and social welfare organizations, is extended as justification for the exemption of trade associations and other forms of business leagues.[61] These entities function to

---

[54] *Id.* at 278.
[55] *Id.* at 356.
[56] *Id.* at 368.
[57] *Id.* at 371.
[58] *Id.* at 408. A companion book by the author addresses this point in additional detail and traces the origins and development of a hypothetical charitable organization to illustrate the applicability of various federal and state laws concerning nonprofit organizations. See *Starting and Managing a Nonprofit Organization: A Legal Guide*, 5th ed. (Hoboken, NJ: John Wiley & Sons, 2009).
[59] The congressional budget and tax committees and the Department of the Treasury measure the economic value (revenue ''losses'') of various tax preferences, such as tax deductions, credits, and exclusions (termed *tax expenditures*). The federal income tax charitable contribution deduction tends to be the sixth- or seventh-largest tax expenditure.
[60] In general, Pappas, ''The Independent Sector and the Tax Law: Defining Charity in an Ideal Democracy,'' 64 *S. Cal. L. Rev.* 461 (Jan. 1991).

There is another rationale for tax exemption, known as the *inherent tax rationale*. See *Tax-Exempt Organizations* § 1.5. The essence of this rationale is that the receipt of what otherwise might be deemed income by a tax-exempt organization is not a taxable event, in that the organization is merely a convenience or means to an end, a vehicle whereby those participating in the enterprise may receive and expend money collectively in much the same way as they would if the money were expended by them individually. Although this rationale is not followed in the charitable organizations setting, it chiefly underlies the tax exemption for organizations such as social clubs, homeowners' associations, and political organizations.
[61] See *Tax-Exempt Organizations* ch. 14.

promote the welfare of a segment of society: the business, industrial, and professional community. An element of the philosophy supporting this type of tax exemption is that a healthy business climate advances the public welfare. The tax exemption for labor unions and other labor organizations rests upon a similar rationale.[62]

The tax exemption for fraternal beneficiary organizations also depends, at least in part, on this defense. A study of the insurance practices of large societies by the Department of the Treasury[63] concluded that this rationale is inapplicable with respect to the insurance programs of these entities because the ''provision of life insurance and other benefits is generally not considered a good or service with significant external benefits'' to society generally. The report stated, however, that ''tax exemption for these goods and services [insurance and like benefits] may be justified in order to encourage'' the charitable activities conducted by these organizations. The inherent tax rationale[64] ''may'' provide a basis for tax exemption for ''certain'' of these societies' services, according to the report. Further, the report observed that ''[i]nsurance is not a type of product for which consumers may lack access to information on the appropriate quantity or quality that they need.'' Therefore, the market failure rationale[65] ''may not be applicable'' in this instance.

Other federal tax exemption provisions may be traced to an effort to achieve a particular objective. These provisions tend to be of more recent vintage, testimony to the fact of a more complex Internal Revenue Code. For example, specific tax exemption for veterans' organizations[66] was enacted to create a category of organizations entitled to use a particular exemption from the unrelated business income tax,[67] and statutory exemption for homeowners' associations[68] came about because of a shift in the policy of the Internal Revenue Service (IRS) regarding the scope of tax exemption provided for social welfare organizations. The tax exemption for college and university investment vehicles was the result of Congress's effort to preserve the exempt status of a specific common investment fund in the face of an IRS determination to the contrary.[69] As is so often the case with respect to the tax law generally, a particular tax exemption provision can arise as the result of case law, or to clarify it; this was the origin of statutes granting tax exemption to cooperative hospital service organizations,[70] charitable risk pools,[71] child care organizations,[72] public safety testing entities,[73] and qualified tuition programs.[74]

---

[62] See *Tax-Exempt Organizations* § 16.1.
[63] U.S. Department of the Treasury, *Report to the Congress on Fraternal Benefit Societies*, Jan. 15, 1993.
[64] See *supra* note 60.
[65] See text accompanied by *infra* notes 76–80.
[66] See *Tax-Exempt Organizations* § 19.11(a).
[67] See *id.* § 24.10, text accompanied by note 947.
[68] See *id.* § 19.14.
[69] See *id.* § 11.5.
[70] See *id.* § 11.4.
[71] See *id.* § 11.6.
[72] See *id.* § 8.8.
[73] See *id.* § 11.3.
[74] See *id.* § 19.17.

All of the foregoing rationales for tax-exempt organizations have been described in philosophical, historical, political, policy, or technical tax terms. Yet another approach to an understanding of exempt organizations can be found in economic theory.

Principles of economics are founded on the laws of supply (production) and demand (consumption). Using the foregoing analyses, exempt organizations appear to have arisen in response to the pressures of the supply side—namely, the need for the goods and services provided—and the force of pluralistic institutions and organizations in society. Others, however, view tax-exempt organizations as responses to sets of social needs that can be described in demand-side economic terms, a ''positive theory of consumer demand.''[75]

According to the demand-side analysis, consumers in many contexts prefer to deal with nonprofit, tax-exempt, usually charitable organizations in purchasing goods and services, because the consumer knows that a nonprofit organization has a ''legal commitment to devote its entire earnings to the production of services,''[76] whereas for-profit organizations have a great incentive to raise prices and cut quality. Generally, it is too difficult for consumers to monitor these forces. This means that consumers have a greater basis for trusting tax-exempt organizations to provide the services—a restatement, in a way, of the fiduciary concept. Thus, the consumer, pursuant to this analysis, ''needs an organization that he can trust, and the non-profit, because of the legal constraints under which it must operate, is likely to serve that function better than its for-profit counterpart.''[77]

This phenomenon has been described as ''market failure'' as far as for-profit organizations are concerned, in that, in certain circumstances, the market is unable to police the producers by means of ordinary contractual devices.[78] This, in turn, has been described as ''contract failure,'' which occurs when consumers ''may be incapable of accurately evaluating the goods promised or delivered'' and ''market competition may well provide insufficient discipline for a profit-seeking producer.''[79] Hence, according to this theory, the consuming public selects the nonprofit organization, which operates without the profit motive and offers the consumer the ''trust element'' that the for-profit organizations cannot always provide.

Although the economic demand-side theory is fascinating and undoubtedly contains much truth, it probably overstates the aspect of consumer demand and downplays historical realities, tax considerations, and human frailties. The nonprofit organization antedates the for-profit corporation, and many of today's tax-exempt organizations may be nonprofit because their forebears started out as such. In addition, the forces of pluralism of institutions and organizations continue to shape much of the contemporary independent sector.

---

[75] Hansmann, "The Role of Nonprofit Enterprise," 89 *Yale L.J.* 835, 896 (1980).
[76] *Id.* at 844.
[77] *Id.* at 847.
[78] *Id.* at 845.
[79] *Id.* at 843.

(c) Freedom of Association

Tax exemption for nonprofit membership organizations may be viewed as a manifestation of the constitutionally protected right of association accorded the members of these organizations. There are two types of *freedom of association*. One type—termed the *freedom of intimate association*—is the traditional type of protected association derived from the right of personal liberty. The other type—*the freedom of expressive association*—is a function of the right of free speech protected by the First Amendment to the U.S. Constitution.

By application of the doctrine of freedom of intimate association, the formation and preservation of certain types of highly personal relationships are afforded a substantial measure of sanctuary from unjustified interference by government.[80] These personal bonds are considered to foster diversity and advance personal liberty.[81] In assessing the extent of constraints on the authority of government to interfere with this freedom, a court must make a determination of where the objective characteristics of the relationship, which is created when an individual enters into a particular association, are located on a spectrum from the most intimate to the most attenuated of personal relationships.[82] Relevant factors include size, purpose, policies, selectivity, and congeniality.[83]

The freedom to engage in group effort is guaranteed under the doctrine of freedom of expressive association[84] and is viewed as a way of advancing political, social, economic, educational, religious, and cultural ends.[85] Government, however, has the ability to infringe on this right when compelling state interests, unrelated to the suppression of ideas and that cannot be achieved through means significantly less restrictive of associational freedoms, are served.[86]

These two associational freedoms have been the subject of a U.S. Supreme Court analysis concerning an organization's right to exclude women from its voting membership.[87] The Court found that the organization involved and its chapters were too large and unselective to find shelter under the doctrine of freedom of intimate association. Although the Court also conceded that the "[f]reedom of association therefore plainly presupposes a freedom not to associate," it concluded that the governmental interest in eradicating gender-based discrimination was superior to the associational rights of the organization's male members.[88] In

---

80 *Pierce v. Society of Sisters*, 268 U.S. 510 (1925); *Meyer v. Nebraska*, 262 U.S. 390 (1923).

81 *Zablocki v. Redhail*, 434 U.S. 374 (1978); *Quilloin v. Walcott*, 434 U.S. 246 (1978); *Smith v. Organization of Foster Families*, 431 U.S. 816 (1977); *Carey v. Population Serv. Int'l.*, 431 U.S. 678 (1977); *Moore v. East Cleveland*, 431 U.S. 494 (1977); *Cleveland Bd. of Educ. v. LaFleur*, 414 U.S. 632 (1974); *Wisconsin v. Yoder*, 406 U.S. 205 (1973); *Stanley v. Illinois*, 405 U.S. 645 (1972); *Stanley v. Georgia*, 394 U.S. 557 (1969); *Griswold v. Connecticut*, 381 U.S. 479 (1965); *Olmstead v. United States*, 277 U.S. 438 (1928).

82 *Runyon v. McCrary*, 427 U.S. 160 (1976).

83 *Roberts v. United States Jaycees*, 468 U.S. 609 (1984).

84 *Rent Control Coalition for Fair Housing. v. Berkeley*, 454 U.S. 290 (1981).

85 *Boy Scouts of America et al. v. Dale*, 530 U.S. 640 (2000); *NAACP v. Claiborne Hardware Co.*, 458 U.S. 886 (1982); *Larson v. Valente*, 456 U.S. 228 (1982); *In re Primus*, 436 U.S. 412 (1978); *Abood v. Detroit Bd. of Educ.*, 431 U.S. 209 (1977).

86 *Brown v. Socialist Workers '74 Campaign Committee*, 459 U.S. 87 (1982); *Democratic Party v. Wisconsin*, 450 U.S. 107 (1981); *Buckley v. Valeo*, 424 U.S. 1 (1976); *Cousins v. Wigoda*, 419 U.S. 477 (1975); *American Party v. White*, 415 U.S. 767 (1974); *NAACP v. Button*, 371 U.S. 415 (1963); *Shelton v. Tucker*, 364 U.S. 486 (1960); *NAACP v. Alabama*, 347 U.S. 449 (1958).

87 *Roberts v. United States Jaycees*, 468 U.S. 609 (1984).

88 *Id.* at 622–29.

general, the Court held that to tolerate this form of discrimination would be to deny ''society the benefits of wide participation in political, economic, and cultural life.''[89]

§ 1.4 STATISTICAL PROFILE OF CHARITABLE SECTOR

The charitable sector and the federal tax law with respect to it have a common feature: enormous and incessant growth. This expansion is reflected in all of the principal indicators pertaining to this sector, including the number of organizations, the sector's asset base, the amount of charitable giving and granting, its annual expenditures, its share of the gross national product, and the size of its workforce. There is, however, this direct correlation: As the nonprofit sector expands, so too does the body of federal and state law regulating it. No end to either of these expansions is in sight.[90]

Over the years, there have been many efforts to analyze and portray the nonprofit sector. One of the first of these significant undertakings, utilizing statistics, conducted jointly by the Survey Research Center at the University of Michigan and the U.S. Census Bureau, was published in 1975 as part of the findings of the Commission on Private Philanthropy and Public Needs.[91] The data compiled for the commission's use were for 1973. Contemporary charitable giving statistics are explored below, but one striking basis of comparison cannot be resisted at this point. Charitable giving in that year was $26 billion, while for 2008 the amount was over $307 billion.[92]

Research of this nature developed for the commission spawned recurring statistical portraits of the sector. One of the most comprehensive of these analyses is that provided in the periodic almanac published by the Urban Institute.[93] Others include a fascinating portrait of the ''third America''[94] and the annual survey of charitable giving published by the Giving USA Foundation.[95] The IRS's Statistics of Income Division collects data on tax-exempt organizations.[96] Further, various subsets of the nonprofit sector are the subject of specific portrayals.[97]

---

[89] *Id*. at 625. In general, see *Tax-Exempt Organizations* § 1.7; Brody, "Entrance, Voice, and Exit: The Constitutional Bounds of the Right of Association," 35 *U.C. Davis L. Rev*. (no. 4) 821 (April 2002); Linder, "Freedom of Association after *Roberts v. United States Jaycees*," 82 *Mich. L. Rev*. (no. 8) 1878 (1984).

[90] "The rapid growth of the nonprofit sector in the last half century has led to greatly increased attention from the media, scholars, the government, and the public." O'Neill, *Nonprofit Nation: A New Look at the Third America* 34 (Jossey-Bass, 2002) (*Nonprofit Nation*).

[91] *Report of the Commission on Private Philanthropy and Public Needs: Giving in America—Toward a Stronger Voluntary Sector* (1975).

[92] See text accompanied by *infra* note 125.

[93] The most recent version of this almanac is Wing, Pollak, & Blackwood, *The Nonprofit Almanac 2008* (Washington, D.C.: The Urban Institute Press) (*Nonprofit Almanac*).

[94] *Nonprofit Nation*.

[95] These annual publications of this organization are titled *Giving USA*.

[96] The IRS publishes various editions of the *Statistics of Income Bulletins*.

[97] E.g., *Yearbook of American and Canadian Churches* (National Council of the Churches of Christ in the United States of America, various editions); *Foundation Giving: Yearbook of Facts and Figures on Private, Corporate and Community Foundations* (The Foundation Center, various editions); *Foundation Management Report* (Council on Foundations, various editions). The American Hospital Association publishes statistics concerning hospitals; the National Center for Education Statistics publishes data on independent colleges and universities; and the American Society of Association Executives publishes information concerning the nation's trade, business, and professional associations. There are several other analyses of this nature.

The nonprofit sector in the United States is not uniformly labeled; it goes by many names. In addition to *nonprofit*, adjectives used include *tax-exempt, voluntary, nongovernmental, independent, and voluntary*.[98] (In the author's view, *nonprofit sector* endures as the sturdiest of the terms.) In its most expansive definition, the nonprofit sector comprises all tax-exempt organizations and some entities that cannot qualify for exemption. Independent Sector defined the *independent sector* as all charitable[99] and social welfare organizations.[100]

As Independent Sector defined the sector, it is comprised of "many, varied" organizations, such as "religious organizations, private colleges and schools, foundations, hospitals, day-care centers, environmental organizations, museums, symphony orchestras, youth organizations, advocacy groups, and neighborhood organizations, to name a few." This analysis continued: "What is common among them all is their mission to serve a public purpose, their voluntary and self-governing nature, and their exclusion from being able to distribute profits to stockholders."[101]

Any assessment of any consequence of the nonprofit sector includes a discussion of the number of organizations in the sector. Nonetheless, it is "surprisingly difficult to answer the seemingly simple question, How many nonprofit organizations are there in the United States?"[102] The simple answer is: millions. There are "several million" nonprofit organizations, although "no one really knows how many."[103]

In an understatement, the observation was made that "[m]easuring the number of organizations in the independent sector is a complex activity, largely because of the diversity of its components."[104] There are several reasons for this. One reason is that church organizations (of which there are an estimated 350,000[105]) are not required to file annual information returns with the IRS,[106] so data concerning them is difficult to amass. Also, hundreds of organizations fall under a group exemption[107] and thus are not separately identified. Further, smaller nonprofit organizations need not seek recognition of tax exemption from the IRS.[108] Small organizations are not required to file annual information returns

---

[98] Indeed, there is little uniformity as to this term. See text accompanied by *supra* note 7.

[99] That is, organizations that are tax-exempt pursuant to IRC § 501(a) because they are described in IRC § 501 (c)(3) (see *Tax-Exempt Organizations*, pt. three).

[100] That is, organizations that are tax-exempt pursuant to IRC § 501(a) because they are described in IRC § 501 (c)(4) (see *Tax-Exempt Organizations*, ch. 13). This definition of the independent sector is in the 2002 edition of the *Nonprofit Almanac* at 7–8. Today, the *Nonprofit Almanac* does not attempt a definition of the sector but instead surveys the "nonprofit landscape" (*Nonprofit Almanac* at 3–5).

[101] *Nonprofit Almanac* (2002) at 3.

[102] *Nonprofit Nation* at 8.

[103] *Id*. at 1.

[104] *Id*. at 8. The point was articulated more forcefully in the fifth edition (1996) of the *Nonprofit Almanac*, where it was stated that "[c]ounting the number of institutions in the independent sector is a challenge." *Nonprofit Almanac* at 25.

[105] *Nonprofit Almanac* at 139. The term *church* includes analogous religious congregations, such as temples and mosques. See *Tax-Exempt Organizations* § 10.3.

[106] See *Tax-Exempt Organizations* § 27.2(b)(i).

[107] See *Tax-Exempt Organizations* § 25.6.

[108] These are organizations that normally do not generate more than $5,000 in revenue. See *Tax-Exempt Organizations* § 27.2(b)(ii).

with the IRS but are required to electronically file a short notice as to their existence.[109]

The number of tax-exempt organizations that are formally recognized in the federal tax law context is approaching 2 million. The most recent analysis posited the number of exempt organizations registered with the IRS (based on 2005 data) at about 1.4 million.[110] This analysis also reported that 528,024 exempt organizations report to the IRS.[111]

Because a ''price cannot be placed on the output of most nonprofit organizations,'' their percent of the gross domestic product is difficult to assess; the best estimate is that it is about 5 percent.[112] When the measure is in terms of wages and salaries paid, the percentage rises to approximately 8 percent.[113] Other ways to measure the size of the sector are its revenue (about $1,006.7 billion in 2006),[114] its outlays (about $915.2 billion in 2005),[115] and its paid employment (12.9 million in 2005).[116] Most of the sector's revenue is in the form of fees for services provided, followed by contributions and grants.[117] As to outlays (2006 data), the funds are expended by the organizations (88.7 percent), granted (8 percent), or invested or used as a buffer for cash flow (3.3 percent).[118]

The number of public charities (in 2005) is said to be 876,164; the number of public charities that reported to the IRS was set at 310,683.[119] Public charities had (in 2005) $1.1 trillion in expenses and $2 trillion in total assets.[120] The number of public charities increased by 66.1 percent during the period 1995–2005.[121] During that period, the revenue of public charities increased by 99.5 percent.[122] Financial support for public charities swelled from $107 billion in 1995 to $244 billion in 2005—an increase of 128.3 percent.[123] During this period, the total assets of public charities grew from $843 billion to nearly $2 trillion, an increase of 134.3 percent.[124]

Charitable giving in the United States in 2008 is estimated to be $307.65 billion, a decrease of 2 percent (–5.7 percent when adjusted for inflation) compared to the revised estimate of $314.07 billion for 2007.[125] Giving by living individuals in 2008 totaled an estimated $229.28 billion; this level of giving constituted an estimated 75 percent of all charitable giving for the year. Gifts in the form of

---

[109] See *Tax-Exempt Organizations* § 27.3. The IRS has not, as of mid-2009, published any data resulting from this notification requirement.
[110] *Nonprofit Almanac* at 3, 140.
[111] *Id*. at 3.
[112] *Id*. at 9.
[113] *Id*. at 10.
[114] *Id*. at 115.
[115] *Id*.
[116] *Id*. at 18, 27.
[117] *Id*. at 115. Fees for services and goods were estimated to be 70.3 percent of the total; contributions and non-government grants were said to be 12.3 percent of the total (*id*. at 143–144).
[118] *Id*. at 121.
[119] *Id*. at 140.
[120] *Id*. at 141.
[121] *Id*. at 148.
[122] *Id*. at 152.
[123] *Id*.
[124] *Id*. at 158.
[125] These data are from *Giving USA 2009*, published by the Giving USA Foundation, researched and written by the Center on Philanthropy at Indiana University.

charitable bequests in 2008 are estimated to be $22.66 billion (7 percent of total giving). Grantmaking by private foundations was an estimated $41.21 billion in 2008 (13 percent of the total). Gifts from corporations in 2008 totaled an estimated $14.5 billion (5 percent of total giving for that year).

Giving to religious organizations amounted to an estimated $106.89 billion in 2008, accounting for about 35 percent of total giving during that year. In the realm of education, giving totaled an estimated $40.94 billion for 2008 (13 percent of the total). Giving to human services organizations was an estimated amount of $25.88 billion in 2008 (9 percent of the total). Giving to health care entities in 2008 totaled an estimated $21.64 billion (7 percent of the total). Public-society benefit organizations received an estimated $23.88 billion in 2008 (8 percent of the total). Giving to organizations in the arts, culture, and humanitarian fields was about $12.79 billion in 2008 (4 percent of the total). Giving to international affairs organizations was about $13.3 billion in 2008 (4 percent of the total). Giving in 2008 to environment/animal organizations was an estimated $6.58 billion (2 percent of the total).

Here are some other perspectives on the nonprofit sector; it:

- Has more civilian employees than the federal government and the 50 state governments combined
- Employs more people than any of the following industries: agriculture; mining; construction; transportation, communications, and other public utilities; and finance, insurance, and real estate
- Generates revenue that exceeds the gross domestic product of all but six foreign countries: China, France, Germany, Italy, Japan, and the United Kingdom[126]

Statistics, of course, cannot provide the entire nonprofit sector picture. As the Commission on Private Philanthropy and Public Needs observed (albeit 35 years ago), the ''arithmetic of the nonprofit sector finds much of its significance in less quantifiable and even less precise dimensions—in the human measurements of who is served, who is affected by nonprofit groups and activities.'' The Commission added:

> In some sense, everybody is [served or affected by the sector]: the contributions of voluntary organizations to broadscale social and scientific advances have been widely and frequently extolled. Charitable groups were in the forefront of ridding society of child labor, abolitionist groups in tearing down the institution of slavery, civic-minded groups in purging the spoils system from public office. The benefits of non-profit scientific and technological research include the great reduction of scourges such as tuberculosis and polio, malaria, typhus, influenza, rabies, yaws, bilharziasis, syphilis and amoebic dysentery. These are among the myriad products of the nonprofit sector that have at least indirectly affected all Americans and much of the rest of the world besides.
>
> Perhaps the nonprofit activity that most directly touches the lives of most Americans today is noncommercial ''public'' television. A bare concept twenty-five years ago, its development was underwritten mainly by foundations. Today it comprises a network of some 240 stations valued at billions of dollars, is increasingly supported by small, ''subscriber'' contributions and has

[126] *Nonprofit Nation* at 12.

> broadened and enriched a medium that occupies hours of the average American's day.
>
> More particularly benefited by voluntary organizations are the one quarter of all college and university students who attend private institutions of higher education. For hundreds of millions of Americans, private community hospitals, accounting for half of all hospitals in the United States, have been, as one Commission study puts it, ''the primary site for handling the most dramatic of human experiences—birth, death, and the alleviation of personal suffering.'' In this secular age, too, it is worth noting that the largest category in the nonprofit sector is still very large indeed, that nearly two out of three Americans belong to and evidently find comfort and inspiration in the nation's hundreds of thousands of religious organizations. All told, it would be hard to imagine American life without voluntary nonprofit organizations and associations, so entwined are they in the very fabric of our society, from massive national organizations to the local Girl Scouts, the parent-teachers association or the bottle recycling group.[127]

§1.5 CATEGORIES OF TAX-EXEMPT ORGANIZATIONS

Understanding of and perspective on the charitable sector, from a law and statistics standpoint, may be enhanced by placement of it in the entirety of the tax-exempt sector.

The breakdown as to these tax-exempt organizations is as follows:[128] 100 instrumentalities of the United States,[129] 5,850 single-parent title-holding companies,[130] 984,386 charitable organizations,[131] 116,890 social welfare organizations,[132] 56,819 labor and agricultural organizations,[133] 71,878 business leagues,[134] 56,369 social and recreational clubs,[135] 63,318 fraternal beneficiary societies,[136] 10,088 voluntary employees' beneficiary societies,[137] 20,944 domestic fraternal beneficiary societies,[138] 14 teachers' retirement funds,[139] 5,901 benevolent life insurance associations,[140] 9,808 cemetery companies,[141] 3,565 credit unions,[142] 1,646 mutual insurance companies,[143] 16 crop operations finance corporations,[144] 300 supplemental unemployment benefit trusts,[145] 1 employee-funded pension trust,[146] 35,113 war veterans' organizations,[147] 9 group legal

---

[127] *Report of the Commission on Private Philanthropy and Public Needs: Giving in America—Toward a Stronger Voluntary Sector* 34–48 (1975).
[128] *Nonprofit Almanac* at 2–3.
[129] Organizations described in IRC § 501(c)(1) (see *Tax-Exempt Organizations* § 19.1).
[130] Organizations described in IRC § 501(c)(2) (see *Tax-Exempt Organizations* § 19.2(a)).
[131] Organizations described in IRC § 501(c)(3) (see *Tax-Exempt Organizations* pt. 2). The entities referenced in notes 146–152 of this book are also charitable organizations.
[132] Organizations described in IRC § 501(c)(4) (see *Tax-Exempt Organizations* ch. 13).
[133] Organizations described in IRC § 501(c)(5) (see *Tax-Exempt Organizations* ch. 16).
[134] Organizations described in IRC § 501(c)(6) (see *Tax-Exempt Organizations* ch. 14).
[135] Organizations described in IRC § 501(c)(7) (see *Tax-Exempt Organizations* ch. 15).
[136] Organizations described in IRC § 501(c)(8) (see *Tax-Exempt Organizations* § 19.4(a)).
[137] Organizations described in IRC § 501(c)(9) (see *Tax-Exempt Organizations* § 18.3).
[138] Organizations described in IRC § 501(c)(10) (see *Tax-Exempt Organizations* § 19.4(b)).
[139] Organizations described in IRC § 501(c)(11) (see *Tax-Exempt Organizations* § 18.6).
[140] Organizations described in IRC § 501(c)(12) (see *Tax-Exempt Organizations* § 19.5).
[141] Organizations described in IRC § 501(c)(13) (see *Tax-Exempt Organizations* § 19.6).
[142] Organizations described in IRC § 501(c)(14) (see *Tax-Exempt Organizations* § 19.7).
[143] Organizations described in IRC § 501(c)(15) (see *Tax-Exempt Organizations* § 19.9).
[144] Organizations described in IRC § 501(c)(16) (see *Tax-Exempt Organizations* § 19.10).
[145] Organizations described in IRC § 501(c)(17) (see *Tax-Exempt Organizations* § 18.4).
[146] Organizations described in IRC § 501(c)(18) (see *Tax-Exempt Organizations* § 18.6).
[147] Organizations described in IRC § 501(c)(19) (see *Tax-Exempt Organizations* § 19.11(a)).

services organizations,[148] 28 black lung benefit trusts,[149] 2 veterans' organizations founded prior to 1880,[150] 1 trust described in section 4049 of the Employee Retirement Income Security Act,[151] 1,133 title-holding companies for multiple beneficiaries,[152] 10 organizations providing medical insurance for those difficult to insure,[153] 12 state-formed workers' compensation organizations,[154] 160 religious and apostolic organizations,[155] 18 cooperative hospital service organizations,[156] and 1 cooperative service organization of educational institutions.[157]

This enumeration of tax-exempt organizations does not include references to farmers' cooperatives,[158] political organizations,[159] homeowners' associations,[160] multiemployer pension trusts,[161] day care centers,[162] shipowners' protection and indemnity organizations,[163] or charitable risk pools.[164]

The federal tax law recognizes 68 categories of tax-exempt organizations.[165]

---

[148] Organizations that were described in IRC § 501(c)(20), prior to its expiration in 1992.
[149] Organizations described in IRC § 501(c)(21) (see *Tax-Exempt Organizations* § 18.5).
[150] Organizations described in IRC § 501(c)(23) (see *Tax-Exempt Organizations* § 19.11(b)).
[151] Organizations described in IRC § 501(c)(24) (see *Tax-Exempt Organizations* § 18.6).
[152] Organizations described in IRC § 501(c)(25) (see *Tax-Exempt Organizations* § 19.2(b)).
[153] Organizations described in IRC § 501(c)(26) (see *Tax-Exempt Organizations* § 19.15).
[154] Organizations described in IRC § 501(c)(27) (see *Tax-Exempt Organizations* § 19.16).
[155] Organizations described in IRC § 501(d) (see *Tax-Exempt Organizations* § 10.7).
[156] Organizations described in IRC § 501(e) (see *Tax-Exempt Organizations* § 11.4).
[157] Organizations described in IRC § 501(f) (see *Tax-Exempt Organizations* § 11.5).
[158] Organizations described in IRC § 521 (see *Tax-Exempt Organizations* § 19.12).
[159] Organizations described in IRC § 527 (see *Tax-Exempt Organizations* ch. 17).
[160] Organizations described in IRC § 528 (see *Tax-Exempt Organizations* § 19.14).
[161] Organizations described in IRC § 501(c)(22) (see *Tax-Exempt Organizations* § 18.6).
[162] Organizations described in IRC § 501(k) (see *Tax-Exempt Organizations* § 8.8).
[163] Organizations described in IRC § 526(d) (see *Tax-Exempt Organizations* § 19.13).
[164] Organizations described in IRC § 501(n) (see *Tax-Exempt Organizations* § 11.6). The *Nonprofit Almanac* stated that there are 4,105 tax-exempt organizations other than those specifically enumerated (at 3).

As the preceding footnotes indicate, the many categories of tax-exempt organizations are discussed in various chapters throughout *Tax-Exempt Organizations*. Nonetheless, as the following observation by the U.S. Tax Court affirms, "[t]rying to understand the various exempt organization provisions of the Internal Revenue Code is as difficult as capturing a drop of mercury under your thumb." *Weingarden v. Commissioner*, 86 T.C. 669, 675 (1986), *rev'd on other grounds*, 825 F.2d 1027 (6th Cir. 1987).
[165] See *Tax-Exempt Organizations* app. C.

CHAPTER TWO

The United States Tax System: An Overview

§ 2.1 **Concept of Income** 28
§ 2.2 **Gross Income** 30
§ 2.3 **Exclusions from Income** 31
§ 2.4 **Concept of *Adjusted Gross Income*** 31
§ 2.5 **Deductions** 32
(a) Business Expense Deductions 32
(b) Personal Expense Deductions 33
(c) Itemized Deduction Limitation 33
§ 2.6 **Standard Deduction** 34
§ 2.7 **Concept of Taxable Income** 34
(a) Personal Exemption 35
(b) Dependent Exemption 35
(c) Phaseout of Exemptions 35
§ 2.8 **Taxable and Nontaxable Entities** 35
§ 2.9 **Annual Accounting Period** 37
§ 2.10 **Accounting Methods** 37
§ 2.11 **Timing** 38
§ 2.12 **Property** 38
(a) Real Property 39
(b) Personal Property 39
(c) Tangible Personal Property 39
(d) Intangible Personal Property 39
§ 2.13 **Inventory** 40
§ 2.14 **Gain** 41
(a) Basis 42
(b) Adjusted Basis 43
(c) Determination of Gain 44
(d) Realization 44
(e) Appreciation 45
(f) Recognition 45
§ 2.15 **Taxation of Income** 46
§ 2.16 **Capital Assets, Gains, and Losses** 50
(a) Capital Assets 50
(b) Ordinary Income; Capital Gains and Losses 51
(c) Long- and Short-Term Capital Gains and Losses 52
§ 2.17 **Carryovers and Carrybacks** 52
§ 2.18 **Alternative Minimum Tax** 53
§ 2.19 **Depreciation** 55
§ 2.20 **Capital Gains and Dividends Rates** 56
§ 2.21 **Taxation of Corporate Distributions** 56
§ 2.22 **Accumulated Earnings and Personal Holding Company Taxes** 57
§ 2.23 **Tax Credits** 57
§ 2.24 **Foreign Tax Credits** 58

The law in the United States concerning charitable giving is essentially a component of the federal income tax law.[1] The federal law of charitable giving is inextricably intertwined with nearly all aspects of the federal law of income taxation, so much so that a full understanding of the law of charitable giving requires comprehension of the overall federal tax structure. This chapter provides an overview of that structure, as a setting for the tax law subjects that are integral to the law of charitable giving.

The U.S. income tax system has evolved into a comprehensive and complex body of statutory law, regulatory law, and case law.[2] Within this labyrinth of tax law, however, is a basic structure. This fundamental framework incorporates important concepts and terms that underpin the income tax system. This basic structure, and the concepts and terms that make up this system, are examined in this chapter. Given the facts that the Internal Revenue Code is close to 10,000 pages in length (and growing), and that there are hundreds of volumes of tax regulations, tax rulings, and court opinions, this must be the most cursory of summaries.

The U.S. income tax is a tax on the receipt of income. The tax is imposed on most entities that receive income, and is computed and assessed on an annual basis. This income tax consists of a ''regular'' income tax and an alternative minimum tax. These taxpaying entities generally file annual returns with the IRS; these returns report income and other items used in the computation of the income tax.

There is more to the federal tax system than the income taxes. Payroll taxes are imposed on wages, with corresponding taxes on self-employment income. Excise taxes are levied on certain goods and services. A fourth element of the U.S. tax system consists of estate, gift, and generation-skipping transfer taxes.[3]

Various aspects of the federal tax laws are subject to change. For example, some dollar amounts and income thresholds are indexed for inflation. The standard deduction, tax rate brackets, and the annual gift tax exclusion are illustrations of amounts that are indexed for inflation. The IRS adjusts these numbers annually and publishes the inflation-adjusted amounts in effect for a tax year prior to the beginning of that year. Also, some provisions of the federal tax statutory laws have been enacted on a temporary basis or have parameters that vary by statute from year to year.[4]

§ 2.1 CONCEPT OF INCOME

Because the federal income tax is imposed on income, what is or is not income is a threshold concern. The term *income* connotes the receipt or incurrence of money or property (collectively, some form of economic benefit) as a result of an enterprise or investment. This is distinguishable from *wealth*, which is accumulated money or property.

---

[1] Portions of this chapter are based on Joint Committee on Taxation, *Overview of the Federal Tax System as in Effect for 2008* (JCX-32-08), April 14, 2008.

[2] A court observed that the Internal Revenue Code is a ''vast and exceedingly complex statutory apparatus.'' *Judicial Watch, Inc. v. Rossotti*, 2004-1 U.S.T.C. ¶ 50,115 (4th Cir. 2003).

[3] As to this element of the tax system, see ch. 8.

[4] E.g., Joint Committee on Taxation, *List of Expiring Federal Tax Provisions 2007–2020* (JCX-1-08), January 11, 2008.

The concept of what is or is not income initially seems straightforward and simple. When one performs labor, one typically receives compensation in the form of wages, salary, bonuses, commissions, fees, and/or plan benefits. One may also receive goods, which are commonly considered as payment in kind. Both forms of payment generally constitute income, as a return for services rendered.

When one invests money or capital, one typically receives interest, dividends, rent, royalties, or a similar return as a result of the investment. One may also receive property as a return on one's investment. These forms of payment generally are also forms of income, as a return on the investment.

Some forms of payment, however, do not fit neatly within these concepts of income or profit. An award of compensatory damages and punitive damages in a civil action raises interesting questions. Compensatory damages repay a victim for a loss suffered by payment of dollars of value relative to the loss sustained. The victim is being made whole for a loss, not receiving some sort of profit from his or her labor or capital. Punitive damages—money awarded to a victim as a punishment to the wrongdoer—are also not the result of some profitable endeavor of labor or capital.

An item of income is considered, for tax purposes, to first be an item of *gross income*.

The federal tax law contemplates, in addition to the generation of gross income, persons who are the recipients of the income and who will pay a tax on it. These persons generally are:

- Individuals
- Corporations
- Trusts
- Estates

The ways of determining gross income and the rates for taxing it differ, but these persons are *taxpayers*: those human beings and entities, the latter recognized in the law (fictionally) as persons, that are obligated to pay the federal income tax.

A U.S. citizen or resident alien generally is subject to the U.S. individual income tax on his or her worldwide taxable income.[5] Taxable income equals the taxpayer's total gross income less certain exclusions, exemptions, and deductions. Graduated tax rates are then applied to a taxpayer's taxable income to determine his or her income tax liability. A taxpayer may face additional liability if the alternative minimum tax applies. A taxpayer may reduce his or her income tax liability by the application of one or more tax credits.

In general, partnerships and S corporations are treated as pass-through (or conduit) entities for federal income tax purposes. Thus, federal income tax is not imposed at the entity level in these instances. Rather, the income of these entities is passed through and taxed to the owners at the individual (or other type of owner) level.

---

[5] Foreign tax credits generally are available against U.S. income tax imposed on foreign-source income to the extent of foreign income taxes paid on that income. A nonresident alien generally is subject to the U.S. individual income tax only on income with a sufficient nexus to the United States.

In general, estates and most trusts pay tax on income at the entity level, unless the income is distributed or required to be distributed in accordance with governing law or under the terms of the governing instrument. These entities determine their tax liability using a special tax rate schedule; they are subject to the alternative minimum tax. Certain trusts, however, do not pay federal income tax at the trust level. For example, certain trusts that distribute all income currently to beneficiaries are treated as pass-through entities. Other trusts are treated as being owned by their grantors in whole or in part for tax purposes; in these instances, the grantors are taxed on the income of the trust.

§ 2.2 GROSS INCOME

The term *gross income* is defined in the Internal Revenue Code as "all income from whatever source derived."[6] The statutory definition of gross income is broadly defined by the Supreme Court to include all "undeniable accessions to wealth, clearly realized, and over which the taxpayer has complete dominion."[7] The Court made it clear that these accessions to wealth are income regardless of their source, and regardless of any attached label as to their nature. Under this broad definition, a gain (accession to wealth) that is clearly realized, regardless of label or source, is gross income.

Gross income includes, among other items:

- Alimony
- Annuities
- Bartering income
- Business income
- Cancellation of indebtedness
- Capital gains
- Compensation for services
- Dividends
- Gambling winnings
- Interest
- Life insurance and endowment contracts payments
- Pensions and annuities
- Prizes and awards
- Rental income
- Royalties
- Wages, salaries, and gratuities

Many other items of compensation or gain can be identified within the sweeping definition of gross income.[8]

---

[6] IRC § 61(a).
[7] *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).
[8] IRC §§ 71–90.

Defining and computing gross income is the initial step in the process of computing and determining tax on income.

§ 2.3 EXCLUSIONS FROM INCOME

Despite this expansive definition of gross income, Congress excluded certain items from consideration as gross income.[9] Items specifically excluded from gross income by statute are referred to as *exclusions* and are not included in arriving at the total gross income figure, for tax purposes, for a taxpayer.

Examples of exclusions include:

- Accident and health plan proceeds
- Contributions to capital
- Disaster relief payments
- Educational assistance programs
- Employer-provided health insurance
- Employer-provided meals and lodging
- Employer-provided pension contributions
- Fringe benefits
- Gifts and inheritances
- Housing allowances for clergy
- Interest on state and local bonds
- Life insurance proceeds
- Military allowances
- Scholarships
- Veterans' benefits
- Welfare and public assistance benefits
- Workers' compensation benefits

Excluding certain income items from the scope of gross income is the second step in computing and determining tax on income.

§ 2.4 CONCEPT OF *ADJUSTED GROSS INCOME*

The term *adjusted gross income*, for an individual means gross income less certain expenses.[10] The business expense deductions discussed below are allowed as deductions from gross income to arrive at adjusted gross income.

Other items (''above-the-line'' deductions) that involve subtraction from gross income to determine adjusted gross income include:

---

[9] IRC §§ 101–139A.
[10] IRC § 62(a).

- Alimony payments
- Capital losses
- Contributions to a qualified retirement plan by a self-employed individual
- Contributions to individual retirement arrangements
- Health savings accounts
- Higher education expenses
- Interest on education loans
- Moving expenses
- Trade or business expenses

Making adjustments to gross income by deducting certain amounts to arrive at adjusted gross income is the third step in computing and determining tax on income.

The reason for the concept of adjusted gross income is to provide a fair basis for the allowance of noneconomic personal expense deductions. Thus, adjusted gross income is gross income after adjusting for the taxpayer's economic costs of generating revenue.

§ 2.5 DEDUCTIONS

Deductions are expense items incurred in the production of gross income that are allowed to be subtracted (deducted) from gross income to arrive at adjusted gross income.

(a) Business Expense Deductions

Deductions are a reflection of the fact that there are costs inherently associated with the production of income, and that these costs are neither uniform nor borne equally by all taxpayers. Equal amounts of gross income (revenue) may have different costs of production (expense). Therefore, to arrive at a fair base on which to impose an income tax, deductions are allowed to cover the costs associated with the production of a given amount of income. As a result of the business deductions allowed by the federal tax law, income tax is imposed on the net economic gain, not the total gross gain.

For example, assume two taxpayers have received equal amounts of gross income and have equal adjustments. Each taxpayer is an air courier company. They each have a gross income of $1 million, representing its revenue for the year. Taxpayer A has a fleet of modern, fuel-efficient planes. During the year, Taxpayer A burned $10,000 of fuel. The fuel expense is a cost of doing business and is a deduction from gross income. The adjusted gross income of Taxpayer A for the year (aside from other deductions) thus is $990,000. Taxpayer B, however, has a fleet of old, inefficient, fuel-hungry planes. During the same year, Taxpayer B burned $40,000 of fuel. The comparable adjusted gross income of Taxpayer B for the year is $960,000. Although each taxpayer has generated the same amount of gross revenue for the year, each had different costs of doing business in earning the revenue. Therefore, to arrive at a fair base on which to tax the income of

each taxpayer, deductions are allowed to cover the differing costs of generating revenue.

Deductions against income are allowed for costs associated with profit-seeking (business or investment) activities that generate income. Personal, living, or family expenses are not profit-seeking expenses and are not allowed as business expense deductions.[11] Furthermore, business expense deductions are generally limited to those outlays that are: ordinary and necessary, current, and incurred for business reasons.[12]

The federal tax law sets forth a number of allowable deductions, including depreciation[13] and loss[14] deductions. The business expense deduction is not, however, available for payments that are in fact contributions.[15]

(b) Personal Expense Deductions

As noted, deductions from the federal income tax are generally available for expenses associated with the cost of carrying on a trade or business. These costs represent the economic cost of generating revenue. The net result from the deductions is economic gain or income. Because they represent personal consumption and not the economic cost of doing business, personal expenses are not generally allowed as deductions from income.

Although the purpose of the income tax scheme is to tax economic profit or gain, the law permits a number of personal expense deductions that have no bearing on economic gain. There are a number of policy reasons underlying these personal deductions. Casualty[16] and medical[17] deductions are allowed for expenses that may be unanticipated and/or unduly burdensome. Charitable deductions[18] are allowed to encourage and promote philanthropic endeavors. Home mortgage interest[19] deductions are allowed as a form of tax subsidy for borrowers who use capital to purchase homes. These personal expense deductions are allowed for social policy reasons, rather than for the costs associated with producing economic gain.

Personal expense deductions (itemized deductions in lieu of the standard deduction) are deducted from adjusted gross income to arrive at *taxable income* as the fourth step in computing and determining tax on income.

(c) Itemized Deduction Limitation

The total amount of otherwise allowable itemized deductions for individuals (other than those for medical expenses; casualty, theft, or wagering losses; and

---

[11] IRC § 262.
[12] IRC §§ 162(a), 212.
[13] IRC §§ 167, 168.
[14] IRC § 165.
[15] Reg. § 1.162-15(a)(1). To allow the use of a business expense deduction for charitable contributions would be to subvert the percentage limitations on the deductibility of charitable gifts (see ch. 7). E.g., *May v. Commissioner*, 71 T.C.M. (CCH) 2498 (1996).
[16] IRC § 165(c)(3).
[17] IRC § 213(a).
[18] IRC § 170(a).
[19] IRC § 163(a).

investment interest, but including the charitable contribution deduction) is reduced by 3 percent of the amount of the taxpayer's adjusted gross income in excess of an annual base figure (indexed for inflation).[20] Otherwise allowable itemized deductions, however, may not be reduced by more than 80 percent.[21]

This limitation on itemized deductions is scheduled to be repealed. This repeal is phased in over five years, with the otherwise applicable limitation reduced by one-third in tax years beginning in 2006 and 2007, and by two-thirds in years beginning in 2008 and 2009. The overall limitation is to be repealed for tax years beginning after December 31, 2009.[22]

§ 2.6 STANDARD DEDUCTION

Individual taxpayers, when appropriate, itemize their allowable personal expenses as their personal deduction from adjusted gross income. As an election in lieu of itemization, individual taxpayers are permitted to use a *standard deduction*.[23] This feature of the federal tax law enables taxpayers to take a personal deduction if there are insufficient itemized deductions and/or without the need for recordkeeping to support itemized personal expenses.

The standard deduction (in lieu of personal itemized expense deductions) is deducted from adjusted gross income to arrive at taxable income as an alternative fourth step in computing and determining tax on income.

§ 2.7 CONCEPT OF TAXABLE INCOME

The term *taxable income* is defined by the federal tax law.[24] For taxpayers claiming itemized deductions (ID), taxable income is defined as gross income minus the deductions allowed by the federal tax law other than the standard deduction. The deductions that may be itemized (some of which are referenced earlier) include state and local income taxes (or, in lieu of income, sales), real property and certain personal property taxes, home mortgage interest, charitable contributions, certain investment interest, medical expenses (in excess of 7.5 percent of adjusted gross income (AGI)), casualty and theft losses (in excess of 10 percent of AGI and in excess of $100 per loss), and certain miscellaneous expenses (in excess of 2 percent of AGI). For taxpayers electing the standard deduction, taxable income is defined as AGI minus the taxpayer's standard deduction (SD). Taxpayers in either category are also entitled to a personal and/or dependent exemption (P/DE). Mathematically, the formula is:

$$AGI - ((ID \text{ or } SD) + P/DE) = Taxable\ income$$

Taxable income is the base figure on which the federal income tax is imposed.

---

[20] The annual base amount for 2009 was $166,800 (or $83,400 for married couples filing separate returns) (Rev. Proc. 2008-66, 2008-2 C.B. 1107, § 3.11).

[21] IRC § 68.

[22] Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107–16, 106th Cong., 1st Sess. (2001) (EGTRRA), § 103.

[23] IRC § 63(c). The standard deduction for 2010 for married individuals filing joint returns is $11,400; for heads of households, $8,400; for unmarried individuals, $5,700; and for married individuals filing separately, $5,700 (Rev. Proc. 2009-50, 2009-2 C.B. § 3.11(1)).

[24] IRC § 63.

(a) Personal Exemption

Every individual taxpayer is entitled to deduct from adjusted gross income an amount allowed as a personal exemption (unless that taxpayer can be claimed as a dependent by another taxpayer). This personal exemption is allowable for individual taxpayers and not other taxpaying entities. Individuals filing joint tax returns with their spouses can take two personal exemptions, one for themselves and one for their spouse. This personal exemption amount is determined annually, with the amount adjusted for inflation.[25]

(b) Dependent Exemption

In addition to deducting an amount from adjusted gross income as a personal exemption, individual taxpayers can deduct the same amount as a dependency deduction. When the taxpayer meets a five-part test—member of household or relationship test; citizenship test; joint return test; gross income test; support test—a deduction is allowable for a dependent.

(c) Phaseout of Exemptions

The deduction for personal and dependent exemptions is phased out for taxpayers with adjusted gross income above a threshold amount (indexed for inflation), which is based on filing status.[26]

The total amount of exemptions that may be claimed by a taxpayer is reduced by 2 percent for each $2,500 (or portion of that amount) by which the taxpayer's adjusted gross income exceeds the applicable threshold. The phaseout rate is 2 percent for each $1,250 for married taxpayers filing separate tax returns.[27]

This exemption phaseout rule is scheduled to be repealed over a five-year phase-in period. The otherwise applicable personal exemption phaseout is reduced by one-third in tax years beginning in 2006 and 2007, and is reduced by two-thirds in tax years beginning in 2008 and 2009. This repeal is fully effective for tax years beginning after December 31, 2009.[28]

§ 2.8 TAXABLE AND NONTAXABLE ENTITIES

The entities subject to the imposition of a federal income tax are, as noted, corporations,[29] individuals,[30] estates,[31] and trusts.[32] Due to the nature of the income tax

[25] IRC §§ 151–152. The personal exemption amount for 2010 is $3,650 (Rev. Proc. 2009-50, 2009-2 C.B., § 3.19).

[26] IRC § 151(d)(3)(A), (C). For 2009, the threshold amounts were $250,200 for married individuals filing a joint return, $208,500 for heads of households, $166,800 for unmarried individuals, and $125,100 for married individuals filing separate returns (Rev. Proc. 2008-66, 2008-2 C.B. 1107, § 3.19(2)).

[27] IRC § 151(d)(3)(B). For 2009, the point at which a taxpayer's personal exemptions are completely phased out was $372,700 for married individuals filing a joint return, $331,000 for heads of households, $289,300 for unmarried individuals, and $186,350 for married individuals filing separate returns (Rev. Proc. 2008-66, 2008-2 C.B. 1107, § 3.19(2)).

[28] EGTRRA § 102.

[29] IRC § 11.

[30] IRC § 1.

[31] *Id.*

[32] *Id.*

system, an anomaly is created by the taxation of corporate entities. Corporations are legal fictions—recognized by the law as entities that are owned by their stockholders. Income received by a corporation generally is subject to an income tax. Corporations that are subject to tax are known as *C corporations*.[33] When the corporation pays out its income in the form of dividends to stockholders, the income is again subject to tax at the individual level. This results in *double taxation*; first at the corporate level, then again at the individual level.

To alleviate this burden, certain small business corporations that meet special statutory criteria are not taxed at the corporate level, but only at the individual level. These qualifying corporations are known as *S corporations*[34] and are treated in much the same way as partnerships. That is, if an S corporation election is made, the income of the corporation will flow through it to, and be taxable directly to, the shareholders. Limited liability companies are also generally taxed in the same manner as partnerships.

Business entities such as partnerships and limited liability companies, though separate legal entities, are not taxable entities. Income received by partnerships is reported on the partnership level, but the income tax is imposed on each individual partner on the partner's share of partnership income. The same is true with respect to members of limited liability companies. Income received by sole proprietorships is taxed to the individual proprietor generating the income.

One category of taxpaying entity is the *individual*. Individuals are living, natural persons (human beings), not fictional creatures.

A *corporation* is a creature of law, existing as an entity generally created pursuant to state law. The hallmark of a corporation is that it usually shields and insulates persons (individuals) from legal liability that may arise during the course of its existence and operation.

As noted above, corporations are generally owned by individual taxpaying shareholders, and are themselves taxpaying entities. This results in two layers of income taxation.

Special rules apply to a corporation that has elected to be taxable as a regulated investment company,[35] a real estate investment trust,[36] or a real estate mortgage investment conduit.[37]

Another category of taxpaying entity is the *estate*. An estate is recognized as a legally separate person, separate from the individual who, by death, created it. An estate is the legal creation that encompasses all the property and rights belonging to a deceased individual, or *decedent*.

Trusts are also creatures of law. A trust is a legal entity created by state law and encompasses property transferred to it (known as the trust *res*) by the trust's creator/donor (known as the *grantor* of the trust) for the benefit of some one or some thing (known as the trust *beneficiary*). A trust may be created during the life

[33] These corporations are so named because the federal income taxation of them is the subject of U.S. Code, Title 26, Subtitle A, Chapter 1, Subchapter C (IRC §§ 301–385).

[34] These corporations are so named because the federal income taxation of them is the subject of U.S. Code, Title 26, Subtitle A, Chapter 1, Subchapter S (IRC §§ 1362–1379).

[35] IRC §§ 851–860.

[36] IRC §§ 856–860.

[37] IRC §§ 860A–860G.

of a grantor (an *inter vivos* trust), or upon the death of a grantor (a *testamentary* trust).

Other business entities or organizations that do not meet the definition or criteria of a corporation may not be separately taxed. Instead, the taxable income they receive may be taxable to the individuals that form or compose the organization. These types of organizations that are not corporations are generically referred to as *associations*.

Even though an organization is not considered to be a corporation for purposes of state law, it may be deemed a corporation for purposes of federal income tax law.[38] Typically, organizations would like to be deemed associations to avoid taxation, whereas the government would like them to be considered separate taxable entities. The IRS has promulgated criteria used to determine entity classification; these are in the *check-the-box regulations*.[39]

This demonstrates an important aspect of federal income tax law: substance, not form, usually governs and controls federal income tax questions.

§ 2.9 ANNUAL ACCOUNTING PERIOD

The income tax imposed on entities is reported and taxed on an annual basis for an *annual accounting period* or tax year.[40] All of an entity's income is therefore allocated to the appropriate tax year.

There are two methods of reporting or accounting for income on an annual basis. The first is the *calendar year* method.[41] A calendar year is, as its name implies, a period of 12 consecutive months that corresponds to a calendar year. It begins on January 1 and ends on December 31. Individuals are typically calendar year taxpayers. The second method is the *fiscal year*.[42] This annual period is any other 12-month period beginning on the first day of a calendar month and ending on the last day of the twelfth calendar month for that period. As an example, a 12-month period beginning on July 1 in the current year and ending on June 30 of the following year is a fiscal year.

§ 2.10 ACCOUNTING METHODS

Closely related to the annual accounting period (the tax year in which income is received or allocated) is the taxpayer's method or basis of calculating when the entity receives income. This is referred to as a taxpayer's *accounting method*.[43] The particular accounting method used to determine when an entity receives income will necessarily affect the year to which the income is allocated. Once again, there are two methods: the *cash receipts and disbursement method*[44] and the *accrual method*.[45]

---

[38] IRC § 7701 defines a corporation to include an association.
[39] Reg. §§ 301.7701-2 to -4. See *Tax-Exempt Organizations* § 4.1(b).
[40] IRC § 441.
[41] IRC § 441(d).
[42] IRC § 441(e).
[43] IRC § 446.
[44] IRC § 446(c)(1).
[45] IRC § 446(c)(2).

Under the cash receipts and disbursements method, income (and expense) is recognized to the taxpayer when cash is received (income) or paid out (expense). In the accrual method, income (and expense) is recognized when a right to receive income or an obligation for an expense arises.

§ 2.11 TIMING

Because income is taxed on an annual basis, *timing* can be important. Timing concerns the question of determining the tax year in which an income or expense item is taken into account for tax purposes. The receipt of income in a particular tax year can have a significant impact on an entity's tax burden. A taxpayer can, and may wish to, accelerate or postpone the receipt of income in any particular year so as to minimize tax.

Timing is directly related to the annual accounting period and method of accounting of a taxpayer. The timing implications of each are apparent when one views a simple transaction. An individual taxpayer is entitled to receive the sum of $5,000 immediately upon the completion of a contract. The taxpayer completes the contract on December 20 of Year 1, but does not receive the cash payment until January 15 of Year 2, several weeks later.

Under the cash method of accounting, the taxpayer in this example recognizes receipt of the income on January 15, when it is actually received.[46] Under the accrual method, the taxpayer recognizes the income on December 20, because the right to receive the income arose upon the completion of the contract, not when the payment was actually received.

Assuming a calendar year taxpayer, the method of accounting will affect the tax year in which the $5,000 income in this example is taxed. The income in the example is allocated to Tax Year 2 under the cash method of accounting, but to Tax Year 1 under the accrual method.

If a fiscal year beginning November 1 and ending October 31 is assumed, the $5,000 income would fall within the same taxable year under either method of accounting.

As can be seen from this simple example, timing differences in the taxpayer's annual accounting period and method of accounting can have significant tax consequences.

§ 2.12 PROPERTY

As noted at the beginning of this chapter, the federal income tax system is designed to tax income, not wealth. Again, income is generally viewed as the current receipt or realization of money or property as an economic profit or gain (accession to wealth), while *wealth* is previously earned and accumulated money or property.

Income can take a number of forms. It can be in the form of a medium of exchange, the most common medium being currency. Dollars, francs, pounds, rubles, yen, and the like are each forms of currency used by nations as their economic medium of exchange. One may receive money (currency) in exchange for goods or services. Noncurrency mediums of exchange, however, also exist for

[46] Under a rule of law known as the *claim-of-right doctrine*, however, this income may be taxable in Year 1.

providing goods and services in an economy. One may receive property, or labor, as compensation in exchange for the provision of goods or services. These noncurrency receipts are just as much income or accessions to wealth (economic gain) as are the receipts of currency (money). These forms of nonmonetary or noncurrency income are barter income and are taxable as income.

All property of every kind is either real property or personal property.

(a) Real Property

Real property essentially is land. Real property includes not just the physical land, but things that are naturally or artificially attached or annexed to the physical land. A tree is a natural attachment to land; a building is an artificial attachment.

One major characteristic of real property, as distinguished from other forms of property, is its permanence, its immobile nature. Real property, and things attached to it (fixtures), are permanently affixed in place. Land, and things attached to it, is not movable.

Another major characteristic of real property is that it has a real, tangible, physical manifestation.

(b) Personal Property

Personal property can be defined by exclusion. It is all property that is not real property. Personal property includes a realm of items. Personal property is itself divided into two major categories: tangible and intangible personal property.

(c) Tangible Personal Property

Tangible personal property is physical property that is capable of being seen and touched. It has substance. Unlike real property, which is immovable land, personal property is movable.

Some examples of tangible personal property are automobiles, furniture, jewelry, and animals.

(d) Intangible Personal Property

Intangible personal property is personal property that is incapable of being seen or touched; it is not perceptible by human senses. It is neither physical land nor other physical property. Intangible personal property is usually evidenced by a form of documentation.

Intangible personal property can take many forms. The most common type of intangible personal property is a security, such as a stock or bond, which is evidenced by a stock certificate or bond instrument. It can be a right under a contract. By virtue of the law governing relationships between parties to a contract, one party may have the right to some performance by another party. That right is not manifested in any physical form. The right arises, nonetheless, and exists in law. It has value to the party seeking performance, and the right to performance (or the economic value of the performance) can be enforced through a legal action. The right to performance in a contract, therefore, is intangible personal property.

Goodwill in a business is another example of intangible personal property. The reputation and customer loyalty that people associate with the name of a business is a valuable, and protectable, business asset. Customer goodwill is not, however, manifested in anything physical. It is the imperceptible and intangible good feelings and loyalties people have and associate with a business concern.

§ 2.13 INVENTORY

Inventory, for income tax purposes, is generally considered to be the stock in trade of a person, usually a business entity. It is the sum total of items, raw materials, or finished goods held by the person for production of income in the trade or business. Inventory is most often held by a corporation rather than an individual.

Inventory represents a part of the cost of the goods sold in a business and, therefore, is a component of expense to be deducted from gross income to more clearly reflect economic gain or profit to the person. Because the inventory of a person is dynamic, constantly changing as goods are sold and new inventory is added to stock, means and methods for identifying and valuing the constantly changing stock in trade must be employed. Inasmuch as income tax is assessed on an annual basis, the means and methods used must account for yearly change in inventories.

The main reason for utilizing inventories is to match costs of doing business with the revenues generated by sales of the items. As more directly stated in the federal tax law, it is to clearly reflect income. Indeed, the federal tax law requires that inventories be used when necessary to clearly determine a person's income.[47]

A simple example shows the importance of inventories in measuring income. In this illustration, a taxpaying business has an inventory of five items. Each item cost the business $20. Three of the items in the inventory were sold. Each item was sold for $30. The three sales generated a total revenue to the business of $90 (3 × $30 = $90). The three inventory items cost the business $20, so the total cost of the goods sold was $60 (3 × $20 = $60). The revenue of $90 less the cost of goods sold of $60 results in a net income of $30. The $30 represents the economic gain after taking into account the cost of the inventory sold.

This example may be varied by assigning the items of inventory different costs: item 1, $20; item 2, $22; item 3, $25; item 4, $27; and item 5, $30. If three items were sold for the same $30, how would one measure the value of the cost of the goods sold so as to get a true measure of economic profit? If items one, two, and three were sold, their cost would be $67 with a resulting net income of $23 ($90 − $67 = $23). If items three, four, and five were sold, their cost would be $82 with a net income of only $8 ($90 − $82 = $8). If one were able to individually identify each item sold, one could accurately match the item with its cost and get a clear picture of income; if not, it would be impossible to get a clear reflection of income. Although it may be possible to track and account for a very small inventory of items, the task becomes impractical as the inventory grows and as the inventory of goods turns over during the taxable year.

---

[47] IRC § 471.

To deal with this problem of valuation, two methods are utilized. The first is the *cost method*. It measures the value of an item of inventory on the basis of its actual cost. The second is the *cost or market method*. It measures the cost of inventory items based upon their cost or fair market value, whichever is lower.

The valuation methods are used in conjunction with methods of tracking (identifying) the items of inventory. Two tracking methods are used. The first method is the *first-in, first-out* (FIFO) *method*, which assumes that the items of inventory that are first acquired are the items that are first sold. Either the cost or the cost or market method of valuation may be used. The different valuation methods have an effect on the amount of income that is deemed to be received by the taxpayer in its yearly accounting period. In periods of inflation or rising market prices, income (profits) tends to be greater, whereas in periods of deflation or falling markets, income (profits) tends to be less when cost is used rather than cost or market valuation.

Last-in, first-out (LIFO)[48] is the second method for tracking inventories. It assumes that the items of inventory last purchased are the first sold. Under LIFO, only the cost method of valuation is permitted.[49] Because the most recently purchased items of inventory are the first items sold, the effects of inflation (rising market prices) or deflation (falling market prices) are minimized. The effect of price increases or decreases tend to be less dramatic than under the FIFO method.

Obviously, the choice of method of tracking inventories (FIFO or LIFO) and the method for inventory valuation (cost or cost or market) can have a significant impact on the income (profit or loss) picture of a taxpayer.

§ 2.14 GAIN

In discussing what is income for tax purposes, the Supreme Court noted that accessions to a person's economic resources, clearly realized, and within the control or dominion of the person, are income.[50] An accession to economic resources is an increase or addition to such resources. In other words, a person gains something as an addition to his, her, or its resources by an accession; these gains are forms of income.

The concept of gain is clear in the service context. One performs services and receives a wage or salary. If one is an employee, one's wage or salary is an economic gain in wealth. Personal expenses, but not real economic expenses, are incurred in the production of this income. Gross income and adjusted gross income are basically the same. If one performs personal services as a businessperson, one may have a number of costs associated with that performance. Because a cost is incurred in producing income, the total revenue earned is not a true measure of accession to wealth. The costs incurred are deducted to arrive at a better measure of economic gain. Therefore, business expenses are deducted from gross income to arrive at adjusted gross income. This adjusted gross income is a clearer measure of the economic gain of a businessperson's personal services.

---

[48] Method permitted under IRC § 472.

[49] IRC § 472(b)(2).

[50] *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955).

Gains can arise with respect to property as well. Indeed, the term is more frequently used in the context of transfers of property. When one sells property, one typically receives money in exchange. This is frequently referred to as *liquidating an asset*.

Liquidity refers to the ease with which an asset can be used as a medium of exchange in the economy. Because money is the normal medium of exchange, it is inherently liquid. In contrast, assets like land are not typically used in the market as a medium of exchange. One usually sells, or liquidates, an asset like land for its equivalent value in money. Money is then used for other transactions in the economy. In selling an asset, one is merely changing the form of one's holding. Money is substituted for the asset.

For the most part, all assets (property) have value, even if the value is little or nominal. The value is generally considered to be the *fair market value*, namely, what a willing purchaser is prepared to pay to a willing seller in a fair market in an arm's length (free from undue familiarity) transaction. A fair market is an open market, one not controlled by either the buyer or the seller. The price for goods is determined not by the parties, but by the economics of the marketplace. The law of supply and demand operates freely to set the value of all assets in the market. As supply rises or falls, the cost of the good rises and falls in relation thereto. As the demand rises and falls, the cost of the good likewise rises and falls.

The method used to arrive at the value of an asset is called *valuation*. It attempts to ascertain the fair market value of an asset. The value is usually determined in one of two ways. The first method is the cost, or actual, method of valuation. The value of an asset is considered to be the amount it costs a purchaser to buy the asset. This method purports to measure the actual or true value of the asset. The second method is appraisal. An *appraisal* is an estimate of the value of an asset. It attempts to ascertain an asset's fair market value by making an assessment of various factors that a buyer and seller look to in making an exchange. The relative supply and demand, the cost of comparable goods, and the like are used to estimate an asset's value.

The actual cost of an asset may not be the same as its appraised value. Also, the fair market value of an asset may be different from both the cost and appraised value of an asset. A purchaser may get a bargain sale and pay an amount below that of the market. Likewise, a seller may get a windfall by selling an asset for more than its value in the market. Also, buyer and seller may conspire to fix a price that is not a fair value. Such economic dislocations are normal in an imperfect and real marketplace.

For the most part, in *arm's length* transactions between parties that are not related, the actual selling price of an asset is considered to be its value. Also, when an appraisal is made in good faith, it is considered to be representative of the asset's fair market value.

(a) Basis

The importance of valuation has to do with the measure of the amount of gain derived on the sale or disposition of an asset. Just as gross income is not, without reduction for costs of production, a clear reflection of economic gain, neither is the total amount realized by the seller on the sale of an asset. The total amount

realized on a sale also reflects a return of the initial investment (the cost) in the asset. The return of the cost paid for an asset is not an accession to wealth, but merely a return of previously accumulated and invested wealth. Likewise, costs to improve or enhance the asset are invested and returned as part of the purchase price. Therefore, a mechanism must be used to apportion those costs invested in the asset and returned by the sales proceeds, and those sales proceeds that represent an economic gain to the seller.

Basis is the term that refers to the investment in property. The mechanism for apportioning investments in an asset is the general basis rules found in the federal tax law.[51] The tax basis for an investment in property is usually the cost of acquisition of the asset.[52]

Property that is acquired from a decedent, however, has a *stepped-up* rather than a regular (cost) basis.[53] The person acquiring property from a decedent has a basis equal to the fair market value of the property at the date of the decedent's death (or, if elected, under the alternate valuation date[54]). Any gain in the value of the decedent's asset during the decedent's lifetime will be deemed a nontaxable part of the recipient taxpayer's investment in the property when it is sold.

Property that is acquired by gift has a *carryover* rather than a cost basis.[55] This means that the person who receives a gift of property has the same basis in the property as that of the donor of the property; the basis is carried over to the new owner of the property. Any gain in value of the gifted property in the hands of the donor will be taxable to the recipient when it is sold. The recipient can, however, take advantage of the cost basis of the donor, rather than having a zero cost basis as a result of the gift.

(b) Adjusted Basis

Just as gross income may be adjusted by business expense deductions to reflect the true economic gain of the taxpayer, so too may basis be adjusted to reflect true economic gain (or loss) in the disposition of property.

In determining gain or loss, the federal tax law provides that basis in property be adjusted.[56] Generally, basis is adjusted[57] for the following forms of tax-recognized economic activity:

- Expenditures
- Receipts
- Losses
- Other items properly chargeable to capital account (but no adjustments for certain taxes[58] or other carrying charges and circulation expenditures)[59]

[51] IRC §§ 1011–1023.
[52] IRC § 1012.
[53] IRC § 1014.
[54] IRC § 2032.
[55] IRC § 1015.
[56] IRC § 1011 provides that basis be adjusted as provided in IRC § 1016.
[57] IRC § 1016.
[58] IRC § 266 taxes.
[59] IRC § 173.

Basis is also adjusted under the general rule for the following items to the extent the allowable items resulted in a reduction of tax:

- Exhaustion
- Wear and tear
- Obsolescence
- Amortization
- Depletion

The federal tax law provides for a number of other basis adjustments that are not relevant to an overview of income taxation.[60]

(c) Determination of Gain

On a *sale or other disposition of property*, gain (or loss) is computed as the *amount realized* from the sale or disposition of the property less the adjusted basis[61] in the property.[62] Expressed mathematically, the formula is:

$$\text{Gain (or Loss)} = \text{Amount Realized} - \text{Adjusted Basis}$$

The amount realized on the sale or disposition is the sum of any money received plus the fair market value of any property received in the transaction.[63]

(d) Realization

In order for there to be a gain, there must be a realization of income. The law, as expressed in a Supreme Court opinion,[64] requires that accessions to wealth must be realized for there to be income subject to income taxation.

Economically, gain (or loss) is dynamic, occurring over a period of time. The fair market value of property fluctuates constantly. Property may gain or lose value during the entire time it is owned. This increase or decrease in fair market value represents the economic gain or loss associated with the ownership of the property over time.

Furthermore, economic gain (or loss) can be real or nominal over time. Real gain (or loss) is the actual increase (or decrease) in value of the asset over time. Nominal gain (or loss) is the relative increase (or decrease) in value of the asset over time.

To understand the difference between real and nominal value, one must consider the economic price factor of inflation or deflation in the market. Over time, prices in the marketplace change, possibly reflecting differences in value associated with certain assets. This is real change. Change may also occur in the value of money. If money becomes less valuable (or if the supply of money increases), the value of an asset in relation to money correspondingly changes. If the real value of an item of property remains constant, but the relative value of money

[60] IRC § 1016.
[61] IRC § 1011.
[62] IRC § 1001(a).
[63] IRC § 1001(b).
[64] *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955).

becomes less, the item will cost more because the value of money has declined. This is a phenomenon typical of an inflationary period. Prices for a commodity rise, even though the commodity's real value to consumers remains unchanged. The price change is a nominal increase due to the change in value of money, while the underlying real value of the commodity remains constant.

(e) Appreciation

The term *appreciation* refers to the increase in the value of property. As discussed above, appreciation (the increase in value of property) is composed of two elements, real and nominal changes in the value of property. One element, real appreciation, reflects the true increase in economic value of the property. The other, nominal appreciation, reflects the relative effect of the change in the value of money, not the change in value of the property.

Over time, then, the value (and accessions to wealth) of property of a taxpayer may change. Coupled with that is the fact that the federal income tax system utilizes an annual accounting period for purposes of accounting and taxing income. Each year, a taxpayer may have an increase or decrease in wealth due to the real or nominal change in the value of property held by the taxpayer.

Although changes in value occur over time, and can be measured annually, the income tax system does not attempt to track, measure, and tax economic gain (or loss) annually. Instead, gain (or loss) is accounted for only when some transactional event occurs: namely, a sale, exchange, or other disposition of property. The tax on gains (or losses), then, is a transactional tax, not an economic tax.

Realization denotes the transactional event giving rise to gain (or loss) for income tax purposes. The event is a sale, exchange, or other disposition of property. An event giving rise to realization occurs when property is sold for money, when property is exchanged for other property, or when property is given in exchange for the satisfaction of some contractual obligation. A contractual obligation is a valuable property right; its exchange—the satisfaction of a contract right—for other property is a transactional disposition within the contemplation and reach of the gain provisions of the federal tax law.

Questions arise as to whether a particular event or transaction is a realization of income, and as to when (in which tax year) the realization event occurred.

(f) Recognition

Once an element of gain is realized, the next step is to determine whether such gain will be recognized and subject to income taxation. Under the federal tax law, the general rule is that the "entire amount of gain or loss . . . on the sale or exchange of property shall be recognized."[65] *Recognition* is the process of taking gain into account for income tax purposes. The gain is recognized and subject to current taxation, unless a deferral is permitted.

Under the federal tax law, the deferral of realized gain (or loss) is termed *nonrecognition*. For various policy reasons, Congress has granted a deferral into the future of a currently realized gain. The federal tax law contains a number of

[65] IRC § 1001(c).

non-recognition (nontaxable) provisions.[66] The best-known non-recognition provisions are the following.

Like-Kind Exchanges.[67] Non-recognition is allowed (with some exceptions and under certain conditions) for exchanges of property held for investment, or property used in a trade or business, when such property is exchanged only for property of a like kind to be similarly held for investment, or used in the trade or business. The idea is that gain should not be recognized and taxed in a transaction in which the character of the property remains essentially unchanged. Property is considered to be essentially unchanged if property of a like kind is substituted in its place.

Stock Exchanges.[68] Corporations do not recognize gain on the receipt of money or property acquired in exchange for stock in the corporation. Because stock represents the economic cost of investment by stockholder-owners in the corporation, and not economic revenues, it would be unfair to tax such shareholder basis in the corporate business entity.

Involuntary Conversions.[69] When property is involuntarily or compulsorily converted—through destruction, theft, seizure, condemnation (or threat thereof), and the like—into similar or related property, gain is not recognized. It is considered unfair to impose a taxable gain on a taxpayer who suffers an unintended and involuntary conversion of property.

Congress has also chosen to discourage or penalize certain realization transactions. To accomplish this, losses are not recognized and are, therefore, unavailable to offset other taxable income of the taxpayer. An example are straddles of personal property, especially stocks. The federal tax law denies a taxpayer the recognition of a loss to the extent the loss exceeds unrecognized gain.[70] The abuse policed by the section is whipsawing of the federal treasury. It is unfair to defer (not recognize currently) taxable gain on one part of a straddle transaction, and yet recognize a current loss on another part to offset income and further reduce current tax liability.

§ 2.15 TAXATION OF INCOME

An individual's net income tax liability is the greater of (1) regular income tax liability reduced by any credits allowed against the regular tax or (2) tentative minimum tax reduced by credits allowed against the minimum tax. The amount of income subject to tax is determined differently under the regular and the alternative minimum tax; separate rate schedules apply. Lower rates apply with respect to long-term capital gains; those rates apply for both the regular tax and the alternative minimum tax.

[66] IRC §§ 1031–1042.
[67] IRC § 1031.
[68] IRC § 1032.
[69] IRC § 1033.
[70] IRC § 1092.

Income (a taxpayer's taxable income) is subject, under the regular income tax, to progressive taxation. That is, income is taxed at higher marginal rates as the level of a taxpayer's income rises. The *marginal rate* of taxation refers to a taxpayer's rate of taxation within a defined range of income, such as from zero to $1,000. The range of income (zero to $1,000, for example) is termed an income tax *bracket*. A lower marginal rate of taxation is imposed on low-income brackets, while higher marginal rates of taxation are imposed on high-income brackets. The *effective rate* of taxation is the average tax rate over the range of income subject to the differing marginal rates.

Tax rates for individual taxpayers are divided into four categories: single, married filing jointly, married filing separately, and head of household. The rate of tax on each category is different. To determine regular tax liability, an individual generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. There are also separate tax rates for corporations and estates.

There are six marginal rates of regular federal income taxation for individuals: 10, 15, 25, 28, 33, and 35 percent. The rate of tax thus, as noted, becomes progressively greater as taxable income increases.

The income tax rates for individuals for 2010 are:

If Taxable Income . . .		
Is over:	**But not over:**	**Then regular income tax equals:**
Married individuals filing joint return		
Not over $16,750		10% of taxable income
$16,750	$68,000	$1,675, plus 15% of the amount over $16,750
$68,000	$137,300	$9,362.50, plus 25% of the amount over $68,000
$137,300	$209,250	$26,687.50, plus 28% of amount over $137,300
$209,250	$373,650	$46,833.50, plus 33% of amount over $209,250
$373,650		$101,085.50, plus 35% of amount over $373,650
Unmarried individuals		
Not over $8,375		10% of taxable income
$8,375	$34,000	$837.50, plus 15% of the amount over $8,375
$34,000	$82,400	$4,681.25, plus 25% of the amount over $34,000
$82,400	$171,850	$16,781.25, plus 28% of the amount over $82,400
$171,850	$373,650	$41,827, plus 33% of the amount over $171,850
$373,650		$108,421.25, plus 35% of amount over $373,650
Heads of households		
Not over $11,950		10% of taxable income
$11,950	$45,550	$1,195, plus 15% of the amount over $11,950
$45,550	$117,650	$6,235, plus 25% of the amount over $45,550
$117,650	$190,550	$24,260, plus 28% of the amount over $117,650
$190,550	$373,650	$44,672, plus 33% of the amount over $190,550
$373,650		$105,095, plus 35% of the amount over $373,650[a]

[a]Rev. Proc. 2009-50, 2009-2 C.B. 617 § 3.01.

The 15 percent rate bracket for married couples filing joint returns was increased in 2004, effective for 2005 to 2007. The size of the 10 percent rate bracket for individuals was extended through 2010.

The taxable income of a corporation generally is comprised of gross income less allowable deductions. Gross income generally is income derived from any source, including gross profit from the sale of goods and services to customers, rents, royalties, interest (other than certain interest from certain indebtedness issued by state and local governments), dividends, and gains from the sale of business and investment assets.

Allowable deductions include ordinary and necessary business expenses, such as salaries, wages, contributions to profit-sharing and pension plans and other employee benefit programs, repairs, bad debts, taxes (other than federal income taxes), contributions to charitable organizations (subject to an income limitation), advertising, interest expense, certain losses, and selling expenses. Expenditures that produce benefits in future tax years to a company's business or income-producing activities (such as the purchase of plant and equipment) generally are capitalized and recovered over time through depreciation, amortization, or depletion allowances. A net operating loss typically may be carried back two years or carried forward 20 years and allowed as a deduction in another tax year. Deductions are also allowed for certain amounts despite the lack of a direct expenditure by the taxpayer; for example, a deduction is allowed for all or a portion of the amount of dividends received by a corporation from another corporation (where certain ownership requirements are satisfied). Moreover, a deduction is allowed for a portion of the amount of income attributable to certain manufacturing activities.

Federal tax law also specifies certain expenditures that typically may not be deducted, such as dividends paid to shareholders, expenses associated with earning tax-exempt income,[71] certain entertainment expenditures, certain executive compensation in excess of $1 million per year, a portion of the interest on certain high-yield debt obligations that resemble equity, and fines, penalties, bribes, kickbacks, and other illegal payments.

Income tax bracket	Percentage tax rate
$0–$50,000	15%
$50,000–$75,000	25%
$75,000–$10 million	34%
Over $10 million	35%[a]

[a]IRC § 11(b)(1). These rates are not adjusted for inflation.

A corporation with taxable income in excess of $100,000 is required to increase its tax liability by the lesser of 5 percent of the excess or $11,750. This increase in tax phases out the benefits of the 15 percent and 25 percent rates for corporations with taxable income between $100,000 and $335,000. A corporation with taxable income in excess of $335,000 and no more than $10 million, in effect, pays tax at a flat 34 percent rate. A corporation with taxable income in excess of $15 million is required to increase its tax liability by the lesser of 3 percent of the excess or $100,000.[72] This increase in tax recaptures the benefits of the 34 percent rate in a

[71] For example, the carrying costs of tax-exempt state and local obligations, and the premiums on certain life insurance policies, are not deductible.

[72] IRC § 1(f)(8).

manner analogous to the recapture of the benefits of the 15 percent and 25 percent rates.

Thus, there are four marginal rates of income taxation for corporations: 15, 25, 34, and 35 percent. As with individuals, the marginal tax imposed on corporations increases as taxable income increases. With respect to corporations, however, the benefit of progressive rates (lower levels of income taxed at marginally lower rates) is phased out, as described, as taxable corporate income increases.

In contrast to the treatment of capital gains in the individual income tax context, there is no separate rate structure for corporate capital gains. Thus, the maximum rate of tax on the net capital gains of a corporation is 35 percent. A corporation may not deduct the amount of capital losses in excess of capital gains for any tax year. Disallowed capital losses may be carried back three years or carried forward five years.

Corporations are taxed at lower rates on income from certain domestic production activities. This rate reduction is effected by the allowance of a deduction equal to a percentage of qualifying domestic production activities income. For tax years beginning in 2008 and 2009, this deduction is equal to 6 percent of the income from manufacturing, construction, and certain other activities. Thereafter, the deduction is increased to 9 percent.[73]

Domestic corporations that are affiliated through 80 percent or more corporate ownership may elect to file a consolidated return. For purposes of calculating tax liability, corporations filing a consolidated return generally are treated as divisions of a single corporation. Thus, the losses (and credits) of one corporation generally can offset the income (and thus reduce the otherwise-applicable tax) of other affiliated corporations.

Trusts and estates also are subject to income taxation.[74] A 15 percent rate applies to taxable income not over $1,950; taxable income over $1,950 but not over $4,560 is subject to a $292.50 tax, plus tax at the rate of 25 percent of the amount over $1,950; taxable income over $4,560 but not over $7,000 is subject to a $955 tax, plus tax at the rate of 28 percent of the amount over $4,600; taxable income over $7,000 but not over $9,550 is subject to a $1,627 tax, plus tax at the rate of 33 percent of the amount over $7,000; and taxable income over $9,550 is subject to a $2,468.50 tax, plus tax at the rate of 35 percent of the amount over $9,550.[75]

One of the significant factors for individuals in relation to the marginal tax rates is that tax deductions (including the charitable contribution deduction) and tax credits have greater economic value for the higher marginal rate taxpayers. Because every dollar of taxable income has a corresponding tax, every dollar excluded from tax has a tax savings. A dollar that escapes tax by reason of a tax deduction at the 35 percent level saves the taxpayer 35 cents on the dollar, while a dollar protected from tax at the 10 percent level saves the taxpayer only 10 cents

[73] At the fully phased-in 9 percent deduction, a corporation is taxed at a rate of 35 percent on 91 percent of qualifying income, resulting in an effective tax rate of 31.85 percent. A similar reduction applies to the graduated rates applicable to individuals with qualifying domestic production activities income.

[74] IRC § 1(e).

[75] Rev. Proc. 2003-85, 2003-2 C.B. 1184, § 3.01.

on the dollar. This feature of the U.S. income tax law is an unavoidable consequence of progressive income taxation.

§ 2.16 CAPITAL ASSETS, GAINS, AND LOSSES

A *capital asset* is an item of investment property held by a person, irrespective of whether the property is connected to the person's trade or business.[76]

(a) Capital Assets

The law excludes from consideration as capital assets the following:

- Inventory
- Stock in trade
- Depreciable business property
- Real business property
- Copyrights and other artistic works (within certain guidelines)
- Trade or business receivables
- Government publications (within certain guidelines)[77]

Whether property is held by a person primarily for sale to customers in the ordinary course of business (usually as inventory or stock in trade) or is a capital asset is a question of fact.[78] Courts consider numerous factors in deciding this issue; no one factor controls.[79] As is nearly always the case in tax matters, the taxpayer has the burden of proving that the property was not held for sale in a business.[80] The following factors are the ones usually taken into consideration in determining whether property is held primarily for sale to customers in the ordinary course of a trade or business: the frequency and continuity of sales, the extent and substantiality of sales, the purpose for which the person acquired and held the property, the time between purchase and sale, the extent of improvements made to facilitate sale, and the person's advertising and promotion efforts.[81]

Despite the seemingly broad definition of a capital asset, and the limited exceptions, the term has been construed to mean, as noted, investment property that tends to appreciate in value over time. Indeed, the Supreme Court held that property seemingly within the statutory definition of a capital asset may be excluded from that classification when the property is an integral part of the taxpayer's business and is not truly investment property.[82]

---

[76] IRC § 1221(a).
[77] *Id.*
[78] *Pleasant Summit Land Corp. v. Commissioner*, 863 F.2d 263 (3d Cir. 1988), *aff'g on this issue* 54 T.C.M. (CCH) 566 (1987); *S&H, Inc. v. Commissioner*, 78 T.C. 234 (1982).
[79] *Biedenharn Realty Co. v. United States*, 526 F.2d 409 (5th Cir. 1976).
[80] *Welch v. Helvering*, 290 U.S. 111 (1933).
[81] E.g., *Pleasant Summit Land Corp. v. Commissioner*, 863 F.2d 263 (3d Cir. 1988); *Kaltreider v. Commissioner*, 255 F.2d 833 (3d Cir. 1958), *aff'g* 28 T.C. 121 (1957); *Guardian Indus. v. Commissioner*, 97 T.C. 308 (1991), *aff'd without published opinion*, 21 F.3d 427 (6th Cir. 1994). These factors were applied in a charitable giving context in *Pasqualini v. Commissioner*, 103 T.C. 1 (1994); see §§ 4.3, 4.4(a).
[82] *Corn Prods. Ref. Co. v. Commissioner*, 350 U.S. 46 (1955).

(b) Ordinary Income; Capital Gains and Losses

Historically, income has been divided into two major categories: ordinary income and capital gains. *Ordinary income* is the typical (ordinary) type(s) of income—wages and salaries, rent, dividends, interest, and the like. *Capital gain*, in contrast, is revenue generated by the transfer of a capital asset.

Ordinary income is accorded ordinary income tax treatment. This means that the regular income tax rates are applicable to ordinary income. Likewise, on the sale or exchange of a capital asset, any gain generally is included in income. Capital gain has, however, historically been given preferential tax treatment. For example, prior to tax law changes in 1986, individuals had an effective capital gains tax rate of 20 percent and corporations had a capital gains tax rate of 28 percent. The Tax Reform Act of 1986 repealed the provisions granting reduced rates for individuals for capital gains, fully effective beginning in 1988, and the special capital gains tax rates for corporations was repealed. The maximum tax rate on the net long-term capital gain incurred by an individual was 28 percent, unless the individual's maximum tax rate was less. Nonetheless, the concept of capital gains in the federal tax law was retained, foretelling the day when differential capital gains rates were reinstated. That occurred as the consequence of a major tax law change enacted in 1997. The essence of this revision to law was that the holding periods for determining what is a long-term capital asset were increased and the tax rates for long-term capital gains were reduced.

The net capital of an individual (as well as trusts and estates) is thus taxed at rates lower than the rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the tax year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.[83]

In general, the maximum rate of tax on the adjusted net long-term capital gain of an individual was 20 percent. Any adjusted net capital gain received by an individual in the 15 percent bracket was taxed at a 10 percent rate. These rates applied for purposes of both the regular tax and the alternative minimum tax.[84]

The foregoing 10 percent/8 percent and 20 percent/18 percent capital gain rate rules were reduced to 5 percent (0 percent beginning in 2008), and most other capital gain to 15 percent, in connection with gain taken into account after May 5, 2003.[85]

---

[83] See § 2.16(c).

[84] As to the latter, see § 2.18.

[85] JGTRRA § 301. This change is reflected in IRC § 1(h)(1)(B), (h)(1)(C), (h)(2), and (h)(9). Prior to the enactment of the JGTRRA, ordinary income was generally subject to the same federal income tax rate. This legislation provided, however, that *qualified dividend income* (IRC § 1(h)(11)) would be subject to the federal income tax rate applicable to the class for all other long-term capital gain. As a result, after December 31, 2002, there was a qualified dividend income class subject to a different federal income tax rate than that applicable to other types of ordinary income. The JCTRRA also provided that *qualified 5-year gain* (IRC § 1 (h)(9)) would cease to exist after May 5, 2003, but that it would return after December 31, 2008. The 1997 legislation (the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 105th Cong., 1st Sess. (1997)) provided that gain from certain types of long-term capital gain assets would be subject to different federal income tax rates. Accordingly, after May 6, 1997, there were three classes of long-term capital gains and losses: a class for 28-percent gain (gains and losses from collectibles and IRC § 1202 gains), a class for unrecaptured IRC § 1250 gain (long-term gains not treated as ordinary income that would be treated as ordinary income if IRC § 1250 (b)(1) included all depreciation), and a class for all other long-term capital gain. In addition, this legislation

(c) Long- and Short-Term Capital Gains and Losses

Gains and losses from capital assets are classified as either long- or short-term. The *term* refers to the period of time a capital asset has been held by the taxpayer. The federal tax law provides rules for determining the length of time capital assets have been held.[86]

Long-term capital gains and losses means gains or losses from capital assets held for more than one year.[87] *Short-term capital gains and losses* means gains or losses from capital assets held for not more than one year.[88] Special netting rules apply to these capital gains and losses.[89]

§ 2.17 CARRYOVERS AND CARRYBACKS

The federal income tax is imposed annually. The unit of measure is the tax year, or annual accounting period, for a taxpayer.[90] Each tax year is construed to be a discrete and separate period. In one case, the taxpayer had a net operating loss for its tax year and sought to carry over the loss to another year to offset income. The Supreme Court denied the taxpayer's effort and reinforced the strict concept of a discrete tax year.[91]

To overcome the result in this case, and the harsh effects of denial of an offset in other years of a current net operating loss, Congress created the *net operating loss deduction*.[92] Generally, a *carryback* of a net operating loss to the preceding two tax years is permitted.[93] Likewise, a carryover of such a loss to the subsequent 20 years is generally allowed.[94]

Special rules apply to capital losses.[95] For corporate taxpayers, a carryback of three years and a carryover of five years is generally permitted for net capital losses.[96] Other taxpayers are generally allowed a carryover to the next tax year of:

- The excess of net short-term capital losses over net long-term capital gains, treated as a net short-term capital loss in the succeeding year
- The excess of net long-term capital losses over net short-term capital gains, treated as a long-term capital loss in the succeeding year

---

provided that qualified five-year gain (prior to amendment by the JCTRRA) would be subject to reduced capital gains tax rates under certain circumstances for certain taxpayers. For taxpayers subject to a 10-percent capital gains tax rate, qualified five-year gain would be taxed at an 8-percent capital gains tax rate effective for tax years beginning after December 31, 2000. For taxpayers subject to a 20-percent capital gains rate, qualified 5-year gain would be taxed as an 18-percent capital gains tax rate, provided that the holding period for the property from which the gain was derived began after December 31, 2000.

[86] IRC § 1223.

[87] IRC § 1222(3), (4).

[88] IRC § 1222(1), (2).

[89] IRC § 1222.

[90] See § 2.9.

[91] *Burnet v. Sanford & Brooks Co.*, 282 U.S. 359 (1931).

[92] IRC § 172.

[93] IRC § 172(b)(1)(A)(i).

[94] IRC § 172(b)(1)(A)(ii).

[95] IRC § 1212.

[96] Net capital loss is defined in IRC § 1222(10).

§ 2.18 ALTERNATIVE MINIMUM TAX

In the past, certain high-income taxpayers were able to greatly reduce their income tax liability because of their receipt of exempt or preferred income. To curb this perceived abuse, Congress adopted an *alternative minimum tax* to ensure that taxpayers with tax preference income nonetheless pay a minimum amount of income tax. An alternative minimum tax is imposed on an individual, corporation, estate, or trust in an amount by which the tentative minimum tax exceeds the regular income tax for the tax year.[97]

For individuals, the tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess.[98] The taxable excess is so much of the alternative minimum taxable income (AMTI) as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular income tax are also used in computing the tentative minimum tax. AMTI is the taxpayer's taxable income increased by the taxpayer's tax preference items and adjusted by redetermining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

A corporation is subject to an alternative minimum tax that is payable, in addition to other tax law liabilities, to the extent it exceeds the corporation's regular income tax liability.[99] The tax is imposed at a flat rate of 20 percent on alternative minimum taxable income in excess of a $40,000 exemption amount.[100] Credits that are allowed to offset a corporation's regular tax liability generally are not allowed to offset its minimum tax liability. If a corporation pays the alternative minimum tax, the amount of the tax paid is allowed as a credit against the regular tax in future years.

Alternative minimum taxable income is the corporation's taxable income increased by the corporation's tax preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items. Among the preferences and adjustments applicable to the corporate alternative minimum tax are accelerated depreciation on certain property, certain expenses and allowances related to oil and gas and mining exploration and development, certain amortization expenses related to pollution control facilities, net operating losses, and certain tax-exempt interest income. In addition, corporate alternative minimum taxable income is increased by 75 percent of the amount by which the corporation's adjusted current earnings exceed its alternative minimum taxable income (determined without regard to this adjustment). *Adjusted current earnings* generally are determined with reference to the rules that apply in determining a corporation's earnings and profits.

---

[97] IRC §§ 55–59.

[98] IRC § 55(b)(1)(A).

[99] IRC § 55(b)(1)(B).

[100] This exemption amount is phased out for corporations with income above certain thresholds; it is completely phased out for corporations with alternative minimum taxable income of $310,000 or more.

The exemption amounts are (1) $45,000 ($70,950 in tax years beginning in 2009) in the case of married individuals filing a joint return and surviving spouses; (2) $33,750 ($46,700 in tax years beginning in 2009) in the case of other unmarried individuals; (3) $22,500 ($35,475 in tax years beginning in 2009) in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns or an estate or trust.

The items of tax preference subject to the individual alternative minimum tax include:

- Amount by which the depletion deduction exceeds adjusted basis
- Amount by which excess intangible drilling costs exceed 65 percent of net income from oil, gas, and geothermal property
- Certain private activity bond tax-exempt interest
- Appreciated capital gain property claimed as charitable contribution, but not tangible personal property[101]

In addition to the items of tax preference, the alternative minimum tax rules require that certain adjustments be made to selected tax items. Certain adjustments are made for:

- Depreciation
- Mining exploration and development costs
- Long-term contracts
- Alternative tax net operating loss deduction
- Pollution control facilities
- Installment method of accounting
- Alternative tax energy preference deduction

Certain other adjustments are made for noncorporate taxpayers:

- Alternative tax itemized deductions
- Personal exemptions and standard deduction
- Circulation, research, and experimental expenses
- Incentive stock options
- Passive farm tax shelter losses
- Other passive business activity losses

Other adjustments are made for corporate taxpayers:

- Adjusted current earnings

[101] IRC § 57. The alternative minimum tax rules once included the appreciation element in charitable gifts of appreciated property as a tax preference item, but that requirement was repealed.

- Merchant marine capital construction funds
- Blue Cross/Blue Shield organizations[102]

Calculating the alternative minimum tax is a multistep process. The taxpayer first adds *regular taxable income* (RTI) to the amount of *tax preference items* (TPI) to obtain the *alternative minimum taxable income* (AMTI). Second, the taxpayer reduces his or her alternative minimum taxable income (AMTI) by an *exemption* (Exempt). The resulting amount is multiplied by the *alternative minimum tax rate* (AMT Rate), and then reduced by any available *alternative minimum tax foreign tax credit* (AMTFTC). The result is a *tentative minimum tax* (TMT). The taxpayer's regular tax is then subtracted from the TMT to yield a minimum tax that is imposed in addition to the regular tax.

Mathematically, the process for computing the alternative minimum tax is:

$$RTI + TPI = Alternative\ minimum\ taxable\ income$$
$$((AMTI - Exempt) \times AMT\ rate) - AMTFTC = Tentative\ minimum\ tax$$
$$TMT - Regular\ tax = Minimum\ tax$$

The resulting minimum tax is an additional tax liability resulting from adding back certain tax preferences that reduced the taxpayer's initial tax liability.

Not all expenses are currently deductible to taxpayers. When an asset is expected to have a useful life that will extend substantially beyond the current taxable year, the federal tax law denies a deduction and requires capitalization of the expenditure.[103] The underlying concept of this rule is that it would be unfair to permit a taxpayer to receive the benefit of a current deduction for an asset that will provide economic utility over a period of years. Examples of assets with long useful lives are:

- Land
- Buildings
- Plants and equipment
- Patents
- Goodwill

The cost of these types of assets must be capitalized rather than fully deducted in the tax year of acquisition.

§ 2.19 DEPRECIATION

One method for recovering the capital invested in long-lived assets is depreciation. A *depreciation deduction* is allowed for the reasonable exhaustion, wear and tear, and obsolescence of property held for investment or used in trade or business.[104] Generally, an amount of the purchase price is deducted each year as a portion of the total acquisition cost. The total depreciation, and the period of depreciation, are meant to approximate the value of the asset over its useful life.

[102] IRC § 56.
[103] IRC § 263.
[104] IRC § 167.

Some assets are depreciated over a period that is shorter than their expected life.[105] This accelerated depreciation is designed to encourage investment in certain assets.

As an example, an asset is purchased for $1,000. It has an expected useful life of five years. At the end of its useful life, it is expected to not have any remaining value, not even salvage value. Under the straight-line method of depreciation, an equal amount is to be deducted each year over the life of the asset. In other words, depreciation is ratable. Here, $200 is deducted each year for five years.

The depreciation recapture rules in the federal tax law are designed to prevent the conversion of ordinary income into capital gains. The federal tax law requires taxpayers to recapture prior depreciation deductions and convert what might otherwise be capital gains into ordinary income. The federal tax law contains a number of provisions that accomplish recapture. The most important provisions are the recapture of depreciation on real property and on personal property.

§ 2.20 CAPITAL GAINS AND DIVIDENDS RATES

On the sale or exchange of a capital asset, any gain generally is included in income. Any net capital gain of an individual is taxed at maximum rates lower than the rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the tax year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

Capital losses generally are deductible if full against capital gains. In addition, individuals may annually deduct up to $3,000 of capital losses from ordinary income. Any remaining unused capital losses may be carried forward indefinitely to another tax year.

A separate rate structure applies to capital gains and dividends. Under present law, the maximum rate of tax on the adjusted net capital gain of an individual is 15 percent. In addition, any adjusted net capital gain otherwise taxed at a 10- or 15-percent rate is taxed at a zero percent rate. These rates apply for purposes of both the regular income tax and the alternative minimum tax. Certain qualified dividends generally are taxed at the same rate as capital gains.

§ 2.21 TAXATION OF CORPORATE DISTRIBUTIONS

The taxation of a corporation generally is separate and distinct from the taxation of its shareholders.[106] A distribution by a corporation to one of its shareholders generally is taxable as a dividend to the shareholder to the extent of the corporation's current or accumulated earnings and profits.[107] Thus, the amount of a corporate dividend generally is taxed twice: Once when the corporation earns the

[105] IRC § 168.

[106] Cf. § 2.8, text accompanied by *supra* note 33.

[107] See § 2.20. A distribution in excess of the earnings and profits of a corporation generally is a tax-free return of capital to the shareholder to the extent of the shareholder's adjusted basis (generally, cost) (see § 2.14(a)) in the stock of the corporation; this type of distribution is a capital gain if in excess of basis. A distribution of property other than cash generally is treated as a taxable sale of the property by the corporation and is taken into account by the shareholder at the property's fair market value. A distribution of common stock of the corporation generally is not a taxable event as to either the corporation or the shareholder.

income and secondly when the dividend is distributed to the shareholder.[108] Conversely, amounts paid as interest to the debt-holders of a corporation generally are subject to only one level of tax (at the recipient level) inasmuch as the corporation generally is allowed a deduction for the amount of interest expense paid or accrued.

Amounts received by a shareholder in complete liquidation of a corporation generally are treated as full payment in exchange for the shareholder's stock. A liquidating corporation recognizes gain or loss on the distributed property as if the property were sold to the distributee for its fair market value. If a corporation, however, liquidates a subsidiary corporation of which it has 80 percent or more control, gain or loss is not generally recognized by either the parent corporation or the subsidiary corporation.

§ 2.22 ACCUMULATED EARNINGS AND PERSONAL HOLDING COMPANY TAXES

Taxes at a rate of 15 percent (the top rate generally applicable to the dividend income of individuals[109]) may be imposed on the accumulated earnings or personal holding company income of a corporation. The accumulated earnings tax may be imposed if a corporation retains earnings in excess of reasonable business needs. The personal holding company tax may be imposed on the excessive passive income of a closely held corporation. These two tax regimes are designed to ensure that both a corporate tax and a shareholder tax are effectively imposed on corporate earnings.

§ 2.23 TAX CREDITS

Deductions against income have the effect of a tax savings. Depending on the marginal rate of a taxpayer, every dollar of a deduction results in a tax savings of the amount of tax at the marginal rate. A 35 percent taxpayer will save 35 cents in taxes for every dollar of a deduction. A 10 percent taxpayer, by contrast, will save only 10 cents in taxes for every dollar of a deduction. Deductions are, therefore, worth more to high-bracket taxpayers than to low-bracket taxpayers.

To alter this consequence, *tax credits* are sometimes substituted for tax deductions. A tax credit is a dollar-for-dollar offset against income tax. Because each dollar of credit substitutes for a dollar of tax, the tax savings is 100 percent. Further, the value of tax savings is equal for all taxpayers, regardless of marginal tax rate. Therefore, high-income taxpayers receive the same value for their tax credits as do low-income taxpayers.

The federal tax law contains an array of tax credits, such as for child care,[110] adoption expenses,[111] child tax payments,[112] Hope scholarships,[113] lifetime

---

[108] This double taxation is mitigated by a maximum tax rate of 15 percent generally applicable to dividend income of individuals (see § 2.20).
[109] See § 2.20.
[110] IRC § 21.
[111] IRC § 23.
[112] IRC § 24.
[113] IRC § 25A(b).

learning,[114] research activities,[115] new markets,[116] work opportunity,[117] energy,[118] and reforestation.[119]

§ 2.24 FOREIGN TAX CREDITS

Sometimes, U.S. citizens and corporations are taxed by foreign governments on income that is also taxable by the U.S. To offset or minimize the impact of this type of double tax burden, federal tax law provides a tax credit, subject to a limitation,[120] for income taxes paid to foreign countries.[121] The limitation is designed to prevent taxpayers from using the foreign tax credits to offset or reduce U.S. tax on income from U.S. sources.

The foreign tax credit limitation is computed using the overall method.[122] Under this method, the maximum foreign tax credit allowed is found by dividing *foreign source taxable income* (FSTI) by *worldwide taxable income* (WTI), and multiplying the result by the taxpayer's U.S. tax. Stated mathematically, the formula is:

$$(FSTI/WTI) \times U.S.\ tax = Maximum\ foreign\ tax\ credit$$

For example, a taxpayer has a worldwide taxable income of \$100,000. From country A, taxpayer has \$30,000 of taxable income. From country B, taxpayer has \$20,000 of taxable income. Taxpayer's U.S. tax is \$25,000. The maximum foreign tax credit available to taxpayer is \$12,500: ((\$30,000 + \$20,000)/\$100,000) × \$25,000 = \$12,500.

[114] IRC § 25A(c).
[115] IRC § 41.
[116] IRC § 45D.
[117] IRC § 51(a).
[118] IRC § 48(a).
[119] IRC § 48(b).
[120] IRC § 904.
[121] IRC §§ 901–908.
[122] IRC § 904(a).

PART TWO

Basics of Charitable Giving Law

CHAPTER THREE

Fundamental Concepts

§ 3.1 **Meaning of *Gift*** **61**
- (a) General Rules 62
- (b) *Quid Pro Quo* Situations 69
- (c) Incidental Benefits 77
- (d) Absence of Value Transferred 79
- (e) Absence of Donor Ownership 82
- (f) Donor Recognition 83
- (g) Recommendatory Rights 83
- (h) Anticipatory Income Assignments 86
- (i) Credit Card Rebate Plans 91
- (j) Dividends Paid to Charities as Stockholders 93
- (k) Requirement of *Completion* 93
- (l) Employee Hardship Programs 95
- (m) Mandatory Payments 96

§ 3.2 **Meaning of *Donor*** **98**

§ 3.3 **Meaning of *Charitable Organization*** **98**
- (a) Introduction 98
- (b) *Charitable* Organizations—Criteria 100

§ 3.4 **Public Charities and Private Foundations** **108**
- (a) Public Charitable Organizations 109
- (b) Other Organizations That Are Not Treated as Private Foundations 119
- (c) Private Foundations 120

§ 3.5 **Unrelated Business Rules** **120**
- (a) Introduction 121
- (b) *Trade* or *Business* Defined 122
- (c) Regularly Carried On 122
- (d) Concept of *Unrelated Business* 123
- (e) *Unrelated Business Taxable Income* 124
- (f) Exempted Activities 124
- (g) Exempted Income 125

§ 3.6 **Factors Affecting Income Tax Deductibility of Charitable Gifts** **126**

§ 3.7 **Grantor Trust Rules** **127**

§ 3.1 MEANING OF *GIFT*

The basic federal law on the subject of the tax aspects of charitable giving is contained in the Internal Revenue Code and in the interpretations of that body of law found in court opinions, Treasury Department and IRS regulations, and IRS public rulings. (Technically not *law*, pronouncements by the IRS on this subject may be found in private letter rulings, technical advice memoranda, and chief counsel

advice memoranda.) This body of law is specific on various aspects of the law of charitable giving, as the pages of this book attest.

Despite this extensive treatment of these aspects of the law, there is a dramatic omission in the rules concerning charitable giving; the federal law is scarce on the meaning of the word *gift* or contribution.[1] This is highly significant, because there obviously must be a *gift* before there can be a *charitable gift* (and one or more charitable contribution deductions).

(a) General Rules

There are two ways to view the concept of a charitable gift: from the standpoint of the contributor and the standpoint of the recipient charity.

Contributor's Standpoint. Integral to the concept of the charitable contribution deduction, then, is the fundamental requirement that money or property transferred to a charitable organization be transferred pursuant to a transaction that constitutes a *gift*.[2] Just because money is paid, or property is transferred, to a charitable, educational, religious, or like organization, does not necessarily mean that the payment or transfer is a gift. Consequently, when a university's tuition, a hospital's health care fee, or an association's dues are paid, there is no gift, and thus there is not a charitable deduction for the payment.[3] These are situations in which the absence of a gift is because the payor received a material *quid pro quo* in exchange for the payment.[4]

Certainly, there is some law, most of it generated by the federal courts, as to what constitutes a gift. (The Internal Revenue Code and the tax regulations are essentially silent on the subject.) Basically, the meaning of the word *gift* has two elements: it is a transfer that is *voluntary* and is motivated by something other than *consideration*.[5] Thus, the income tax regulations (promulgated in amplification of the business expense deduction rules) state that a transfer is not a

[1] By contrast, most state charitable solicitation statutes contain a definition of the term *gift*. See *Fundraising* § 4.1.

[2] For these purposes, the terms *contribution*, *gift*, and *donation* are synonymous (although the word *donation* tends to be used where the transfer is of a small amount of money or involves property of little value). E.g., *Seed v. Commissioner*, 57 T.C. 265 (1971); *DeJong v. Commissioner*, 36 T.C. 896 (1961), *aff'd*, 309 F.2d 373 (9th Cir. 1962). The IRS observed that the essential elements of a gift are (1) a donor that is competent to make the gift; (2) a donee capable of accepting the gift; (3) a clear and unmistakable intention on the part of the donor to absolutely and irrevocably divest himself or herself of the title, dominion, and control of the subject matter of the gift, in *praesenti*; (4) the irrevocable transfer of the present legal title and of the dominion and control of the entire gift to the donee so that the donor can exercise no further act of dominion or control over it; (5) a delivery by the donor to the donee of the subject matter of the gift or of the most effectual means of commanding the dominion of it; and (6) acceptance of the gift by the donee. INFO 2005-0141, citing *Well v. Commissioner*, 31 B.T.A. 899 (1934). See § 3.6.

[3] E.g., *Channing v. United States*, 4 F. Supp. 33 (D. Mass. 1933), *aff'd per curiam*, 67 F.2d 986 (1st Cir. 1933), *cert denied*, 291 U.S. 686 (1934); *McLaughlin v. Commissioner*, 51 T.C. 233 (1968), *aff'd*, 69-2 U.S.T.C. ¶ 9467 (1st Cir. 1969); *Ryan v. Commissioner*, 28 T.C.M. (CCH) 1120 (1969); *Oppewal v. Commissioner*, 30 T.C.M. (CCH) 1177 (1971); *Winters v. Commissioner*, 30 T.C.M. (CCH) 1238 (1971); *Summers v. Commissioner*, 33 T.C.M. (CCH) 695 (1974); *Brotman v. Commissioner*, 36 T.C.M. (CCH) 279 (1977); *Bass v. Commissioner*, 46 T.C.M. (CCH) 1262 (1983); *Whitaker v. Commissioner*, 67 T.C.M. (CCH) 2408 (1994); Rev. Rul. 68-432, 1968-2 C.B. 104; Rev. Rul. 54-580, 1954-2 C.B. 97.

[4] See § 3.1(b).

[5] *Consideration* is something being received (usually, goods and/or services) in return for a payment. When payments are made to receive something in exchange, the transaction is in the nature of a contract.

contribution when it is made "with a reasonable expectation of financial return commensurate with the amount of the donation."[6] Instead, this type of payment is a purchase (of a product and/or a service). Thus, the IRS states that a *contribution* is:

> A voluntary transfer of money or property that is made with no expectation of procuring financial benefit commensurate with the amount of the transfer.[7]

The IRS follows another principle of law:

> Where consideration in the form of substantial privileges or benefits is received in connection with payments by patrons of fund-raising activities, there is a presumption that the payments are not gifts.[8]

A corollary of these seemingly simple rules is that, as these guidelines reflect, a single transaction can be partially a gift and partially a purchase, so that when a charitable organization is the payee, only the gift portion is deductible.[9]

In an oft-quoted passage, the Supreme Court observed that a gift is a transfer motivated by "detached or disinterested generosity."[10] Along this same line, the Court referred to a gift as a transfer made "out of affection, respect, admiration, charity or like impulses."[11] A third element, reflected in these quotations, that may be considered in this context is *donative intent*.[12] This component of the definition is inconsistently applied.[13] It is the most problematic of the three, inasmuch as it is usually difficult to ascertain what was transpiring in the mind of a donor at the time of a gift (if, in fact, that is what the transaction was); some courts struggle in efforts to determine the subjective intent of a transferor.[14] The other two factors focus on the external circumstances surrounding the transaction, with emphasis

---

[6] Reg. § 1.162-15(b).

[7] Reg. § 1.170A-1(c)(5).

[8] Rev. Rul. 86-63, 1986-1 C.B. 88.

[9] See §§ 3.1(b), 22.2.

[10] *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960), quoting from *Commissioner v. LoBue*, 351 U.S. 243, 246 (1956).

[11] *Robertson v. United States*, 343 U.S. 711, 714 (1952).

[12] E.g., *DeJong v. Commissioner*, 309 F.2d 373 (9th Cir. 1962), *aff'g* 36 T.C. 896 (1961); *Transamerica Corp. v. United States*, 254 F. Supp. 504 (N.D. Cal. 1966), *aff'd*, 392 F.2d 522 (9th Cir. 1968); *Fausner v. Commissioner*, 55 T.C. 620 (1971); *Wolfe v. Commissioner*, 54 T.C. 1707 (1970); *Howard v. Commissioner*, 39 T.C. 833 (1963); *Crosby Valve & Gage Co. v. Commissioner*, 46 T.C. 641 (1966), *aff'd*, 380 F.2d 146 (1st Cir.), *cert. denied*, 389 U.S. 976 (1967).

[13] For example, in the context of the charitable split-dollar insurance plans legislation (see § 17.6), the legislative history states that the concept of a *charitable gift* "generally is interpreted to mean a voluntary transfer of money or other property without receipt of adequate consideration and with donative intent." H. Rep. No. 106-478, 106th Cong., 1st Sess. 168 (1999). By contrast, however, the Tax Court, on one occasion, applied only the first element of that definition. In fact, the court wrote that, in determining whether the transactions ostensibly involving a gift were entered into "with the expectation of any quid pro quo from" the charitable organization involved, "we shall focus on the external features relating to" the transactions. *Signom v. Commissioner*, 79 T.C.M. (CCH) 2081, 2091 (2000).

[14] *Transamerica Corp. v. United States*, 254 F. Supp. 504 (N.D. Cal. 1966), *aff'd*, 392 F.2d 522 (9th Cir. 1968); *Crosby Valve & Gage Co. v. Commissioner*, 46 T.C. 641 (1966), *aff'd*, 380 F.2d 146 (1st Cir.), *cert. denied*, 389 U.S. 976 (1967); *Wardwell Estate v. Commissioner*, 301 F.2d 632 (8th Cir. 1962), *rev'g* 35 T.C. 443 (1960); *Citizens & S. Nat'l Bank v. United States*, 243 F. Supp. 900 (W.D.S.C. 1965); *Marquis v. Commissioner*, 49 T.C. 695 (1968); *Perlmutter v. Commissioner*, 45 T.C. 311 (1965).

on whether the putative donor received anything of value as a consequence of the putative gift.[15]

In one donative-intent case, a partnership was formed to assist a religious center, which was deeply in debt, by borrowing funds and purchasing the center and then leasing it back. Subsequently, the partnership transferred the center to a church after the center defaulted on the lease; a court ruled that the transfer to the church did not give rise to a charitable deduction because the partners' intent was to generate funds to satisfy the mortgage, rather than to benefit the church.[16] By contrast, a court held that donors of a 20 percent interest in a parcel of real estate to a church had the requisite donative intent, even though they agreed to purchase the property and lease it back to the church.[17] Also, donors were found to have donative intent in connection with a contribution of a scenic easement over a portion of their residential estate, even though they pursued a reconveyance of the easement following disallowance of a significant portion of the charitable deduction.[18]

Some aspects of the state of the law on this point, as reflected in another view of the Supreme Court, are that a ''payment of money [or transfer of property] generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return.''[19] This observation was made in the context of an opinion concerning a charitable organization that raised funds for its programs by providing group life, health, accident, and disability insurance policies, underwritten by insurance companies, to its members. Because the members had favorable mortality and morbidity rates, experience rating resulted in substantially lower insurance costs than if the insurance were purchased individually. Because the insurance companies' costs of providing insurance to the group were uniformly lower than the annual premiums paid, the companies paid refunds of the excess (dividends) to the organization; the dividends were used for its charitable purposes. Critical to the organization's fundraising efforts was the fact that it required its members to assign it all dividends as a condition of participating in the insurance program. The organization advised its insured members that each member's share of the dividends, less its administrative costs, constituted a tax-deductible contribution.

The Supreme Court, however, disagreed with that conclusion. It found that none of the ''donors'' knew that they could have purchased comparable insurance for a lower cost; the Court thus assumed that the value of the insurance provided by the organization at least equaled the members' premium payments. The

---

[15] In one instance, the IRS erroneously issued a tax refund to an individual; when the mistake was discovered, the individual's defense was that the refund was a gift from the IRS. The Tax Court observed that although the Commissioner of Internal Revenue ''has the authority to make a refund of overpayments,'' the court was ''unaware of any provision [in the Internal Revenue Code] that authorizes him to make gifts.'' *Young v. Commissioner* (unpublished) (2004). Moreover, the court found itself ''hard pressed to find that [the IRS] made the payment based on a detached and disinterested generosity, out of affection, respect, or admiration of [this taxpayer] so as to constitute a gift'') (see notes 10, 11). The court said nothing about donative intent.

[16] *Suna v. Commissioner*, 56 T.C.M. (CCH) 720 (1988), *aff'd*, 893 F.2d 133 (6th Cir. 1990).

[17] *Douglas v. Commissioner*, 58 T.C.M. (CCH) 563 (1989).

[18] *McLennan v. United States*, 91-1 U.S.T.C. ¶ 50,230 (Ct. Cl. 1991), *aff'd*, 994 F.2d 839 (Fed. Cir. 1993). Another illustration of this donative intent element is an opinion holding that a payment incurred under duress, pursuant to an order from a city to fill a gully in a city street adjacent to the payor's property, was not a contribution. *Alman v. Commissioner*, 39 T.C.M. (CCH) 527 (1979).

[19] *United States v. American Bar Endowment*, 477 U.S. 105, 116–17 (1986).

Court concluded that these individuals failed to demonstrate that they intentionally gave away more than they received. The Court wrote: ''The *sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration. The taxpayer, therefore, must at a minimum demonstrate that he [or she] purposefully contributed money or property in excess of the value of any benefit he [or she] received in return.''[20] Thus, by comparing the cost of similar insurance policies, the Court reached the conclusion that the members had received full value for what they paid in the form of insurance premiums.

Essentially the same rule was subsequently articulated by the Court when it ruled that an exchange having an ''inherently reciprocal nature'' was not a gift and thus could not be a charitable gift, even though the recipient was a charity.[21] In this case, the Court considered the character of payments to the Church of Scientology, which provides ''auditing'' sessions designed to increase members' spiritual awareness and training courses at which participants study the tenets of the faith and seek to attain the qualifications necessary to conduct auditing sessions. The church, following a ''doctrine of exchange,'' set forth schedules of mandatory fixed prices for auditing and training sessions, although the prices varied according to a session's length and level of sophistication.

The payors contended that the payments were charitable contributions. The Court disagreed, holding that the payments were made with an expectation of a *quid pro quo* in terms of goods or services, which are not deductible. The Court focused on the fact that the church established fixed prices for the auditing and training sessions, calibrated particular prices to sessions of particular lengths and sophistication levels, returned a refund if services went unperformed, distributed ''account cards'' for monitoring prepaid but as-yet-unclaimed services, and categorically barred the provision of free services.

Reviewing the legislative history of the charitable contribution deduction, the Court found that ''Congress intended to differentiate between unrequited payments to qualified recipients and payments made to such recipients in return for goods or services. Only the former were deemed deductible.''[22] In this case, charitable deductions were not allowed because the payments ''were part of a quintessential *quid pro quo* exchange.''[23] In so holding, the Court rejected the argument that payments to religious organizations should be given special preference in this regard.[24] Several years before, the IRS published its position on the point, holding that payments for the auditing and training sessions are comparable to payments of tuition to schools.[25]

---

[20] *Id*. at 118.

[21] *Hernandez v. Commissioner*, 490 U.S. 680, 692 (1989).

[22] *Id*. at 690.

[23] *Id*. at 691.

[24] *Cf*. the dissent, *id*. at 704, which argued that the *quid* was exclusively of spiritual or religious worth and that precedents show that, in somewhat comparable circumstances, the IRS has a practice of allowing deductions for fixed payments for religious services.

Subsequently, Congress, in the context of writing law as to charitable gift substantiation requirements and *quid pro quo* contributions, created exceptions for *intangible religious benefits* (see §§ 21.3(a), 22.2).

[25] Rev. Rul. 78-189, 1978-1 C.B. 68. In *Brown v. Commissioner*, 62 T.C. 551 (1974), *aff'd*, 523 F.2d 365 (8th Cir. 1975), it was held that the payments are not deductible as medical expenses. IRC § 213.

A third opinion from the Supreme Court on this point held that funds transferred by parents to their children while the children served as full-time, unpaid missionaries of a church were not deductible as charitable contributions to or for the use of the church.[26] This opinion turned on whether the funds transferred to the children's accounts were deductible as contributions *for the use of* the church. In deciding this issue, the Court looked to the legislative history of this term and concluded that this phraseology was intended by Congress to convey a meaning similar to the words ''in trust for,'' so that in selecting the phrase *for the use of*, Congress was referring o donations made in trust or in a similar legal arrangement.[27] The Court added that although this interpretation ''does not require that the qualified organization take actual possession of the contribution, it nevertheless reflects that the beneficiary must have significant legal rights with respect to the disposition of donated funds.''[28]

The Court thus rejected the claim that a charitable deduction should be allowed when the charitable organization merely has ''a reasonable ability to supervise the use of contributed funds.''[29] It observed that the IRS ''would face virtually insurmountable administrative difficulties in verifying that any particular expenditure benefited a qualified donee'' were a looser interpretation of the phrase utilized.[30] The larger interpretation would, wrote the Court, ''create an opportunity for tax evasion that others might be eager to exploit,'' although the Court was quick to note that ''there is no suggestion whatsoever in this case that the transferred funds were used for an improper purpose.''[31]

The Court also found that the funds were not transferred ''in trust for'' the church. The money was transferred to the children's personal bank accounts on which they were the sole authorized signatories. No trust or ''similar legal arrangement'' was created. The children lacked any legal obligation to use the money in accordance with church guidelines, nor did the church have any legal entitlement to the money or a cause of action against missionaries who used their parents' money for purposes not approved by the church. Thus, the charitable deductions were denied.[32]

Notwithstanding these three Supreme Court opinions, however, the donative intent doctrine, as noted, has its adherents. For example, a court denied an estate tax charitable deduction to an estate because a trust, funded by the estate, from which the gifts were made, was modified solely to preserve the estate tax charitable deduction.[33]

In that case, the decedent created a trust, which was funded with interests in real property. This trust had charitable remainder beneficiaries, but the trust did not qualify for the estate tax charitable contribution deduction[34] because it was a

---

[26] *Davis v. United States*, 495 U.S. 472 (1990).
[27] A discussion of gifts for the use of charitable organizations is in § 10.3.
[28] *Davis v. United States*, 495 U.S. 472, 483 (1990).
[29] *Id.* at 484–85.
[30] *Id.* at 485.
[31] *Id.*
[32] See also *Cook v. Commissioner*, 57 T.C.M. (CCH) 681 (1989); *Brinley v. Commissioner*, 46 T.C.M. (CCH) 734 (1983); Priv. Ltr. Rul. 9405003.
[33] *La Meres Estate v. Commissioner*, 98 T.C. 294 (1992).
[34] See § 8.3(b).

defective (for tax purposes) split-interest trust.[35] Following the donor's death, a successor trust was established, with equivalent funding of the income interest beneficiaries outside the trust. The second trust became a wholly charitable trust and the estate claimed a charitable deduction for the amounts that were paid to the charitable beneficiaries. This process did not constitute a qualifying reformation.[36] The IRS disallowed the charitable deduction claimed by the estate, and the Tax Court upheld the disallowance. The court found that the trust "was an attempt to qualify the charitable bequests for the [estate tax charitable] deduction."[37] The court added that "[t]here is no evidence indicating a nontax reason" for the second trust,[38] and disallowed the deduction because the trust "was modified for reasons independent of tax considerations."[39] The court added that if it ruled to the contrary, it would be rendering the reformation procedure superfluous, because the trust could be retroactively amended.

In another donative-intent case, a husband and wife granted to a charitable conservancy organization a scenic easement over 167 acres of their 407 acres of property; they claimed a $206,900 charitable contribution deduction for the gift.[40] On audit, the IRS disallowed the deduction, claiming, in part, that the donors lacked the requisite donative intent. The alleged absence of donative intent was based on the assertion that the donors made the gift of the scenic easement for the sole purpose of maintaining their property's value and to receive a tax deduction. The government made much of the fact that the donee conservancy group "recited the estimated tax advantages of a scenic easement conveyance" and that the donors sought reconveyance of the easement once the charitable deduction was disallowed.[41]

The matter went to court, where it was found that the requisite donative intent was present at the time the scenic easement was conveyed. The court said that the federal tax law "permits deductions for *bona fide* gifts notwithstanding the motivations of a taxpayer."[42] The court wrote that, "[i]n order to be entitled to a tax deduction, the taxpayer must not expect a substantial benefit as a *quid pro quo* for the contribution.[43] "However," the court continued, the "charitable nature of a contribution is not vitiated by receipt of a benefit incidental to the greater public benefit."[44] While generally agreeing with the IRS's construction of the facts, the court found that the donors' decision to contribute the easement "would invariably encourage other neighboring landowners to impose similar development restrictions on their property."[45] The court also found that the donors believed that the imposition of a conservation easement on their property would diminish the value of the property. Thus, the court, in rejecting the IRS's

[35] See § 5.3.
[36] See § 8.7(b).
[37] *Estate of La Meres v. Commissioner*, 98 T.C. 294, 308 (1992).
[38] *Id.*
[39] *Id.*
[40] This type of gift is discussed in § 9.7.
[41] *McLennan v. United States*, 91-2 U.S.T.C. ¶ 50,447, at 89,644 (Cl. Ct. 1991).
[42] *Id.*
[43] *Id.*
[44] *Id.*
[45] *Id.*

allegations, ruled that any benefit that inured to the donors from the conveyance "was merely incidental to an important, public spirited, charitable purpose."[46]

There are at least three court opinions holding that when a donor retains sole signatory power over a contribution, the donor is not entitled to a charitable contribution deduction because the gift has not been completed.[47]

Nonetheless, despite all of the foregoing, one federal court of appeals put this matter rather starkly, succinctly observing that this is a "particularly confused issue of federal taxation."[48] Not content with that, this appellate court went on to portray the existing Internal Revenue Code structure on this subject as being "cryptic," with the indictment that "neither Congress nor the courts have offered any very satisfactory definition" of the terms *gift* or *contribution*.[49]

Charity's Standpoint. The foregoing analysis reviewed the treatment of a payment as a gift from the standpoint of the (ostensible) contributor. On occasion, however, the issue can arise from the perspective of the recipient. In one such instance, a court ruled that contributions made by members of a church congregation to its pastor on "special occasions" were taxable income, rather than tax-free gifts, to the pastor and his spouse.[50] Cash gifts were collected in the sanctuary; the funds were not recorded in the church's records. The court observed that the cash transfers "were facilitated by and through church personnel, and would not have [arisen] absent the . . . [pastor's and his spouse's] relationship with the church."[51] Rejecting the contention that the transfers were merely gifts from individuals, the court found that the transfers were "initiated, sponsored, collected and distributed by the congregation as an aggregate body"; the funds were held to be "processed" through the congregation.[52] Concluded the court: "The transfers to the [pastor and his spouse] were not detached or disinterested in the same way as an individual who chooses to send the pastor and his wife ten dollars on a birthday or during the Christmas season."[53]

This characterization of contributions poses problems for churches, schools, and other such organizations when the constituency, or a portion of it, wants to provide assistance to an individual (member of the clergy, teacher, coach, and the like) with some additional financial support in the form of "gifts." One can still make gifts to others without the funds being income to the recipient. When the

---

[46] *Id*. at 89,645. This opinion was affirmed. *McLennan v. United States*, 994 F.2d 839 (Fed. Cir. 1993).

[47] *Gookin v. United States*, 707 F. Supp. 1156 (N.D. Cal. 1988); *Burke v. United States*, 88-1 U.S.T.C. ¶ 9,391 (D. Conn. 1988); *Davis v. Commissioner*, 81 T.C. 806 (1983), *aff'd*, 767 F.2d 931 (9th Cir. 1985). *Cf. Carter v. United States*, 973 F.2d 1479 (9th Cir. 1992). In general, see § 3.1(j).

[48] *Miller v. IRS*, 829 F.2d 500, 502 (4th Cir. 1987).

[49] *Id*. A charitable gift may be made by means of a payroll deduction program. Rev. Rul. 54-549, 1954-2 C.B. 94; Priv. Ltr. Rul. 200307084. An otherwise valid (and deductible) charitable gift may be a fraudulent conveyance that is voidable by creditors or by a bankruptcy trustee. See Bein, "Should Charitable Contributions by Insolvent Debtors Be Fraudulent Conveyances?" 8 *J. Tax'n Exempt Orgs*. (no. 4) 162 (Jan./Feb. 1997); Bein, "Can Charitable Contributions Be Voidable Fraudulent Conveyances?" 8 *J. Tax'n Exempt Orgs*. (no. 3) 115 (Nov./Dec. 1996).

[50] *Goodwin v. United States*, 870 F. Supp. 265 (S.D. Iowa 1994).

[51] *Id*. at 267.

[52] *Id*. at 268.

[53] *Id*. The "detached or disinterested" phraseology was in reference to the language used by the Supreme Court in *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960). The *Goodwin* opinion was affirmed at 95-2 U.S.T.C. ¶ 50,534 (8th Cir. 1995).

effort is orchestrated through the offices of the organization, however, at some point through some alchemy the funds become transformed into income taxable to the organization.

As to the tax treatment, contributions to a church or similar entity used for salaries are deductible by the donors as charitable gifts and, of course, the salaries are taxable to those who receive them. Gifts made individually are not deductible to the contributors and are not taxable income to the donee. It is not purely idle speculation to think that some members of the congregation of the church in this case deducted their special-occasion gifts.

(b) *Quid Pro Quo* Situations

As noted, when a transaction involves consideration, so that the erstwhile donor receives something of value approximate to the amount transferred, there is no gift. This is because the person received a *quid pro quo* in exchange for the transfer, and thus there is no true gift at all. (There are several sets of circumstances in which a transfer is partially a gift and partially a sale or exchange;[54] these circumstances are discussed elsewhere.[55])

In one case, a manufacturer of sewing machines sold the machines on a discounted basis (bargain sales) to schools and other charitable organizations. The issue was whether the company was entitled to a charitable deduction for the gift element in the transactions. The court formulated the appropriate test as follows:

> [I]f the benefits received, or expected to be received, are substantial, and meaning by that, benefits greater than those that inure to the general public from transfers for charitable purposes (which benefits are merely incidental to the transfer), then in such case we feel the transferor has received, or expects to receive, a quid pro quo sufficient to remove the transfer from the realm of deductibility [as a charitable gift].[56]

In application of this standard, the court differentiated between the discounts allowed to schools and those for other charities. As to the former, the court concluded that the discounts were offered "for the *predominant* purpose of encouraging those institutions to interest and train young women in the art of machine sewing; thereby enlarging the future potential market by developing prospective purchasers of home sewing machines and, more particularly [the company's] machines—the brand on which the future buyers learned to sew."[57] Thus, these discounts were held not to be of a charitable nature, with the court convinced that the company's "predominant reason for granting such discounts was other than charitable" in that it "expected a return in the nature of future increased sales."[58] By contrast, as to the bargain sales of sewing machines to

---

[54] For example, the IRS ruled that proposed sales of columbarium niches and cenotaphs, by a parish of the Roman Catholic Church, for an amount greater than their fair market value, would give rise to a charitable contribution deduction for the amount exceeding value. Priv. Ltr. Rul. 200213021. These niches would be used for the interment of cremated remains and the cenotaphs used for remembrances of loved ones who are buried elsewhere. The agency also ruled that, inasmuch as the niches and cenotaphs would be used for decedents for whom the Church had conducted or expected to conduct a funeral ceremony, the sales would not be an unrelated business. See § 3.5.

[55] See § 22.2.

[56] *Singer Co. v. United States*, 449 F.2d 413, 423 (Ct. Cl. 1971) (emphasis in original).

[57] *Id.* at 423 (emphasis in original).

[58] *Id.* at 424.

charitable organizations other than schools, the court was of the view that ''any benefits to be derived from such discounts were merely incidental to the charitable nature of the transfer and, therefore, do not destroy the claimed charitable contribution deduction.''[59] The incidental effect of this giving policy was the ''development and maintenance of a favorable public image for [the company] in the eyes of those [charitable] organizations and their members.''[60]

In another case, a company was denied a charitable contribution deduction for the transfer of land to a high school district, on the ground that the conveyance was made with the expectation that, as a consequence of the construction of public access roads through the property, it would receive substantial benefits in return.[61] Indeed, that is what occurred. The court wrote that the ''receipt or expected receipt of substantial benefits in return for a conveyance precludes a charitable contribution [deduction].''[62] The court found that the company ''knew that the construction of a school and the attendant roads on its property would substantially benefit the surrounding land, that it made the conveyance expecting its remaining property to increase in value, and that the expected receipt of these benefits at least partially prompted [the company] to make the conveyance.''[63] The court concluded that ''this is more than adequate reason to deny [the company] a charitable contribution for its conveyance.''[64]

In a similar circumstance, two property owners conveyed a parcel of real estate to a corporation, taking back a note secured by a deed of trust on the property. The next year, these individuals delivered a quitclaim deed for a one-half interest in the note and deed of trust to a school and claimed a charitable deduction for the value of the transfer. Two years later, as part of a settlement, the individuals assigned the note to a creditor. They advised the school of the situation, causing the school to quitclaim its interest in the note and trust to the creditor. The next year, these individuals made a cash payment to the school and claimed a charitable deduction for that payment. The court held that the portion of the gift of money equal to the value of the interest in the note and trust that the school quitclaimed to the creditor was not a gift and thus was not deductible; the excess was found to be a charitable gift.[65] This was the outcome because, had the school not executed the quitclaim, the individuals would have been obligated to pay an additional and comparable sum of money to the creditor. ''Under such circumstances,'' wrote the court, ''it can only be concluded that [the individuals] received a benefit of equal value when [the school] executed the quitclaim.''[66]

In another instance, an individual canceled certain property interests and a purchase option in a manner that favored a university. A charitable deduction was claimed for the transfer of this benefit for charitable purposes. The court, however, refused to view that transaction in isolation, or as occurring in advance of other related transactions, but instead regarded it as an integral part of a series of transactions in which the individual benefited. Indeed, the court valued the

---

[59] *Id.*
[60] *Id.*
[61] *Ottawa Silica v. United States*, 699 F.2d 1124 (Fed. Cir. 1983).
[62] *Id.* at 1135.
[63] *Id.*
[64] *Id.*
[65] *Considine v. Commissioner*, 74 T.C. 955 (1980).
[66] *Id.* at 968.

interests passing to the university at $276,500. At the same time, however, the court found that the individual received a *quid pro quo* from the transaction in the amount of $295,963.[67]

Several other court opinions contain applications of the *quid pro quo* rationale in this setting.[68] This rationale is, of course, that the transferor is receiving goods, services, and/or other benefits of value comparable to the money and/or property transferred, and thus the transaction is a purchase rather than a gift.[69]

This rationale is followed by the IRS. An illustration of the IRS's application of these rules appears in its guidance concerning the deductibility of payments to a private school when the ''donor'' is a parent of a child attending the school.[70] Basically, payments of tuition to a school are not deductible as charitable gifts.[71] The general standard in this context is this:

> Whether a transfer of money by a parent to an organization that operates a school is a voluntary transfer that is made with no expectation of obtaining a commensurate benefit depends upon whether a reasonable person, taking all the facts and circumstances of the case into account, would conclude that enrollment in the school was in no manner contingent upon making the payment, that the payment was not made pursuant to a plan (whether express or implied) to convert nondeductible tuition into charitable contributions, and that receipt of the benefit was not otherwise dependent upon the making of the payment.[72]

The IRS generally presumes that such payments are not charitable contributions when one or more of the following factors is present:

- The existence of a contract under which the parent agrees to make a ''contribution'' and which contains provisions ensuring admission of the parent's child
- A plan allowing parents either to pay tuition or to make ''contributions'' in exchange for schooling
- The earmarking of a contribution for the direct benefit of a particular student
- The otherwise unexplained denial of admission or readmission to a school of children of parents who are financially able, but who do not contribute to the school

[67] *Signom v. Commissioner*, 79 T.C.M. (CCH) 2081 (2000).

[68] E.g., *Stubbs v. United States*, 428 F.2d 885 (9th Cir. 1970), *cert. denied*, 400 U.S. 1009 (1971); *Jefferson Mills, Inc. v. United States*, 367 F.2d 392 (5th Cir. 1966); *Wegner v. Lethert*, 67-1 U.S.T.C. ¶ 9,229 (D. Minn. 1967); *Allis-Chalmers Mfg. Co. v. United States*, 200 F. Supp. 91 (E.D. Wis. 1961); *Seldin v. Commissioner*, 28 T.C.M. (CCH) 1215 (1969); *Scheffres v. Commissioner*, 28 T.C.M. (CCH) 234 (1969). Some old cases also are based on this rationale: e.g., *Bogardus v. Commissioner*, 302 U.S. 34 (1937); *Channing v. United States*, 4 F. Supp. 33 (D. Mass. 1933).

[69] A purchaser of a ticket to an event held by or for the benefit of a charitable organization who does not attend the event is not the maker of a charitable gift, in that the purchaser receives a material benefit merely by having the right to decide whether to attend the event. *Urbauer v. Commissioner*, 63 T.C.M. (CCH) 2492 (1992).

[70] Rev. Rul. 83-104, 1983-2 C.B. 46.

[71] *Oppewal v. Commissioner*, 468 F.2d 1000 (1st Cir. 1972); *DeJong v. Commissioner*, 309 F.2d 373 (9th Cir. 1962), *aff'g* 36 T.C. 896 (1961). The IRS ruled that payments to a church made in expectation that the church will pay the tuition for the contributors' children at a church-related school are not deductible as charitable gifts. Priv. Ltr. Rul. 9004030. By contrast, a contribution to a school was held to qualify as a deductible gift notwithstanding the fact that the donor's grandchild then attended the school. Priv. Ltr. Rul. 8608042.

[72] Rev. Rul. 83-104, 1983-2 C.B. 46, 47.

Moreover, in other cases, although no single factor may be determinative, a combination of several factors may indicate that a payment is not a charitable contribution. In these cases, both ''economic and noneconomic pressures placed upon parents'' are taken into account.[73] The factors that the IRS will ordinarily take into consideration, but will not limit itself to, are:

- The absence of a significant tuition charge
- Substantial or unusual pressure to contribute applied to parents of children attending a school
- Contribution appeals made as part of the admissions or enrollment process
- The absence of significant potential sources of revenue for operating the school other than contributions by parents of children attending the school
- Other factors suggesting that a contribution policy has been created as a means of avoiding the characterization of payments as tuition

Nonetheless, the IRS concluded: ''However, if a combination of such factors is not present, payments by a parent [to a school attended by a child of the parent] will normally constitute deductible contributions, even if the actual cost of educating the child exceeds the amount of any tuition charged for the child's education.''[74]

A federal court of appeals upheld the IRS's disallowance of a charitable deduction for tuition payments made to a religious school, where the children of the payors were in attendance, rejecting the arguments that there was a gift or that enactment of the rules as to intangible religious benefits changed the law in this area.[75] A set of parents claimed charitable contribution deductions for a portion of their tuition payments, with the ''gift'' element ostensibly being equal to the proportion of the school day allocated to religious education. The appellate court ruled that the additions to the tax law of charitable giving of the charitable gift substantiation requirements[76] and the *quid pro quo* contribution rules[77] did not change the substantive definition of a charitable contribution, but rather added ''procedural provisions regarding the documentation of tax return information.'' These rules include exceptions for contributions for which solely religious benefits are received.[78]

---

[73] *Id*. at 47–48.

[74] *Id*. at 48. Also *Haak v. United States*, 451 F. Supp. 1087 (D. Mich. 1978); *Yoshihara v. Commissioner*, 78 T.C.M. (CCH) 789 (1999).

[75] *Sklar v. Commissioner*, 282 F.3d 610 (9th Cir. 2002), *aff'g* 79 T.C.M. (CCH) 1815 (2000).

[76] See § 21.1.

[77] See § 22.2.

[78] One of the arguments advanced by the appellants in *Sklar v. Commissioner*, 282 F.3d 610 (9th Cir. 2002), was that their theory as to deductibility of the tuition payments is in accord with the IRS's ''policy'' of permitting members of the Church of Scientology to deduct payments for certain services, as stated in a 1997 closing agreement. The appellate court stated in dicta that this policy is in violation of the Internal Revenue Code or the Establishment Clause. 282 F.3d at 618–20. The IRS thereafter issued an information letter explaining that tuition payments to religious schools are not deductible as charitable gifts (INFO 2004-0091). These litigants again sought a charitable contribution deduction for a portion of tuition they paid to a religious school and again lost in court. *Sklar v. Commissioner*, 125 T.C. 281 (2005), *aff'd*, 549 F.3d 1252 (9th Cir. 2008).

In general, Hildenbrand, ''No, You Still Can't Deduct that Payment to Your Child's Private Religious School: An Analysis of the Ninth Circuit Decision in *Sklar v. Commissioner*,'' 55 *Tax Law*. (no. 4) 995 (Summer 2002); Raby & Raby, ''Religious Tuition as Charitable Contribution,'' 29 *Exempt Org. Tax Rev*. (no. 2) 287 (Aug. 2000).

A comparable issue can arise with seminars for which there is no enrollment or entrance fee. At the conclusion of the seminar, the participants may be given the opportunity to make a contribution to the educational organization that conducted it. The organization may suggest, but not require, that participants contribute a specified amount to cover the costs incurred by the organization in providing the seminar. A ''contribution'' of this nature is not a gift and is not deductible as a charitable contribution.[79]

Likewise, a payment to a home for the elderly, or similar institution or organization, is generally not a gift when the payor has a dependent parent who is a resident of the home.[80] However, an unrestricted contribution to a combined charity fund by a payor in this circumstance is deductible when the fund distributes the contributions to member organizations, which include the home, according to a formula.[81]

Still another example of payments that are for services rendered are those for adoption assistance. Thus, a court held that a husband and wife were not entitled to a charitable contribution deduction for payments made to a charitable organization that operated an adoption service for placement of a child in their home; the payment was an adoption fee rather than a gift.[82] There is (questionable) authority to the contrary, holding that even though a charitable organization provided adoption services to the ''donor,'' a payment by the donor to the organization following placement of a child was a deductible charitable contribution because the organization was not authorized by law to charge for its adoption services.[83]

Still another illustration of this point arose when the Chief Counsel's Office of the IRS ruled that a business corporation's contribution to a charitable organization, designated by an employee of the corporation, was not deductible as a charitable gift by the corporation because the contribution was made under a program to match the employee's contribution to the corporation's political action committee.[84] The reason for the lack of deduction: the corporation received a *quid pro quo* for the payment to the charity, in the form of a contribution to its political action committee. Typically, a ''charity-PAC matching program'' (recognized by the Federal Election Commission[85]) allows employees of a business to designate a charitable organization as the recipient of a contribution from the corporate

[79] Rev. Rul. 76-232, 1976-1 C.B. 62. If the contribution is in excess of the monetary value of all benefits and privileges received, however, the amount of the excess would be a deductible charitable gift. See, e.g., § 23.2. Also, under appropriate circumstances, the expenses of attending a seminar may be deductible as a business expense, notwithstanding the fact that the seminar is conducted by a charitable or educational (IRC § 501(c)(3)) organization.

[80] In one instance, a subscription by an individual for a ''room endowment'' to a charitable nursing home was held to create an enforceable legal obligation by the individual or her estate; when paid, it was, for tax purposes, properly deemed a charitable contribution, even though the subscription, which entitled the individual to occupy the room, was paid the day before she was admitted to the home. *Estate of Wardwell v. Commissioner*, 301 F.2d 632 (8th Cir. 1962).

[81] Rev. Rul. 80-77, 1980-1 C.B. 56.

[82] *Arceneaux v. Commissioner*, 36 T.C.M. (CCH) 1461 (1977).

[83] *Wegner v. Lethert*, 67-1 U.S.T.C. ¶ 9,229 (D. Minn. 1967). This opinion is surely in error, for the test is the extent of the value of the services received by the ''donor'' rather than the cost of providing the services or similar circumstances concerning the ''donee.''

[84] Gen. Couns. Mem. 39877.

[85] Federal Election Commission Advisory Op. 1989–7.

employer. The contribution subsequently made by the corporation was an amount equal to the sum of the contributions that the employees made to the corporation's political action committee during the previous year.[86]

In a further illustration of this point, two courts denied contribution status to payments to the United States Olympic Team (a charitable organization), made by parents of a figure skater while accompanying her to various international competitions, because the payors were ''motivated primarily by concern for their daughter rather than by an interest in the Olympic Team in general.''[87] The appellate court said that ''a contribution may not be deducted where the expectation of personal benefit is the primary motive.''[88]

One of the best-publicized of these issues was the tax consequences for contributions made in the context of athletic scholarship programs. Although the specific rule in this connection was ultimately provided by Congress,[89] IRS guidelines published in 1986 (which were superseded by the statutory provision), well illustrate the general principle.

The athletic scholarship program that troubled the IRS can be described generally as follows. An individual pays $300 to an athletic scholarship program maintained by a tax-exempt university, thereby becoming a ''member'' of the program. The only benefit accorded members is that they are permitted to purchase, for $120, a season ticket to the university's home football games in a designated area in the stadium. Because the games are regularly sold out well in advance, tickets to the games covered by the season ticket would not have been readily available to the ''donor'' if the ''donor'' had not made the payment. The $300 membership fee is paid annually and a separate payment is required for each season ticket. The university did not inform its ''donors'' of the fair market value of the right to purchase a season ticket in the designated area.

The IRS held that under these circumstances, the right to purchase the season ticket was a ''substantial benefit.''[90] Because this substantial benefit was afforded the ''donor'' because of payment of the membership fee, the IRS held that a presumption arose that the $300 reflected the value of the benefit received; thus, there was no charitable deduction for the payment. The IRS noted that, assuming the same facts except that the individual paid $500, the ''donor'' made a charitable gift of $200.

These guidelines also offered a variation of these facts, which are the same as in the first instance, except that the tickets are made available to members before

---

[86] In a somewhat mysterious application of this principle, the IRS ruled that contributions by certain graduates of a college or university to an historical preservation society would not be deductible by the donors, where the funds donated would be used to preserve the historically valuable characteristics of a building housing a fraternity of which the prospective donors were members (alumni), because of their ''personal interest'' in the fraternity. Priv. Ltr. Rul. 9119011.

[87] *Babilonia v. Commissioner*, 681 F.2d 678, 679 (9th Cir. 1982), *aff'g* 40 T.C.M. (CCH) 485 (1980).

[88] *Id.*, 681 F.2d at 679.

[89] IRC § 170(l). Pursuant to this rule, if a person makes an otherwise deductible payment to or for the benefit of a college or university, and in exchange receives the right to purchase tickets for seating at an athletic event in the institution's athletic stadium, 80 percent of the payment for the right to buy the tickets is treated as a deductible charitable contribution. This rule applies when the right to purchase tickets is for seating in a suite, skybox, or other special viewing area; the limitations of the rules pertaining to the deductibility of skybox tickets (IRC § 274(1)(2)) are inapplicable. IRC § 274(f); Tech. Adv. Mem. 200004001.

[90] Rev. Rul. 86-63, 1986-1 C.B. 88, 89.

sale to the general public and that seating in the stadium ''reasonably comparable'' to that available to the donor as a result of the membership would have been ''readily available'' to the donor even if the payment had not been made. On these facts, the IRS found the benefit ''not substantial,'' so that the entire $300 was a deductible charitable gift. In another variation, the facts are the same as in the first instance, except that the games are not regularly sold out and seating reasonably comparable to that available to the ''donor'' as a result of membership would not have been readily available to the ''donor'' if the payment had not been made. Also, the university reasonably estimated that the fair market value of the right to purchase a season ticket in the designated area of the stadium was $''X'' and it advised prospective members that the difference between $300 and $X was a deductible gift. In making that estimate, the university considered the level of demand for tickets, the general availability of seats, the relative desirability of seats based on their types, locations, and views, and ''other relevant factors.''[91] Under these circumstances, again, the right to purchase the ticket was a ''substantial benefit,''[92] and, again, the IRS's position was that a presumption arose that the $300 reflected the value of the benefit received. Because of the university's estimate that the fair market value of the benefit was $X, however, the IRS regarded the amount equal to the difference between $300 and $X as a deductible charitable gift.

One other illustration of this point is the matter of amounts paid to charitable organizations for chances to participate in raffles, lotteries, or similar drawings or to participate in puzzle or other contests for valuable prizes. These are not gifts; the general rule is that the purchase price of a raffle ticket and the like is equal to the value of the chance to win the prize. Therefore, there is no charitable contribution deduction for the payment. (In some instances, however, an amount paid to a charity in excess of a benefit received can be a charitable gift.[93]) Nonetheless, when an activity such as this is operated as a charitable fundraising effort, such as a sweepstakes program; when a purchase by the participants is not involved; and when it is clearly stated in the promotional materials that a payment is not required to enter the promotion, the payments to the charitable organization are deductible as charitable contributions.[94]

Other instances in which a payment to a charitable organization was regarded as other than a gift include:

- Transfer of securities to a church in trust to provide for perpetual care of the transferor's plot in the church's cemetery[95]
- Payments to a church for the rental of a hall for the payors' child's wedding[96]
- Payments to a charitable organization that operated an adoption agency in exchange for adoption services[97]

---

[91] *Id.* at 88.
[92] *Id.* at 89.
[93] E.g., Rev. Rul. 67-246, 1967-2 C.B. 104. See, e.g., § 22.2.
[94] E.g., Priv. Ltr. Rul. 200012061.
[95] *Estate of Wood v. Commissioner*, 39 T.C. 1 (1962).
[96] *Ryan v. Commissioner*, 28 T.C.M. (CCH) 1120 (1969).
[97] *Murphy v. Commissioner*, 54 T.C. 249 (1970); *McMillan v. Commissioner*, 31 T.C. 1143 (1959).

- Payments to a temple for a bar mitzvah[98]
- Payments to a museum for lectures, concerts, and exhibitions[99]
- Payments to a rabbi in connection with the payor's divorce[100]
- Expenses of driving children to Girl Scout functions, because the payor's own children were the principal beneficiaries of the transportation[101]
- Payments to a school for books and graduation announcements[102]
- Contribution of property that remained subject to the "donor's" unrestricted use and control[103]
- Payments to a charitable organization when the donor maintained control over the funds transferred, which went toward personal uses such as subscriptions, dues, and training courses[104]
- Payments to a charitable organization for tickets to a benefit concert[105]
- Payments to a charitable organization in exchange for food and drink[106]
- Ostensible transfer and reconveyance of land between a partnership and a church that was, in general, held to lack economic substance; the transaction constituted a purchase rather than a gift[107]
- Payments by parents to a charitable organization that paid their children's tuition; the payors were not allowed to deduct as charitable contributions the amounts paid to the organization in excess of the tuition payments[108]
- Payment by individuals to a charitable organization that operated a retirement community, because payment obligated the organization to build a cottage for them[109]
- Payments by a minister to his church (held to be his alter ego), inasmuch as he retained control over the money and property involved[110]
- Payment made pursuant to a plea-bargain agreement, which was found to amount to consideration enabling the "donor" to escape incarceration[111]

---

[98] *Feistman v. Commissioner*, 30 T.C.M. (CCH) 590 (1971).
[99] *Cogan v. Commissioner*, 30 T.C.M. (CCH) 987 (1971).
[100] *Brotman v. Commissioner*, 36 T.C.M. (CCH) 279 (1977).
[101] *Hamilton v. Commissioner*, 38 T.C.M. (CCH) 775 (1979).
[102] *Ehrhart v. Commissioner*, 42 T.C.M. (CCH) 1285 (1981).
[103] *Poldrugovaz v. Commissioner*, 47 T.C.M. (CCH) 860 (1984); *Odd v. Commissioner*, 47 T.C.M. (CCH) 1483 (1984).
[104] *Hernandez v. Commissioner*, 51 T.C.M. (CCH) 1631 (1986). This case, as developed at the Supreme Court level, is discussed in § 3.1(a)(i), text accompanied by notes 21–24.
[105] *Urbauer v. Commissioner*, 63 T.C.M. (CCH) 2492 (1992).
[106] *Edwards v. Commissioner*, 64 T.C.M. (CCH) 728 (1992).
[107] *Mount Mercy Associates v. Commissioner*, 67 T.C.M. (CCH) 2267 (1994).
[108] *Graves v. Commissioner*, 68 T.C.M. (CCH) 1445 (1994).
[109] Tech. Adv. Mem. 9423001.
[110] *Page v. Commissioner*, 58 F.3d 1342 (8th Cir. 1995).
[111] *Ruddel v. Commissioner*, 71 T.C.M. (CCH) 2419 (1996). See also *Lombardo v. Commissioner*, 50 T.C.M. (CCH) 1374 (1985).

These matters can operate in reverse. In one instance, an individual attempted to deduct payments made to two charities as business expenses; the court held that they were not business expenses but were charitable gifts—then disallowed the charitable deduction because the individual did not itemize deductions. *Irwin v. Commissioner*, 72 T.C.M. (CCH) 1148 (1996).

In some circumstances, a benefit to a donor will not cause loss of a charitable contribution deduction but instead will cause taxation of gain in addition to a tax deduction. This involves the *step transaction doctrine*, which is discussed elsewhere.[112] Nonetheless, it is appropriate to illustrate the point here. In one case, an individual contributed appreciated securities to a charitable organization with the understanding that the charity would liquidate the stock and purchase his yacht with the sales proceeds. The charity completed the transaction; the donor was found to be taxable on the gain realized as the result of liquidation of the stock.[113] The appellate court wrote that ''where there is an understanding that a contribution of appreciated property will be utilized by the donee charity for the purpose of purchasing an asset of the contributor, the transaction will be viewed as a matter of tax law as a contribution of the asset—at whatever its then value is—with the charity acting as a conduit of the proceeds from the sale of the stock.''[114] The court added: ''This makes the taxpayer/putative-donor taxable on the gain of the stock though entitled to deduct the value of the asset given, whatever that value in fact is.''[115]

(c) Incidental Benefits

When a benefit to a donor is *incidental*, the benefit will not defeat the charitable deduction. The following are several instances of application of that rule.

- A tornado destroyed several homes in a town. The local chapter of the American National Red Cross provided food and temporary shelter to an individual whose home was destroyed. The individual, motivated by gratitude, made a (deductible) contribution to the chapter.[116]
- An individual owned a home in an area served by a volunteer fire department. Neither state nor local taxes were used to support the fire department. The individual made a (deductible) contribution to the volunteer department's annual fund drive.[117]
- An individual's daughter was a member of a local unit of the Girl Scouts of America. The individual made a (deductible) contribution to the Girl Scouts of America.[118]
- Merchants and owners of property in a city made (deductible) contributions to the city to enable it to provide railroad companies with new facilities outside the city, in exchange for the railroads' removal of their inner-city facilities and relinquishment of their right of way through the city (even though the merchants and property owners received some benefit from removal of the railroad facilities).[119]

---

[112] See § 4.8.
[113] *Blake v. Commissioner*, 697 F.2d 473 (2d Cir. 1982), *aff'g* 42 T.C.M. (CCH) 1336 (1981).
[114] *Id.*, 697 F.2d at 480.
[115] *Id.*
[116] Rev. Rul. 80-77, 1980-1 C.B. 56.
[117] *Id.*
[118] *Id.*
[119] Rev. Rul. 67-446, 1967-2 C.B. 119. In this instance, the benefits to the merchants and property owners were considered incidental in comparison to the benefits accruing to the general public. Also Rev. Rul. 79-323, 1979-2 C.B. 106; Rev. Rul. 69-90, 1969-1 C.B. 63.

- An organization made (deductible) contributions to a police department to assist the department, as a regular part of its operations, in offering rewards for information leading to the apprehension and conviction of persons engaging in criminal activity within the community in which the organization was located.[120]
- A parent of a murdered individual made a (deductible) contribution of reward money to the police department of a political subdivision for information leading to the conviction of the murderer, with some or all of the money available for public purposes if not needed to pay the reward.[121]
- An individual made a (deductible) contribution of a tract of land to the federal government and retained the right during his lifetime to train his hunting dog on the trails extending over the tract.[122]
- A developer of a residential community made a (deductible) contribution of real estate, tangible personal property, and cash to a state to assist in the construction of a highway (even though the highway would benefit the planned community).[123]
- An individual made a (deductible) contribution of a tract of land and a house to an educational organization for a conference and retreat center. The contribution was deductible even though the donor retained an adjoining lot for personal use and a nonexclusive easement for pedestrian and vehicular ingress and egress over the existing driveway on the contributed lot.[124]
- A member of a federal advisory committee, who incurs unreimbursed travel and other out-of-pocket expenses while performing services without compensation as a member of that committee, is entitled to a charitable deduction for the expenses as long as the requirements for the deduction are satisfied (''other than those relating to the expectation of any benefit or financial return'').[125]

When a private foundation[126] is a charitable donee and the donor is a disqualified person[127] with respect to the foundation, care must be exercised that the contribution is not an act of self-dealing.[128] An act of self-dealing can be caused if the making of a gift bestows a benefit of some consequence on the disqualified person/donor. When the benefit is merely ''incidental and tenuous,'' however, an act of self-dealing will not result.[129]

The application of rationales other than the *quid pro quo* test in relatively recent years is somewhat surprising, in that Congress, speaking by means of

---

[120] Rev. Rul. 74-246, 1974-1 C.B. 130.
[121] Rev. Rul. 81-307, 1981-2 C.B. 78. Again (see *supra* note 119), the benefit to the donor was deemed incidental in comparison to the benefits accruing to the public.
[122] Rev. Rul. 75-66, 1975-1 C.B. 85.
[123] Priv. Ltr. Rul. 9447028.
[124] Priv. Ltr. Rul. 9729024.
[125] Rev. Proc. 97-52, 1997-2 C.B. 527.
[126] See § 3.4.
[127] See IRC § 4946.
[128] See IRC § 4941. See *Private Foundations,* ch. 5.
[129] *Private Foundations* § 5.7(c).

legislative history in 1954, wrote that gifts are ''contributions which are made with no expectation of a financial return commensurate with the amount of the gift.''[130] Thus, it would seem that the *quid pro quo* test should, unquestionably, be the law.

(d) Absence of Value Transferred

In some instances, a federal income tax charitable contribution deduction is denied because nothing of substance or value was transferred to a charitable organization. For example, in one case, a charitable contribution deduction for the transfer by a corporation of certain film property to the Library of Congress was denied on the ground that what was physically conveyed (principally, negatives on nitrate-base plastic) had little value; the donor claimed a deduction of more than $10 million.[131] Also, a motion picture production company retained access to the property and was relieved of storage costs and potential liability, which the court found to undercut the concept of a gift.

In another case, donors of mining claims to charity were held not to be entitled to any charitable deduction, because the claims lacked any value.[132] The court found a ''total absence of objective support for the value claimed'' and that the testimony of the ''donor's'' expert witness stated values that were mere ''financial fantasies.''[133]

Still another case offers a graphic illustration of this point. In this instance, a court upheld the IRS's denial of a charitable contribution deduction claimed by a corporation for an alleged donation of real property to a state. The IRS had denied the deduction primarily on the basis that the corporation did not own the real property that it had purported to contribute.[134] On appeal, however, the decision was reversed, with the court—applying the doctrine of collateral estoppel—ruling that the government was barred from challenging the ownership of the property in dispute, on the ground that the issue in a condemnation proceeding and the litigation in the case were identical.[135]

Underlying this matter was a dispute as to the location of a boundary line between a state park and property owned by the corporation. The first survey of the property had placed the line at one location; a subsequent survey had placed it elsewhere. A more contemporary survey confirmed that the first survey was correct. This line-shifting created a strip of property that was the parcel of land involved in the case. Eventually, to settle earlier disputes, the corporation executed a quitclaim deed to the state—and claimed a charitable deduction for the fair market value of the property. Applying the doctrine of collateral estoppel, the court found that the true property line had been established in prior litigation,

---

[130] H. Rep. No. 1337, 83d Cong., 2d Sess. A44 (1954); S. Rep. No. 1622, 3d Cong., 2d Sess. 196 (1954). These reports accompanied IRC § 162(b), which provides that a payment cannot be deducted as a business expense (under IRC § 162) when it is properly deductible as a charitable contribution (under IRC § 170) but is not deductible in a tax year because of restrictions such as the percentage limitations (see ch. 7).

[131] *Transamerica Corporation v. United States*, 254 F. Supp. 504 (N.D. Cal. 1966), *aff'd*, 392 F.2d 522 (9th Cir. 1968).

[132] *Parker v. Commissioner*, 86 T.C. 547 (1986). See also *Snyder v. Commissioner*, 86 T.C. 567 (1986).

[133] *Parker v. Commissioner*, 86 T.C. at 565.

[134] *Kamilche Co. v. United States*, 809 F. Supp. 763 (N.D. Cal. 1992).

[135] *Kamilche Co. v. United States*, 53 F.3d 1059 (9th Cir. 1995).

seemingly adding the land to the corporation's assets. Indeed, the government vigorously argued against application of the collateral estoppel rule.

Over the years, however, the state and the corporation had acted as though the property line were at the place established by the second survey. The state maintained the park property, including the disputed parcel, and placed signs around the park (and the property at issue) identifying all of it as park land. Based on these and other facts, the court concluded that the state had acquired title to the property in dispute by virtue of the doctrine of adverse possession. Thus, although the corporation thought it owned this land at the time of the intended gift, the title, unknown to the corporation, had already shifted to the state by operation of law. Therefore, the charitable deduction was denied, on the basis of the fundamental principle that there cannot be a charitable contribution deduction for a "gift" of property that the "donor" did not own at the time of the transaction.

Likewise, the IRS challenged a charitable contribution promotion program that involved gifts of gravesites to charitable organizations; one of the bases of the challenge was that the "donors" never owned the contributed items. The ground for this contention was that the "donors" did not receive a formal deed to the property. This issue arose twice in 1993 in the U.S. Tax Court, with the court observing that state law controls on this issue[136] and that the states' law on the point did not require a deed for the legal transfer of a gravesite or cemetery lot. The court held that it was adequate, as a matter of "administrative efficiency," to use a deed only for the transfer of the gravesites from the original owners to the charitable donees.[137]

This aspect of the law is further illustrated from a different perspective. Forgiveness by the lender of a debt owed by a charitable organization can give rise to a charitable contribution deduction for that lender. For that to occur, however, there must be, in the eyes of the law, a valid, enforceable indebtedness to forgive. This principle was demonstrated in a court case in which the charitable deduction was denied because the underlying obligation was legally deficient.[138]

In this case, a married couple placed their two children with learning disabilities in a private school, rather than a public one, because of the inability of the public school to adequately serve the children's academic needs. The couple relied on the Individuals with Disabilities Education Act (IDEA) for the assertion that they were entitled to reimbursement from the public school system for the tuition and other expenses incurred in connection with their children's attendance at the private school. They endeavored, nonetheless, to forgive the system's obligation to reimburse them for the expenses and claimed a charitable contribution deduction for the amount forgiven.

The IDEA prescribes a multistage administrative procedure by which individuals in these circumstances establish their right to reimbursement. The parents of these children, however, did not avail themselves of that procedure. Once before the court, they submitted an affidavit concerning their consultations with

[136] E.g., *United States v. Mitchell*, 403 U.S. 190, 197 (1971); *Burner v. Harmel*, 287 U.S. 103, 110 (1932).
[137] *Klavan v. Commissioner*, 66 T.C.M. (CCH) 68 (1993); *Weiss v. Commissioner*, 65 T.C.M. (CCH) 2768 (1993).
[138] *Bond v. United States*, 97-2 U.S.T.C. ¶ 50,868 (N.D. Ill. 1997).

educational, psychological, and legal professionals, who agreed with the parents that they had a valid claim for reimbursement. They also submitted a letter from an educational consultant they had consulted, who expressed the view that the parents were entitled to reimbursement. The court rejected these submissions as inadequate to support an ''unequivalent obligation'' on the part of the public school system to provide the reimbursement.[139]

A statutory path was open to this couple to attempt to establish the requisite unconditional obligation, which could then have served as the predicate for a forgiveness.[140] But, as the court stated, ''they didn't elect to pursue that right.''[141] The court referred to the couple's approach as a ''self-proclaimed unilateral decision.''[142] This was not enough to adequately obligate the school system, so the attempt to make the forgiveness the basis for a charitable deduction failed.

When situations like this are particularly egregious or are otherwise abusive, the courts have the authority to levy certain penalties.[143]

Another illustration of this situation is the carefully contrived *circular gift*. A court case illustrated the point.[144] The transaction involved three related organizations. One was a business league operated in support of small business interests (BL). BL was funded by an individual (A). A also established, with BL funds, a charitable organization (CO). A third organization was a for-profit entity (FP), owned 40 percent by A and 60 percent by BL. Upon application, FP would loan money to a borrower at a 3 percent interest rate, with no principal payment due for 20 years. On the day the borrower received the loan proceeds, he or she would transfer the funds to CO, along with a small contribution from his or her own funds. The borrower would then claim a charitable contribution deduction for the entire amount transferred to CO.

The court found a ''cooperative arrangement'' among the three organizations, facilitated by the fact that A was the sole signatory on the bank accounts of the organizations.[145] The court found the following ''circular flow'' of funds: (1) CO loaned money to BL on a short-term basis at a 2.5 percent interest rate; (2) BL then lent the money to FP for a 20-year term, also at a 2.5 percent rate; (3) FP then lent the funds at a 3 percent interest rate to investors; and (4) the investors would complete the flow by contributing the funds to CO.[146] The consequence of this money circle scheme was that the organizations and the ''contributors'' improved themselves financially. With each transaction, FP received a promise of small interest payments and a repayment of principal in 20 years. CO, while breaking even on the funds ''contributed'' (since it was the source of the funds), received a small contribution from an investor's personal funds with each transaction. Each investor received a large tax benefit from the charitable deduction, a benefit that more than offset the present value of the interest and principal he or she agreed to pay to FP. Said the court: ''The loser in the whole enterprise was the federal

---

[139] *Id*. at 90,440.
[140] 20 U.S.C. § 1415.
[141] *Bond v. United States*, 97-2 U.S.T.C. ¶ 50,868 at 90,440 (N.D. Ill. 1997).
[142] *Id*.
[143] See § 10.14.
[144] *Allen v. Commissioner*, 91-1 U.S.T.C. ¶ 50,080 (9th Cir. 1991).
[145] *Id*. at 87,325.
[146] *Id*.

government, which in effect financed the gains received by the [three related] organizations and the private investors.''[147]

One of the many of these ''donors'' (the subject of the case) was B. He borrowed $22,500 from FP; within 20 minutes of the borrowing, he added $2,500 of his own funds and made a $25,000 ''gift'' to CO. The IRS disallowed $22,500 of the claimed charitable deduction and the matter went to court, where the government prevailed. The denial of the deduction was based on the lack of economic substance underlying the transaction. The court concluded that the three organizations ''operated essentially as an integrated whole'' with respect to the loan program.[148] It viewed the three organizations as a ''single unit'' that was not enriched by the $22,500 ''contribution.''[149] The court observed that the passage of the $22,500 through the three organizations left each of them in essentially the same position as if no contribution had been made. Aside from the $2,500 ''true'' contribution, the court found that the only real economic change at the close of the transaction was B's obligation to pay funds over the next 20 years to FP, a result no different than if B had signed a note to pay CO $22,500 over 20 years. The court observed that this type of promise to make a contribution in the future does not qualify for a current charitable contribution.[150]

(e) Absence of Donor Ownership

A related fundamental principle is that a donor, to be a donor, must contribute property that he, she, or it owns.

An illustration of this principle occurred following the grant by the U.S. Forest Service to two individuals, who owned a ranch, of a permit to graze livestock on a parcel of government-owned land in a neighboring national forest. This permit did not allow the permit holder to transfer or sell it; if the property is sold, the permit has to be waived back to the federal government or be canceled. The ranch was subsequently sold; the grazing permit reverted to the government. These individuals claimed a charitable contribution deduction for the alleged value of the permit. A court held that grazing and livestock use permits of this nature do not convey any title, right, or interest to or in the permit holder. This court observed that, because the federal government already held all right, title, and interest in and to the property, it did not receive any value when the permit was waived back to it. The court sagely noted that ''[o]ne cannot donate something one does not own or possess.''[151]

Another illustration of this fundamental point was provided by a case involving a lawyer who contributed, to a tax-exempt university, files of photocopied materials he received from the federal government in connection with his representation of a criminal defendant in a high-profile case. Under the law of the state involved, a lawyer does not own his or her client's case file but rather maintains mere custodial possession of it. Because this lawyer did not possess an ownership interest in the materials, he, in the words of a court, ''was not legally capable of

---

[147] *Id*.
[148] *Id*. at 87, 326.
[149] *Id*.
[150] See the discussion of gifts of notes at § 6.7.
[151] *Bischel v. United States*, 415 F. Supp. 2d 1211, 1213 (D. Nev. 2006).

divesting himself of the burdens and benefits of ownership or effecting a valid gift of the materials.''[152] Thus, the court ruled that a charitable contribution deduction was not available for this gift.

(f) Donor Recognition

One of the most recent applications of this aspect of the law arose out of the identification of college athletic events using the name of the corporate sponsor (such as the conversion of the Cotton Bowl to the Mobil Cotton Bowl). In 1991, the IRS ruled that the payments received by the tax-exempt organization that sponsors the Cotton Bowl were not gifts but were payments for services rendered, in the nature of advertising.[153]

Charitable organizations became concerned about this ruling, as it had implications far beyond college and university bowl games. The IRS bowl game ruling raised, once again, the question as to when the extent of donor recognition renders a payment not a gift.[154] In the aftermath of this ruling, the IRS promulgated proposed guidelines, the IRS and Congress held hearings, the IRS issued proposed regulations, and legislation was passed. The law in this regard is discussed elsewhere.[155]

Thus, a *gift* or *contribution* is a payment of money or a transfer of property to a charitable organization when the person making the payment or transfer does not receive anything of consequence, of approximate value, in return. As noted, and as discussed elsewhere,[156] a payment may be part gift and part payment for a service or good.

(g) Recommendatory Rights

A donor may make a gift to a charitable organization but retain the right to advise—make recommendations—with respect to the gift property, such as on investment policy or on ultimate disposition of the gift property and/or the income generated by the gift property. Normally, the retention of recommendatory rights does not defeat the transaction from being treated for tax purposes as a gift (in this setting, a deductible charitable gift). The recommendatory right is best illustrated by the circumstances surrounding a donor-advised fund.

Federal law distinguishes between *donor-advised funds* and *donor-directed funds*. The latter type of fund involves an arrangement between a charitable organization and a donor whereby the donor retains one or more rights as to the subsequent disposition of the subject of the gift. By contrast, a donor-advised fund does not have the feature of donor direction, but allows the donor to offer advice as to the use of the property that is the subject of the gift, such as subsequent disposition of the property and/or the income from it.

---

[152] *Jones v. Commissioner*, 129 T.C. 146, 159 (2007). Although this decision was affirmed (560 F.3d 1196 (10th Cir. 2009) *cert. den.*, 2009 WL 2485546 (Oct. 5, 2009)), the appellate court did not address the matter of ownership of the property. Also see § 9.12.

[153] Tech. Adv. Mem. 9147007.

[154] In general, it has long been recognized that the mere publicity for a person as a benefactor of a charitable organization is an incidental benefit that does not adversely impact a charitable deduction. E.g., Rev. Rul. 67-137, 1967-1 C.B. 63; Priv. Ltr. Rul 9350009.

[155] See § 23.3.

[156] See § 22.2.

(1) Pre-2006 Law. Prior to 2006, there was little specific law concerning donor-advised funds. The closest reference in the Internal Revenue Code was the provision for a category of private foundations that can receive contributions subject to the requirement that the donor and his or her spouse annually designate public charities to which the foundation must grant the income and principal of the original contribution; deductible charitable contributions are allowed in these circumstances.[157] This, of course, is a type of private foundation that is closely comparable to a donor-directed fund.

A private letter ruling from the IRS is pertinent to this analysis.[158] This ruling involved a private foundation, the trustees of which determined to transfer all of its assets to a community foundation, which in turn would place the assets in a donor-advised fund. The private foundation remained in existence for the sole purpose of advising the community foundation on the use of the fund for charitable purposes. The IRS ruled that the retention of the ability to make this type of recommendation would not constitute a *prohibited material restriction* as that term is used for purposes of the private foundation termination tax.[159]

The law concerning *prohibited material restrictions* is similar to the law pertaining to the distinctions between donor-directed funds and donor-advised funds. This body of law is found in the federal tax regulations.[160] The test under these restrictions is whether the transferee of assets is prevented from freely and effectively employing the transferred assets or the income from them for charitable purposes. For example, if the transferor reserved the right to direct (designate) one or more public charities to which the transferee must distribute the transferred assets and/or income, that would constitute a prohibited material restriction. The same is true with respect to restrictions on the transferee's ability to maintain or manage the assets, or to any other condition imposed on the transferee that prevents it from exercising ultimate control over the assets received from the transferor. This private letter ruling specifically held that the ability to make the recommendation expressed by the trustees of the private foundation did not constitute a prohibited material restriction.

There is, however, one court opinion that directly relates to this matter.[161] The organization involved in that case was held to be tax-exempt as a charitable organization and a publicly supported entity. It established *subaccounts*; donors made gifts to it and the contributions were held in the appropriate subaccounts. A donor had the right to request that the funds in a subaccount (which was not a separate legal entity), representing gifts made by the donor, be used for one or more certain charitable purposes.

The IRS characterized this organization as a ''mere commercial enterprise which provides service to a collection of clients and accordingly performs no exempt activities.''[162] The IRS also asserted that the organization's ''activities are

---

[157] IRC § 170(b)(1)(E)(iii). See § 3.4(b), text accompanied by *infra* note 458.

[158] Priv. Ltr. Rul. 8836033.

[159] IRC § 507. See *Private Foundations* § 13.3.

[160] Reg. § 1.507-2(a)(8)(iii).

[161] *National Foundation, Inc. v. United States*, 87-2 U.S.T.C. ¶ 9,602, 13 Ct. Cl. 486 (1987). See also *The Fund for Anonymous Gifts v. United States*, 99-1 U.S.T.C. ¶ 50,440 (D.C. Cir. 1999), *vacating & remanding* 97-2 U.S.T.C. ¶ 50,710 (D.D.C. 1997).

[162] *National Found.*, 13 Cl. Ct. 486, 491 (1987).

all originated, funded, and controlled by small related groups, by single individuals, or by families'' and that ''these individual donors retain full control of the funds.''[163] The court, however, rejected this characterization and the view that the organization was merely a ''conduit'' of gifts.[164] Indeed, the court found that the donors to this organization ''relinquish all ownership and custody of the donated funds or property'' and that the organization is ''free to accept or reject any suggestion or request made by a donor.''[165] Rather than a ''federation of individual clients serviced by a central organization,'' as the IRS asserted, the court held that the organization was a publicly supported charitable organization that ''exercises full control over the donated funds and exercises independent discretion as to the charitable disbursement of the funds.''[166]

The IRS is studying the matter of donor-directed funds, both as to their public charity/private foundation status[167] and the treatment of transfers to them as gifts.[168] This study is embracing donor-advised funds, notwithstanding an IRS private letter ruling to the contrary.[169] The withdrawal of the revenue ruling concerning maintenance of pooled income funds by community foundations is another manifestation of the difficulties the IRS is having in this area.[170]

The extent to which a donor can maintain any input over the use and ultimate disposition of a gift to a charitable organization is directly addressed by the Internal Revenue Code and the tax regulations in analogous areas. As discussed, however, the IRS has indicated that the specific rules to follow are those enumerated in the context of private foundation status termination.[171]

One of these bodies of law pertains to publicly supported community trusts. Although the tax regulations are generally silent on the matter of donor-directed funds and donor-advised funds, in the sense of use of that phraseology,[172] the regulations pertaining to qualified publicly supported community trusts directly relate to this matter of recommendatory rights. The regulations speak of these trusts as organizations that often receive contributions that are ''maintained in the form of separate trusts or funds, which are subject to varying degrees of control by the governing body'' of the trust.[173] When certain criteria are satisfied, the community trust will be treated as a ''single entity, rather than as an aggregate of separate funds.''[174] One of these criteria is that the transferred assets may not be subjected to ''any material restriction or condition.''[175] That phrase is defined by the private foundation rules, as discussed above.[176] These regulations state that gifts made to a fund that is a component part of a qualified community trust are

---

[163] *Id.*
[164] *Id.* at 492.
[165] *Id.* at 493.
[166] *Id.*
[167] See § 3.4.
[168] Gen. Couns. Mem. 39875, which withdrew Gen. Couns. Mem. 39748.
[169] Priv. Ltr. Rul. 9250041.
[170] Rev. Rul. 93-8, 1993-1 C.B. 125, *revoking* Rev. Rul. 92-108, 1992-2 C.B. 121. See § 13.9(b).
[171] See text accompanied by *supra* notes 159 and 160.
[172] The exception to this observation being the regulations accompanying IRC § 170(b)(1)(E)(iii); see *supra* note 157.
[173] Reg. § 1.170A-9(e)(10).
[174] Reg. § 1.170A-9(e)(11)(i).
[175] Reg. § 1.170A-9(e)(11)(ii)(B).
[176] See text accompanied by *supra* note 159.

considered to be gifts made to the trust for purposes of computing public support; the implication is unmistakable that these gifts are also deductible by the donors, notwithstanding the structure of the recipient charity or the recommendatory rights the donors may have.

Another of these bodies of law involves the grantor trust rules.[177] These rules also are used to evaluate whether a grantor (donor) has retained rights with respect to the transferred property that would cause the transaction to be something other than an outright gift. These rules look to determine whether the grantor has, despite the transaction, retained significant ownership interests.

Still another of these bodies of law relates to the general rule that U.S. donors cannot make deductible contributions to charitable organizations in countries outside the United States (with a few exceptions created by tax treaties[178]). As a consequence of this rule, foreign charities often establish subsidiary charitable organizations in the United States. The federal tax law thus is applied to evaluate whether the domestic charity is merely a conduit of funds to the foreign charity. The U.S. donor becomes entitled to a charitable contribution deduction only when the U.S. charity has complete discretion and control over the gift. When this is the case, the domestic donor is considered to have made a valid gift to the domestic charitable organization.

Consequently, it is clear that the retention of mere recommendatory rights does not prevent a transfer from being considered a *gift*. This conclusion is based on the private foundation status termination rules, the community trust rules, the grantor trust rules, and the conduit charity rules.[179] This conclusion was ratified when Congress, in 2006, enacted a statutory law regime for donor-advised funds, including the concept of the *advisory privilege*.[180]

(2) Statutory Regime. The federal tax law as to donor-advised funds was considerably augmented in 2006, when Congress created statutory law defining the concept of the *donor-advised fund*, along with a host of other rules and tax penalties. Basically, a donor-advised fund is an account (1) that is separately identified by reference to contributions made by one or more donors, (2) that is owned and controlled by a public charity (known as a *sponsoring organization*), and (3) as to which a donor or an advisor to a donor has, or reasonably expects to have, the ability to make recommendations (known as an *advisory privilege*) with respect to the distribution or investment of amounts held in the account by reason of the donor's status as a donor.[181]

(h) Anticipatory Income Assignments

A transaction may appear to be a charitable gift of property but, in actuality, be an anticipatory assignment of the income from the property that would otherwise

---

[177] See § 3.7.
[178] See ch. 18.
[179] The IRS ruled that a donor is entitled to an income tax charitable deduction for a contribution of money or other property to a charitable organization where the donor, or the donor's investment manager, retained the power, under certain conditions, to manage the gift property in a designated account. Priv. Ltr. Rul. 200445023. See § 8.2(k), text accompanied by notes 67–69.
[180] See § 23.4.
[181] IRC § 4966(d)(2)(A).

have flowed directly to the transferor. If that is the case, the charitable contribution deduction is determined as if the gift were of money first received by the donor from the property,[182] subject to the 50 percent limitation,[183] rather than a gift of the property, such as long-term capital gain property subject to the 30 percent limitation.[184] Also, if the property has appreciated in value, the donor may be taxable on the resulting gain.[185]

An anticipatory assignment of income occurs in the charitable giving setting when a person has certain rights in the contributed property that have so matured or ripened that the person has a right to the proceeds from the property at the time the transfer is made.[186] If the transaction is an assignment of income, there may not be a charitable contribution deduction for the fair market value of the property transferred; the transferor may be taxable on the proceeds diverted to the charitable organization, and the charitable deduction may be determined as if the gift were of the after-tax income.

The distinction between a gift and an assignment of income is rarely easy to make. All that is clear in this area is that the assignment-of-income doctrine must be applied on a case-by-case basis.[187] As one court stated: "Whether a taxpayer possesses a right to receive income or gain is, of course, a question of fact, each case turning on its own particular facts. The realities and substance of the events, rather than formalities . . . must govern . . . [the] determination of whether an anticipatory assignment of income occurred."[188]

A court opinion illustrated the sometimes narrow difference between the two types of transfers. A federal district court ruled that a gift to a charitable organization of the long-term capital gains in certain commodity futures contracts gave rise to a charitable contribution deduction for the transfer of that property, and that the transaction was not an anticipatory assignment of income.[189] The case turned on the court's finding that the donor did not retain control over the timing of the sales of the futures contracts by the recipient charitable organization.

The case concerned an individual who formed a charitable organization in the early 1970s and had been president of it since it was established. The organization had a board of trustees which, the court concluded, the founder did not control. From time to time, the founder contributed futures contracts to the organization and claimed charitable contribution deductions for these transfers. Indeed, in 1974, he obtained a private letter ruling from the IRS holding that the contributions gave rise to charitable contribution deductions for the value of the futures contracts and that he need not recognize any gain when the organization sold the contracts. In 1981, however, the federal tax law changed. Beginning with that year, all commodities futures contracts acquired and positions established

---

[182] E.g., *Helvering v. Horst*, 311 U.S. 112 (1940).
[183] See § 7.5.
[184] See § 7.8.
[185] The anticipatory assignment-of-income doctrine can be similar to the step transaction doctrine. The latter doctrine is the subject of § 4.8.
[186] E.g., *Morgan Guaranty Trust Co. v. United States*, 585 F.2d 988, 994 (Ct. Cl. 1978); *S.C. Johnson & Son, Inc. v. Commissioner*, 63 T.C. 778, 786 (1975).
[187] *Harrison v. Schaffner*, 312 U.S. 579 (1941).
[188] *Peterson Irrevocable Trust No. 2 v. Commissioner*, 51 T.C.M. (CCH) 1300, 1316 (1986), *aff'd*, 822 F.2d 1093 (8th Cir. 1987).
[189] *Greene v. United States*, 806 F. Supp. 1165 (S.D.N.Y. 1992).

had to be marked to market at year-end, and the gains (or losses) had to be characterized as being 60 percent long-term capital gains (or losses) and 40 percent short-term gains (or losses), regardless of how long the contracts had been held.[190] This law change posed a problem for the donor, because the charitable deduction for a gift of short-term capital gain property is confined to the donor's basis in the property;[191] there is no deduction for the full fair market value of the property (as there is for most gifts of long-term capital gain property.)[192] He decided to solve the problem by donating to the organization only the long-term gain portion of futures contracts. In 1982, this individual entered into an agreement under which he contributed to the charitable organization the long-term capital gains of selected futures contracts from his personal accounts at a brokerage house and retained for himself the short-term capital gains. For the most part, the selected contracts were sold on the same day that the gift was made and the portions of the proceeds representing the long-term capital gains were transferred to an account of the organization at the same brokerage house. The donor chose the futures contracts to be donated according to the funding needs of the organization and the amount of unrealized long-term capital gains inherent in them. Once the contracts were transferred to a special account, they were to be sold, pursuant to a standing instruction.

On audit for 1982, the IRS took the position that the full amount of the capital gains on the sales of these contracts was includable in this individual's taxable income. The IRS also disallowed the charitable contribution deductions for that year and prior years. The IRS's position rested on two arguments, one of which was that the transfers of portions of the gain to the organization were taxable anticipatory assignments of income.[193]

The anticipatory assignment rationale had this individual not making gifts of the futures contracts but, instead, giving to the charity money in an amount equal to 60 percent of the contracts sold; he was characterized as receiving the gain and then diverting a portion of it to the organization in an attempt to shield himself from tax liability. The government contended that the organization did not bear any risk in the commodities market, but was simply the recipient of an assignment of the realized long-term capital gains. By contrast, the individual contended that the assignment-of-income theory was inapplicable because no contract for the sale of the property was in existence before the donation was made. His argument was that his right to receive at least some of the proceeds had not matured to the point where a gain from the sale should be deemed to be his income. He argued that he neither controlled the value of the donated interests nor retained any legal right to receive any matured unrealized long-term capital gains that might be realized on sales of the futures contracts.

The court was somewhat troubled by the fact that, as both a director and the president of the organization, as well as the one who timed the initial transfers, this individual appeared to be in a position to ensure that the futures contracts would be sold immediately and that the short-term gains would flow to him at

---

[190] IRC § 1256(a)(3).

[191] IRC § 170(e)(1)(A). See § 4.4(b).

[192] See § 4.3.

[193] The other argument was that the gains on the sales of the futures contracts were taxable by reason of the step transaction doctrine. See § 4.8.

the time of his choosing, while taxes on the long-term gains were avoided. The court conceded that the ''retention of the short-term gains gave the transaction more the appearance of an income assignment.''[194] Nonetheless, the pivotal and deciding issue involved the standing instruction and this individual's influence over it. The evidence showed that the decision to shift contracts to the special account was that of the full board of trustees of the organization and not its president. Thus, the court held that this individual did not have control over the timing of the disposition of the futures contracts once they were transferred to the special account of the charitable organization. The court ruled that ''the donation of the contracts' long-term capital gain, while less tangible than many other forms of gifts, should still be considered a donation of the property.''[195] The court also held that this individual's ''donations of their [the contracts'] long-term capital gain should not properly be considered an anticipatory assignment of income.''[196] Under the court ruling, the donor was not taxable on the long-term capital gain contributed to the foundation, and the charitable deduction was upheld.

An earlier case also illustrated application of the assignment-of-income doctrine. Under the facts of that case, the directors of an insurance company adopted a plan of liquidation, which the corporation's stockholders promptly and overwhelmingly approved. Thereafter, the company obtained approval from the department of insurance in the state in which it operated for the issuance of reinsurance agreements, and for the sale of goodwill and fixed assets to another insurance company. The directors of the company then approved several liquidation arrangements and authorized notification to the stockholders that the first liquidating dividends would be exchanged for stock later that year.

After the liquidation arrangements were approved and before the liquidating distributions began, one of the stockholders contributed stock in the corporation to various public charities. The distributions were subsequently made as planned, and the process of liquidation was soon thereafter completed. The stockholder claimed a charitable contribution deduction for the gift of the stock. The IRS allowed the charitable deduction but, viewing the transactions as anticipatory assignments of income in the form of the liquidation proceeds, taxed the donor on the income subsequently paid to the charities (equivalent to the long-term capital gain generated by the liquidation). A court upheld the IRS's position.[197]

The outcome of this case turned on the likelihood of completion of the liquidation proceedings. The lower court found that the shareholders of the company could have abandoned the liquidation proceedings after these gifts were made and thus that the contribution should not be treated as an anticipatory assignment of the liquidation proceeds. The appellate court, however, decided that, under the facts, the ''realities and substance'' rather than ''hypothetical possibilities'' of the matter showed that the donor expected the liquidation proceedings to be completed and that the likelihood of rescission of the proceedings was

[194] *Greene v. United States*, 806 F. Supp. 1165, 1170 (S.D.N.Y. 1992).
[195] *Id*. at 1172.
[196] *Id*.
[197] *Jones v. United States*, 531 F.2d 1343 (6th Cir. 1976), *overruling Jacobs v. United States*, 390 F.2d 877 (6th Cir. 1968).

remote.[198] The fact that the donor was not a controlling shareholder of the liquidating company was not ''pivotal'' to the court's determination.[199]

A comparison of these two cases shows how fine the line of demarcation in this area can be. In the more recent of the two cases, control was the determining factor; in the other, control was ''only one factor'' in the determination.[200] In the more recent case, the donor was found not to know with ''virtual certainty'' that the contracts would be sold, but only to have had knowledge that gains from the sales were a ''reasonable probability.''[201] There is little distinction between ''reasonable probabilities'' and ''realities and substance.''

When control is clearly present, however, the courts are far more likely to conclude that there has been an anticipatory assignment of income. Thus, in one case, a majority stockholder in a closely held corporation donated part of his holdings to nine charitable organizations approximately nine months after the corporation adopted a plan of liquidation. The court, finding an assignment of income, wrote:

> The shareholders' vote is the critical turning point because it provides the necessary evidence of [the] taxpayer's intent to convert his corporation into its essential elements of investment basis and, if it has been successful, the resulting gains. This initial evidence of the taxpayer's intent to liquidate is reinforced by the corporation's contracting to sell its principal assets and the winding-up of its business functions. In the face of this manifest intent, only evidence to the contrary could rebut the presumption that the taxpayer was, in fact, liquidating his corporation. Yet here the record is barren of any evidence that the taxpayer had any intent other than that of following through on the dissolution. The liquidation had proceeded to such a point where we may infer that it was patently never [the] taxpayer's intention that his donees should exercise any ownership in a viable corporation, but merely that they should participate in the proceeds of liquidation.[202]

Thus, the court concluded that the gift was an assignment of the liquidation proceeds.

In a similar case, a court held that a majority shareholder's contribution of stock in a corporation that was about to be liquidated constituted an anticipatory assignment of liquidation proceeds, and that the taxpayer was not entitled to exclude from gross income the capital gains resulting from the distribution.[203] The court identified three reasons why it was unlikely that the plan of liquidation would be abandoned: (1) the plan of liquidation had been adopted in conformity with federal tax law, which requires that the liquidation must occur within one year to avoid a taxable gain on the sale of assets; (2) the donee, although holding a majority of the stock, did not have the requisite two-thirds control to unilaterally prevent the liquidation; and (3) the donee's policy was to liquidate

---

[198] *Id.*, 531 F.2d at 1345-46.
[199] *Id.* at 1346, n. 3.
[200] *Id.* at 1346.
[201] *Greene v. United States*, 806 F. Supp. 1165, 1169 (S.D.N.Y. 1992). This case was affirmed in an opinion containing an extensive discussion of the anticipatory assignment-of-income doctrine as it applies in the charitable giving setting. 13 F.3d 577 (2d Cir. 1994). In subsequent unsuccessful litigation, the IRS attempted to cause denial of the charitable deduction on the ground that the gift was an unqualified gift of a partial interest in property (see § 9.23) and cause the realization as income of the capital gain inherent in the gifted property (see § 9.11).
[202] *Hudspeth v. United States*, 471 F.2d 275, 279 (8th Cir. 1972).
[203] *Kinsey v. Commissioner*, 477 F.2d 1058 (2d Cir. 1973).

shares of stock given to it. The court wrote that, "[r]ealistically considered, in the light of all the circumstances, the transfer of the stock . . . to [the charitable organization recipient] was an anticipatory assignment of the liquidation proceeds."[204] Thus, the reality was that the liquidation of the contributed stock was certain before the stock was donated to the charitable organization.

In another case, a court held that the contribution of stock warrants to charitable organizations was not an anticipatory assignment of income, and that what otherwise would have been taxable capital gain was not recognized in the hands of the donors.[205] It found that the charitable donees were not legally bound, nor could they be compelled, to sell their warrants. The government's contention that the donors' rights to receive the proceeds of the stock transaction had "ripened to a practical certainty" at the time of the gifts, and that there was a pending "global" transaction for the purchase and sale of the stock involved at the time of the gifts,[206] was rejected. The position of the IRS in the case was seen as being in "stark contrast" to the agency's stance as articulated in a revenue ruling;[207] the court ruled that the IRS was bound by its ruling, which the court characterized as a "concession."[208]

The import of this body of law is not a particular concern for donee charitable organizations. They receive the contributed items and can treat them as gifts. The matter, however, essentially goes to the question of deductibility of the transfers (or the extent of deductibility) and whether the transferor must recognize income or capital gain as the result of the transaction.

(i) Credit Card Rebate Plans

Users of certain types of credit cards make a deductible charitable contribution when a percentage of the price of items (less an administration fee) purchased with the card at participating retailers is transferred to a charitable organization selected by the cardholder.[209] (This is one of the few instances in which a deductible charitable gift can be made with funds that are not taxable as income.)

A company sponsors a series of credit and debit cards that are identified with the company's name. These cards are issued to cardholders throughout the country by banks that have entered into license agreements with the company; the banks may charge an annual fee to the cardholders. The company negotiates agreements with retailers, pursuant to which a percentage of the purchase price

---

[204] *Id*. at 1063. Likewise, *Ferguson v. Commissioner*, 108 T.C. 244 (1997), *aff'd*, 99-1 U.S.T.C. ¶ 50,412 (9th Cir. 1999), in which stock was contributed to charities immediately before the issuer corporation merged following a cash tender offer; the gift was made after the stock changed into a fixed right to receive money, so the donors were taxable on the gain in the stock transferred. This case is discussed in § 6.5, text accompanied by notes 36–37.

[205] *Rauenhorst v. Commissioner*, 119 T.C. 157 (2002).

[206] *Id*. at 167, 168.

[207] Rev. Rul. 78-197, 1978-1 C.B. 83. See § 4.8, note 73.

[208] *Rauenhorst v. Commissioner*, 119 T.C. 157, 173 (2002). The court used the occasion of this opinion to note that although the "general principles underlying the assignment of income doctrine are well established," the "precise contours of the anticipatory assignment of income doctrine in the context of charitable contributions of appreciated property have been the subject of some contention." *Id*. at 163, 164. In general, Haims, "Assignment of Income: Has *Ferguson* Hastened the 'Ripening' Process?," 28 *Exempt Org. Tax Rev*. (no. 3) 475 (June 2000); Walker, "Gifts of Appreciated Property and the Assignment of Income Doctrine," 11 *J. Tax. Exempt Orgs*. (no. 5) 195 (Mar./April 2000).

[209] E.g., Priv. Ltr. Rul. 9623035.

is transferred to the company when one of these cards is used to purchase an item from a participating retailer. When they first receive their company cards, and periodically thereafter, cardholders receive a list of participating retailers. They also are informed of the percentage of the retail purchase price that each participating retailer will pay to the company. After a sale by a participating retailer to a cardholder, the agreed-upon percentage of the purchase price is transferred to the company by the bank (or its agent) that processes the transaction. Of this amount, an administration fee—approximately 20 percent—is retained by the company.

The balance of the amount transferred to the company is placed in a custodial account maintained by the company on behalf of each cardholder; these amounts are considered to be rebates. When they apply for one of these cards, applicants are asked to designate a charitable organization to which they want to have their rebates paid. Cardholders are free to change the designation at any time by notifying the company. Rebates earned appear as a line item on the cardholders' monthly statements from the issuing banks. If the cardholder returns to the retailer an item of merchandise purchased with one of these cards, the amount of the corresponding rebate is deducted from the rebate amount held in the cardholder's custodial account. At the end of each calendar quarter, the company transfers rebates that have accumulated in the various custodial accounts to the charitable organizations selected by the cardholders. For the fourth calendar quarter, these transfers will be made before the end of the calendar year. The cardholders do not receive anything in exchange for the payments to charitable organizations of their rebates.

Instead of causing the company to pay their rebates to a charitable organization, however, cardholders may obtain the rebates for their personal use. Unless they advise the company of their intention to obtain the rebates for themselves, cardholders' rebates are automatically paid over to the designated charities. When the company makes a payment to a charitable organization on behalf of a cardholder, the company provides the organization with the amount of the cardholder's contribution, together with the cardholder's name and address. The company also provides each cardholder with an annual statement reflecting the total amount transferred to a charitable organization on behalf of that cardholder.

The IRS concluded that these rebates paid to charitable organizations are gifts to the organizations by the cardholders. In finding satisfaction of the requirements that a gift be made voluntarily and with charitable intent, the IRS observed that each cardholder has the choice of directing the company to refund rebates to the cardholder or to transfer them to a charitable organization. Moreover, the cardholders also have the opportunity to select the charitable organizations that will receive payments of their rebates. The IRS ruled that the opportunity to decide whether payments will be made to a charity, together with the ability to designate the charity to receive the payments, renders the payments voluntary. The IRS also ruled that these directed rebates are deductible charitable gifts.[210]

---

[210] In almost every charitable gift situation involving money, the contribution is made with after-tax dollars. That is, the funds must first be taken into income before they can be deductible when transferred to charity. Here, however, the IRS concluded that a rebate paid by a retailer participating in the card program is not income to the cardholder. Rather, the rebate reflects a reduction in the purchase price paid for an item purchased with the company's card. This holding is based on Rev. Rul. 76-96, 1976-1 C.B. 23, stating that rebates paid by an automobile manufacturer to qualifying retail customers who purchase new automobiles are not includible in the gross income of the customers.

(j) Dividends Paid to Charities as Stockholders

When a for-profit corporation transfers, without consideration, money or property to a charitable organization that is its sole shareholder, the transfer is treated for federal tax purposes as a distribution constituting a dividend[211] and not as a charitable contribution.[212]

The reasoning underlying this rule of law was articulated by a federal court of appeals in 1967.[213] The court observed that (1) the rationale of the unrelated business income rules is to treat, for tax purposes, tax-exempt organizations with unrelated business income the same as for-profit organizations;[214] (2) to allow a subsidiary of an exempt organization a charitable deduction for amounts distributed to its exempt parent would permit the exempt organization to receive a greater return on its investment in its unrelated business (conducted indirectly by means of the subsidiary) than a nonexempt organization; and (3) it is from this competitive advantage that Congress intended to protect competing for-profit businesses not linked to an exempt organization by taxing unrelated business income of exempt organizations and by limiting an exempt organization's charitable contribution deduction from unrelated business income to grants made to other exempt organizations.[215] This appellate court concluded that an ostensible contribution made by a for-profit subsidiary to its exempt parent is not a contribution considered to be made to another exempt organization, and therefore the benefits of the charitable deduction are not available to it for property transfers of this nature.[216]

Dividend treatment in this context can arise even when the charitable organization receiving a payment from a for-profit corporation is not a stockholder. In one case, a for-profit corporation, organized and operated for the purpose of benefiting a university, distributed funds to the university out of its earnings and profits. The university was not a stockholder of the corporation and did not exercise any control over it. Nonetheless, noting that the profits of the corporation were distributed only to the university, a court held that the university was a beneficial owner of the corporation and applied the dividend treatment rationale accordingly.[217]

(k) Requirement of *Completion*

Explicit and implicit in the foregoing discussion is the concept that, to constitute a *gift*, the transaction must be *completed*. Thus, to make a charitable gift, the donor must part with all right, title, and interest in the donated property.[218]

---

[211] IRC § 316(a), which defines a *dividend* as a distribution of property by a corporation to its stockholders out of its earnings and profits.
[212] Rev. Rul. 68-296, 1968-1 C.B. 105. Dividends are not deductible by the payor corporation.
[213] *Crosby Valve & Gage Company v. Commissioner*, 46 T.C. 641 (1966).
[214] See § 3.5.
[215] As to the latter, see IRC § 512(b)(10).
[216] Also *Dave Inv. Co. v. Commissioner*, 462 F.2d 1373 (9th Cir. 1972).
[217] *United States v. Knapp Brothers Shoe Manufacturing Corporation*, 384 F.2d 692 (1st Cir. 1967), *cert. den.*, 390 U.S. 989 (1968).
[218] The rules are somewhat different in this regard in such contexts as planned giving (see Part Four) and *quid pro quo* situations (see § 22.2), but even there the statement is correct as to the deductible portion of the transaction.

Two situations nicely illustrate the point. A court held that a bargain sale[219] of real estate to a charity, in a transaction that used a contract for deed, gave rise to a charitable deduction in the year the contract was entered into, because the charity essentially received equitable title to the property.[220] In 1994, a married couple signed a contract for sale of real property to a church. The purchase price was to be paid in installments, beginning January 1, 1995. Basically, a *contract for deed* is an arrangement under which, once a down payment is made, the buyer becomes entitled to immediate possession of the property. Legal title, however, remains in the seller until the purchase price is paid in full. In this case, the charity also agreed to insure the property, keep it in good repair and condition, and pay property taxes. The charity was prohibited from assigning, selling, pledging, or mortgaging the property without the donors' consent. Legal title was conveyed to the charity at the end of 1997.

The IRS did not contest the value of the property used to calculate the charitable deduction.[221] The charity was a qualified charitable donee;[222] the IRS conceded that the donors had the requisite charitable intent.[223] The sole issue before the court was whether the donors' entry into the contract for deed effected a *completed gift* of the property during 1994. Framing the issue this way, the court had to determine (1) whether the interest conveyed was sufficient to constitute a completed gift, and (2) when the sale and gift were completed. The IRS took the position that this type of contract did not give rise to a completed gift at the time it was entered into.

State law controls the determination of the nature of the property interest conveyed by one party to another. This law usually is found in pronouncements by the state's highest court. The court in this case, following this analysis, concluded that the purchaser under a contract for deed becomes the equitable owner of the property.

The question of whether a sale of property is complete for tax purposes is one of fact, which is resolved by an examination of all the facts and circumstances. Essentially, the matter comes down to a consideration of when the "benefits and burdens" of ownership shifted. In the case of real property, a sale generally is considered to have occurred at the earlier of the transfer of legal title or the practical assumption of these benefits and burdens.

The court wrote: "A closed transaction for Federal tax purposes results from a contract of sale which is absolute and unconditional on the part of the seller to deliver to the buyer a deed upon payment of the consideration and by which the purchaser secures immediate possession and exercises all the rights of ownership."[224] Having written that, the court noted that there can be a delay in the delivery of the deed and that payment of the purchase price may be deferred by installment payments. Ownership of property, observed the court, amounts to a "bundle of rights with respect to the property."[225]

---

[219] See § 9.19.
[220] *Musgrave v. Commissioner*, 80 T.C.M. (CCH) 341 (2000).
[221] See § 10.1.
[222] See § 3.3.
[223] See § 3.1(a).
[224] *Musgrave v. Commissioner*, 80 T.C.M (CCH) 341, 344 (2000).
[225] *Id*.

In the case, the court sided with the donors. It concluded that the ''bundle of rights that the [charity] received is essentially the same bundle of rights that would have been received had the church obtained legal title to the property and granted a mortgage back'' to the donors.[226] The gift was determined to have been made in 1994, not 1997.

The other situation concerned contributions to a donor-advised fund maintained by a charitable organization on its Internet Web site.[227] Donors are informed that contributions to the donor-advised fund are unconditional and irrevocable. They must affirmatively acknowledge that fact by clicking on a specific field. They are told that ultimate discretion over transfers out of the donor-advised fund lies with the organization. Recommendations from a donor may be followed only after the organization conducts the appropriate due diligence. The organization's policy is to follow the donor's advice, as long as the recommended recipient is a public charity and is prepared to accept the gift. Distributions are not to be made to individuals, private foundations, or other donor-advised funds.

This organization qualifies as a publicly supported charity.[228] The question in this instance was whether transfers to the donor-advised fund constitute the requisite support as contributions. The IRS, in answering this question, looked to the regulations concerning the termination of private foundation status. There it is stated that, to effectuate a transfer of ''all its right, title, and interest in and to all of its net assets,'' a transferor foundation may not impose any material restriction or condition that prevents the transferee organization from freely and effectively employing the transferred assets, or income from them, in furtherance of exempt purposes.[229]

The IRS wrote that the core issue is whether an organization exercises ''dominion and control'' over the asset so as to be considered its owner. Though the IRS did not say so, the issue was whether donors' ability to make these recommendations, and the organization's policy of generally following these recommendations, amounted to a *material restriction or condition*. Without discussion, the IRS ruled that contributions made to this organization, destined for the donor-advised fund, constitute support from the general public.[230]

(l) Employee Hardship Programs

It is common for a for-profit corporation with a large number of employees to have or otherwise participate in a program, administered by a separate organization, by which the employees are provided financial assistance, in the form of gifts and/or loans, in times of temporary extreme hardship due to circumstances such as natural disasters. The IRS has struggled with the tax law aspects of this over the years, ruling on occasion that these organizations are tax-exempt charitable entities, with the private benefit to the employer incidental, and on other occasions that these entities cannot qualify for exemption because the private benefit to the employer is more than insubstantial. Also, if the separate organization is a

---

[226] *Id*.
[227] See § 3.1(f).
[228] See § 3.4.
[229] Reg. § 1.507-2(a)(8).
[230] Priv. Ltr. Rul. 200037053.

private foundation,[231] the IRS has on occasion taken the position that the provision of this type of assistance can amount to self-dealing and the making of taxable expenditures.[232] Another issue is whether contributions to an organization administering this type of program, often made by the corporation's employees, are deductible as charitable gifts.

In one instance, the IRS ruled that contributions made to such an entity constituted deductible gifts.[233] The employer was a large corporation, engaged in retail sales worldwide, with many employees. The principal activity of a public charity, not controlled by the employer, was the making of gifts or loans to employees (and their dependents) of the corporation and its subsidiaries, who were in demonstrated need. The IRS was of the view that the class of eligible recipients was sufficiently broad to constitute a charitable class.[234] (About 5 percent of the employees held salaried management-level positions.) The assistance was provided in cases of "unexpected temporary extreme financial hardship."

Selection of aid recipients was based on objective criteria and demonstration of need, and was made by an independent selection committee or under adequate substitute procedures. The charitable organization was expected to be principally funded by the corporation's employees; contributions could be made by means of an automatic payroll deduction system. The corporation did not reimburse or otherwise compensate its employees for contributions made to the charity, nor did it require the making of gifts or participation in the payroll deduction plan as a condition of employment. The corporation did not charge the charity for any of its services pursuant to the payroll plan. In this situation, the IRS was of the view that charitable purposes were primarily being furthered, that the benefit to the employer was no more than insubstantial, and that contributions to the charitable organization were, as noted, deductible gifts.[235]

In another instance, this type of a program was established by a public charity, as a fund within it, for the benefit of its employees who required emergency services because they had become financially needy or suffered economic hardship due to accident, loss, or disaster.[236] Again, the IRS ruled that gifts to the fund qualified for the charitable contribution deduction.[237]

(m) Mandatory Payments

The concept of the *mandatory contribution* has an oxymoronic ring to it, and for good reason, in that deductible charitable contributions are generally required to be *voluntary*.[238] Yet there are transfers to charitable organizations that are

[231] See § 3.4(c).
[232] See *Private Foundations* chs. 5 and 9.
[233] Priv. Ltr. Rul. 200307084.
[234] See § 3.3(b), text accompanied by *infra* notes 334–344.
[235] Amounts transferred by or for employers to or for the benefit of employees are presumed not to be gifts, but rather items of gross income. IRC § 102(c). The IRS ruled that this rule is "inoperative" in this case because the payments are made by the charitable organization.
[236] Priv. Ltr. Rul. 200243050.
[237] A full discussion of the legal aspects of these programs is in *Private Foundations* §§ 9.3(b), text accompanied by notes 97–100.17, and 9.3(e), text accompanied by note 137 (2010 supp.).
[238] See § 3.1(a).

mandated by law, court order, contract, or even the charitable entity itself.[239] Intermixed with this topic is another general rule, which is that deductible contributions are often expected to be supported with *donative intent*.[240]

An illustration of a mandatory payment to a charitable entity was the dedication of a parcel of land by an individual to a county for use as a public street; the transfer was disallowed as a charitable contribution because the individual was obligated by contract to sell the land to a church.[241] Similarly, an individual was not allowed to deduct a sum paid to fill a gully in a city street, inasmuch as the payment was made in compliance with an order issued by the city.[242] Likewise, a payment made to a tax-exempt retirement home to reserve a room for the payor or a relative of the payor was not a deductible charitable gift.[243] Further, a seller of a home in conjunction with a down payment assistance program conducted by a nonprofit organization, who was obligated to make a ''contribution'' to the organization in an amount equal to the down payment grant provided by the organization to the purchaser of the home, was advised by the IRS that payment was a fee-for-service and not a deductible contribution.[244]

By contrast, when the payor has a choice or an election to make, a payment to a charitable organization can constitute a charitable gift. Thus, when a charitable organization required participants in a group insurance plan to assign dividends to it as a condition of continued participation in the plan, the payments were held to be nondeductible.[245] Subsequently, however, the plan terms were amended to make refund of the dividends an easy-to-exercise option; the IRS ruled that the payments to the charitable organization under the revised circumstances were deductible as charitable gifts.[246]

In analogous circumstances, credit card holders voluntarily elected to contribute rebates generated by their credit card purchases to charitable organizations. The IRS ruled that the payments were deductible as charitable gifts.[247] Likewise, when a ''sponsorship gift'' was requested, but not required, in connection with admission to an exempt retirement home, the payment was considered to be a deductible charitable gift.[248]

The Supreme Court observed that a payment proceeding from the ''constraining force of a moral or legal duty'' is not a charitable gift.[249] This principle was applied by a court in concluding that a portion of the amount paid to an

---

[239] As to the latter, some charitable organizations have policies, perhaps reflected in bylaws, requiring individuals to contribute, often annually, as a condition of serving on the governing board. In some instances, a specific amount is mandated.

[240] See § 3.1(a).

[241] *Taynton v. United States*, 60-1 U.S.T.C. ¶ 9,458 (D. Va. 1960).

[242] *Alman v. Commissioner*, 39 T.C.M. (CCH) 527 (1979).

[243] E.g., *Sedam v. United States*, 518 F.2d 242 (7th Cir. 1975).

[244] E.g., Priv. Ltr. Rul. 200534022. Indeed, because the organization characterized the sellers' payments in connection with this program as ''voluntary contributions,'' the IRS held that the organization was ''encouraging the avoidance of federal income tax,'' which was seen as a nonexempt activity that was one of the bases precluding the organization from acquiring recognition of tax exemption.

[245] *United States v. American Bar Endowment*, 477 U.S. 105 (1986).

[246] Priv. Ltr. Rul. 8725058.

[247] Priv. Ltr. Rul. 200228001.

[248] *Dowell v. United States*, 553 F.2d 1233 (10th Cir. 1977).

[249] *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960).

educational society was in the nature of fees for tuition, in connection with education of the payors' children, and thus was not a charitable contribution.[250]

§ 3.2 MEANING OF *DONOR*

A *donor* is a person who makes a gift. A donor obviously can make a gift (or contribution) to a charitable organization. A donor may or may not obtain a contribution deduction as the result of a charitable gift. Many factors can operate to determine this outcome.[251]

There are several types of donors, that is, several categories of persons who can make contributions to charitable organizations:

Individuals
C corporations[252]
S corporations[253]
Partnerships[254]
Limited liability companies[255]
Trusts[256]
Estates[257]

Organizations that are pass-through entities are not entitled to charitable contribution deductions. The deductions are instead passed through to the shareholders, partners, or members of the organization.[258]

§ 3.3 MEANING OF *CHARITABLE ORGANIZATION*

At the simplest definitional level, a charitable contribution is a *gift* to a charitable organization.[259] Having explored the concept of a gift, it is appropriate to consider the meaning of the term *charitable* for purposes of the law of charitable giving.

(a) Introduction

The law of charitable organizations is more fundamentally the province of the law of tax-exempt organizations.[260] There is not, however, absolute parity

---

[250] *DeJong v. Commissioner*, 309 F.2d 373 (9th Cir. 1962).
[251] See § 3.6.
[252] A *C corporation* is also known as a *regular corporation*; this tax term is derived from the portion of the Internal Revenue Code creating the concept. IRC subch. C, consisting of IRC §§ 301–385. Discussion of a C corporation as a donor is in § 6.13.
[253] An *S corporation* is also known as a *small business corporation*; this term is derived from the portion of the Internal Revenue Code creating the concept. IRC subch. S, consisting of IRC §§ 1361–1379. A Subchapter S corporation is a *pass-through entity*, which means it is not subject to federal income taxation (the taxation is of the shareholders). Discussion of an S corporation as a donor is in § 6.13.
[254] A partnership also is a pass-through entity (see *supra* note 253) (the taxation is of the partners). The federal tax treatment of partnerships is the subject of IRC subch. K consisting of IRC §§ 701–777. Discussion of a partnership as a donor is in § 6.14.
[255] A limited liability company also is a pass-through entity (see note 248), with the incidence of taxation on the members, in that limited liability companies are generally taxed the same as partnerships. An illustration of a limited liability company as a donor is in § 12.3(f), note 203.
[256] See, e.g., § 2.8. A discussion of trusts as donors is in § 9.22.
[257] See § 8.3(a).
[258] See, e.g., §§ 6.13, 6.14.
[259] See § 3.1.
[260] See *Tax-Exempt Organizations*, particularly pt. 3.

between the law of tax-exempt organizations and the law of charitable giving on this point. That is, there are organizations that are considered *charitable* for purposes of federal income tax exemption but not for purposes of the federal income tax charitable contribution deduction. Likewise, there are organizations that are considered *charitable* for purposes of the federal charitable deductions that are not charitable entities under the tax-exempt organizations rules. This is because federal tax law defines organizations that are charitable ones for charitable deduction purposes in a provision of the Internal Revenue Code different from that used for purposes of tax exemption; for charitable giving purposes, the charitable status does not derive from an organization's tax exemption but from its treatment as a charitable donee.

Four Internal Revenue Code sections require highlighting at this point:

- The one providing federal income tax exemption for charitable organizations[261]
- The federal income tax charitable contribution deduction rules, which classify eligible charitable donees[262] and provide that organizations that are charitable entities under the tax exemption rules are eligible charitable donees for purposes of that deduction[263]
- The federal gift tax charitable contribution deduction rules, which classify eligible charitable donees[264]
- The federal estate tax charitable contribution deduction rules, which classify eligible charitable donees[265]

The gift and estate tax rules in this regard are discussed elsewhere.[266] This analysis, then, is confined to the federal income tax rules.

Nearly every organization that is considered a charitable organization for purposes of the federal income tax exemption[267] is considered a charitable organization for purposes of the federal income tax charitable contribution deduction.[268] The only exception to this rule is the organization that tests for public safety. Such an organization, though embraced by the tax exemption rules as a charitable entity, is omitted from charitable donee status for purposes of the income tax charitable contribution deduction.[269]

There are, however, certain organizations that cannot qualify for tax exemption purposes as charitable organizations that can qualify, for purposes of the law of charitable giving, as charitable donees. Nonetheless, these entities are all tax-exempt organizations. They are:

---

[261] IRC § 501(c)(3).
[262] IRC § 170(c).
[263] IRC § 170(c)(1).
[264] IRC § 2522(a).
[265] IRC § 2055(a).
[266] See ch. 8.
[267] IRC § 501(c)(3).
[268] IRC § 170(c)(2). The IRS issues rulings on the qualification of organizations as charitable donees. See, e.g., Priv. Ltr. Rul. 9037021.
[269] The *public safety testing* organization is the subject of *Tax-Exempt Organizations* § 11.3.

- A state, a possession of the United States, a political subdivision of a state or U.S. possession, the United States, or the District of Columbia—but only if the contribution is made for exclusively public purposes[270]
- A post or organization of war veterans, or an auxiliary unit or society of, or trust or foundation for, such a post or organization, that is organized in the United States or any of its possessions, if no part of its earnings inures to the benefit of any private shareholder or individual[271]
- A domestic fraternal society, order, or association, operating under the lodge system, but only if the contribution is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals[272]
- A cemetery company owned and operated exclusively for the benefit of its members, or a corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, if the company or corporation is not operated for profit and no part of its net earnings inures to the benefit of any private shareholder or individual[273]

In summary, organizations that are tax-exempt pursuant to federal tax law generally receive that exemption pursuant to an exemption provision,[274] by virtue of a particular listing.[275] Organizations that are charitable donees for federal income tax law purposes have that status under another provision,[276] by virtue of another listing.[277]

(b) *Charitable* Organizations—Criteria

A summary of the law of charitable organizations, for purposes of the law of charitable giving, is difficult because the term *charitable* is used in many ways. This portion of the analysis is confined to a summary of the law pertaining to those organizations that are charitable in the sense that they are also charitable organizations for federal tax exemption purposes.[278]

---

[270] IRC § 170(c)(1). These entities are not tax-exempt in the sense that they are described in IRC § 501(c). They are, however, very much tax-exempt organizations in the generic sense of that term. See *Tax-Exempt Organizations* § 19.19.

[271] IRC § 170(c)(3). Veterans' organizations generally are tax-exempt by reason of IRC § 501(c)(19). See *Tax-Exempt Organizations* § 19.11(a). Some veterans' organizations are tax-exempt by reason of being classified as social welfare organizations under IRC § 501(c)(4) (see *Tax-Exempt Organizations* ch. 13), and some are classified as charitable organizations under IRC § 501(c)(3) (see *Tax-Exempt Organizations* pt. 3).

[272] IRC § 170(c)(4). These organizations are tax-exempt by reason of IRC § 501(c)(8). See *Tax-Exempt Organizations* § 19.4(a). This is a category of charitable donee only in the case of contributions by individuals.

[273] IRC § 170(c)(5) These organizations are tax-exempt by reason of IRC § 501(c)(13). See *Tax-Exempt Organizations* § 19.6.

Occasionally, the IRS will allow deductibility of a gift, as if it had been made to a charitable donee, when the recipient is a type of tax-exempt organization that does not itself qualify as a charitable donee, as long as the gift is made for a charitable purpose. Instances of organizations of this nature include title-holding corporations (tax-exempt by reason of IRC § 501(c)(2); see *Tax-Exempt Organizations* § 19.2) and business and professional organizations (see *Tax-Exempt Organizations* ch. 14).

[274] IRC § 501(a).

[275] IRC § 501(c).

[276] IRC § 170.

[277] IRC § 170(c).

[278] That is, they are organizations described in IRC § 501(c)(3).

This type of organization is a *charitable donee* if it is

> organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals.[279]

In addition, the following criteria must be met for an organization to be considered a charitable donee:

- It is created or organized in the United States or in a possession of the United States, or under the law of the United States, a state, the District of Columbia, or a possession of the United States.[280]
- No part of the organization's net earnings inures to the benefit of any private shareholder or individual.[281]
- It does not have as a substantial part of its activities attempts to influence legislation. The amount of permissible lobbying in this context is defined by the *substantial part test* or, if the charitable organization makes an election, the *expenditure test*.[282]
- It does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.[283]

There are, therefore, two dimensions to the term *charitable* in this context. One is the definition of the term *charitable* as one of seven categories of charitable donee status (as reflected in the preceding quotation). The other is a definition of the term *charitable* that embraces all categories of charitable donees.

As to the latter definition, the law is clear that the concept of *charity* is an overarching one that encompasses all of the specific categories, such as religion and education. This is because U.S. tax law precepts of charity are based on common law standards, which the courts have held must inform the statutory uses of the term. For example, one court observed that ''we must look to established [trust] law to determine the meaning of the word 'charitable.'''[284] Likewise, the court subsequently wrote that Congress intended to apply these tax rules ''to those organizations commonly designated charitable in the law of trusts.''[285] Another court noted that ''the term 'charitable' is a generic term and includes literary, religious, scientific, and educational institutions.''[286] The U.S. Supreme Court held that ''Congress, in order to encourage gifts to religious, educational, and *other charitable objects*, granted the privilege of deducting . . . gifts from gross income.''[287]

---

[279] IRC § 170(c)(2)(B).
[280] IRC § 170(c)(2)(A).
[281] IRC § 170(c)(2)(C). The *private inurement doctrine* is discussed in *Tax-Exempt Organizations* ch. 20.
[282] IRC § 170(c)(2)(D). The limitations on attempts to influence legislation by charitable donees is the subject of *Tax-Exempt Organizations* ch. 22.
[283] IRC § 170(c)(2)(D). The prohibition on efforts to engage in political campaign activities by charitable donees is the subject of *Tax-Exempt Organizations* ch. 23.
[284] *Pennsylvania Co. for Insurance on Lives v. Helvering*, 66 F.2d 284, 285 (D.C. Cir. 1933).
[285] *International Reform Federation v. District Unemployment Board*, 131 F.2d 337, 339 (D.C. Cir. 1942).
[286] *United States v. Proprietors of Social Law Library*, 102 F.2d 481, 483 (1st Cir. 1939).
[287] *Helvering v. Bliss*, 293 U.S. 144, 147 (1934) (emphasis supplied).

One of the reasons that the term *charitable* has such an all-inclusive gloss in this definitional setting is that the Supreme Court has held that all organizations that wish to qualify as charitable entities—both for tax exemption and charitable donee purposes—must adhere to a *public policy doctrine*. In so doing, the Court wrote that each of these entities must meet ''certain common law standards of charity'' and that ''[t]he form and history of the charitable exemption and deduction sections of the various income tax acts reveal that Congress was guided by the common law of charitable trusts.''[288] The Court said that charitable organizations must ''be in harmony with the public interest'' and ''must not be so at odds with the common community conscience as to undermine any public benefit that might otherwise be conferred.''[289] While recognizing the IRS's authority to determine what is public policy, the Court held that ''a declaration that a given institution is not 'charitable' should be made only where there can be no doubt that the activity involved is contrary to a fundamental public policy.''[290] (In the factual setting of the case, the Court concluded that racial discrimination in education is contrary to public policy and that an educational institution that does not conform to this policy is not charitable.)

These findings were presaged in a Supreme Court observation made more than 100 years earlier: ''A charitable use, where neither law nor public policy forbids, may be applied to almost any thing that tends to promote the well-doing and well-being of social man.''[291]

Nonetheless, the specific legal meanings of the term *charitable* are to be found in the narrower of the two definitions, which is an amalgam of court opinions, Department of Treasury regulations, and IRS rulings. Other bodies of law, although not as extensive, have evolved from use of the other terms, principally *religious*, *educational*, and *scientific*.

Charitable Organizations. There are several ways for an organization to be considered a charitable entity for purposes of the law of charitable giving.[292] These include:

- *Relief of poverty*. This is the most basic and historically founded form of charitable activity. The tax regulations define the term *charitable* to include ''[r]elief of the poor and distressed or of the underprivileged.''[293] Assist ance to the indigent is undoubtedly the most generally understood and accepted form of charitable endeavor.
- *Advancement of religion*. The scope of this category of charitable activity is imprecise, due to the recognition of religious activities as a separate basis for tax-exempt status.[294] Organizations that are charitable because they

[288] *Bob Jones University v. United States*, 461 U.S. 574, 586, 587–88 (1983).
[289] *Id*. at 591–92.
[290] *Id*. at 592.
[291] *Ould v. Washington Hosp. for Foundlings*, 95 U.S. 303, 311 (1877). This broad definition of the term *charitable* and the reach of the public policy doctrine are discussed in *Tax-Exempt Organizations* § 6.2.
[292] The law underlying these categories is discussed in *Tax-Exempt Organizations* ch. 7.
[293] Reg. § 1.501(c)(3)-1(d)(2).
[294] See § 3.3(b)(iii).

advance religion generally are those that support or otherwise assist religious organizations.[295]

- *Advancement of education*. Likewise, the scope of this category of charitable activity is imprecise, due to the recognition of educational activities as a separate basis for tax-exempt status.[296] Organizations that are charitable because they advance education generally are those that support or otherwise assist educational organizations.[297]
- *Advancement of science*. Similarly, the scope of this category of charitable activity is imprecise, due to the recognition of scientific activities as a separate basis for tax-exempt status.[298] Organizations that are charitable because they advance science generally are those that support or otherwise assist scientific organizations.[299]
- *Lessening of the burdens of government*. An organization that is charitable is one that lessens the burden of a government, where the governmental unit considers the burden to be among its burdens. Organizations of this type either provide services directly in the context of government activity or provide support to a governmental agency or department.[300]
- *Promotion of social welfare*. An organization can be charitable if it promotes social welfare; this is one of the broadest categories of charitable organizations. This purpose includes activities such as lessening neighborhood tensions, eliminating prejudice and discrimination, defending human and civil rights secured by law, and combating community deterioration and juvenile delinquency.[301]
- *Community beautification and maintenance*. An organization can be charitable by reason of the fact that its purpose is community beautification and maintenance, and the preservation of natural beauty.[302]
- *Promotion of health*. An organization can be charitable because it engages in activities that promote health.[303] This purpose embraces the establishment and maintenance of hospitals, clinics, homes for the aged, and the like.
- *Promotion of the arts*. An organization may be charitable because it engages in one or more activities that promote the arts. This purpose includes the

---

[295] Reg. § 1.501(c)(3)-1(d)(2).

[296] See § 3.3(b)(ii).

[297] Reg. § 1.501(c)(3)-1(d)(2). College and university fraternities and sororities that maintain chapter houses for active members who are students at these institutions are not charitable organizations, but rather tax-exempt social clubs. IRC § 501(c)(7); see *Tax-Exempt Organizations* ch. 15; Rev. Rul. 69-573, 1969-2 C.B. 125. Gifts to a college or university to acquire or construct a housing facility for use by a designated fraternity or sorority are deductible, however, when the educational institution owns the facility and leases it on a short-term basis to the fraternity or sorority, the designation is not legally binding, and the fraternity or sorority house meets the standards of the college or university for other student housing. Rev. Rul. 60-367, 1960-2 C.B. 73.

[298] See § 3.3(b)(iv).

[299] Reg. § 1.501(c)(3)-1(d)(2).

[300] *Id.*

[301] *Id.*

[302] Rev. Rul. 78-85, 1978-1 C.B. 150.

[303] Rev. Rul. 69-545, 1969-2 C.B. 117. In general, see Hyatt & Hopkins, *The Law of Tax-Exempt Healthcare Organizations*, 3d ed. (Hoboken, NJ: John Wiley & Sons, 2008), particularly pt. 3.

establishment and maintenance of theaters, the promotion of public appreciation of one of the arts, and the promotion and encouragement of the talent and ability of young artists.[304]

- *Promotion of the public interest through law.* An organization can be charitable by functioning as a *public interest law firm*.[305] These firms provide legal representation for important citizen interests that are unrepresented because the cases are not economically feasible for private law firms.
- *Local economic development*. One of the forms of charitable organizations is the local economic development corporation, which engages in a variety of activities, including investment in local businesses, creation of housing opportunities, and encouragement of established businesses to open offices and plants in economically depressed areas.[306]
- *Other*. Other categories of charitable organizations are:
  - Organizations established to promote environmental conservancy[307]
  - Organizations established to promote patriotism[308]
  - Organizations that provide care for orphans[309]
  - Organizations that facilitate student and cultural exchanges[310]
  - Organizations that promote, advance, and sponsor recreational and amateur sports[311]
  - Organizations that maintain public confidence in the legal system[312]

Educational Organizations. Organizations that are considered *educational* for purposes of the law of charitable giving[313] are:

- Formal educational institutions, such as primary, secondary, and postsecondary schools; colleges and universities; early childhood centers; and trade schools.[314] These entities have a regularly scheduled curriculum, a

---

[304] E.g., Rev. Rul. 64-175, 1964-1 (Part 1) C.B. 185; Rev. Rul. 64-174, 1964-1 (Part 1) C.B. 183.
[305] E.g., Rev. Rul. 75-74, 1975-1 C.B. 152.
[306] E.g., Rev. Rul. 81-284, 1981-2 C.B. 130.
[307] E.g., Rev. Rul. 76-204, 1976-1 C.B. 152.
[308] E.g., Rev. Rul. 78-84, 1978-1 C.B. 150. It was held that an estate was entitled to a charitable contribution deduction for the gift of assets to a trust "to be used solely and exclusively in fostering and promoting the cause of patriotism, loyalty and fundamental constitutional government in the United States of America, and in combating subversive activities, socialism and communism, including, if deemed advisable, assistance in the teaching of the principles of conservatism in public affairs among college and high school students." *Buder v. United States*, 7 F.3d 1382 (8th Cir. 1993). The government argued that the trustees of the trust had discretion to dispense funds to organizations that engage in lobbying and political campaign activities, which might preclude the organization from qualifying as a charitable organization (see the text accompanied by notes 220, 221); the court found that contention "cramped" and it "decline[d] to set a standard that is so rigorous that the average testator who is attempting to make a charitable donation will fail to meet it." 7 F.3d at 1386.
[309] E.g., Rev. Rul. 80-200, 1980-2 C.B. 173.
[310] E.g., Rev. Rul. 80-286, 1980-2 C.B. 179.
[311] *Hutchinson Baseball Enterprises, Inc. v. Commissioner*, 73 T.C. 144 (1979), *aff'd*, 696 F.2d 757 (10th Cir. 1982).
[312] *Kentucky Bar Foundation, Inc. v. Commissioner*, 78 T.C. 921 (1982).
[313] The law underlying these categories is discussed in *Tax-Exempt Organizations* ch. 8.
[314] Reg. § 1.501(c)(3)-1(d)(3)(ii)(1).

regular faculty, and a regularly enrolled body of students in attendance at the place where the educational activities are regularly carried on.[315]

- Other types of ''formal'' organizations, such as museums, zoos, planetariums, and symphony orchestras.[316]
- Organizations that have programs related to instruction or training of individuals for the purpose of improving or developing their capabilities.[317] These entities include a wide variety of training organizations and study and research organizations.
- Organizations that have programs related to instruction of the public on subjects useful to the individual and beneficial to the community.[318] These organizations provide a range of personal services, instruct the public in the field of civic betterment, and (again) engage in study and research.

Religious Organizations. Organizations that are considered religious for purposes of the law of charitable giving[319] include:

- Churches, synagogues, and similar places of worship[320]
- Conventions and associations of churches[321]
- Integrated auxiliaries of churches[322]
- Church-run organizations, such as schools, hospitals, orphanages, nursing homes, publishing entities, broadcasting entities, and cemeteries
- Religious orders
- Apostolic groups[323]
- Missionary organizations
- Bible and tract societies

The courts and the IRS traditionally have been reluctant to rule on whether an organization is a church or the like or a religious entity, if only because of concern about constitutional law constraints. This reluctance is dissipating, however, and the IRS and the courts are developing criteria for defining churches and other religious organizations.

Scientific Organizations. Organizations that are considered scientific for purposes of the law of charitable giving[324] include:

---

[315] IRC § 170(b)(1)(A)(ii).
[316] Reg. § 1.501(c)(3)-1(d)(3)(ii)(4).
[317] Reg. § 1.501(c)(3)-1(d)(3)(i).
[318] *Id.*
[319] The law underlying these categories is discussed in *Tax-Exempt Organizations* ch. 10.
[320] IRC § 170(b)(1)(A)(i). A charitable deduction was denied an individual who claimed to be a church because of belief in the Bible; the gifts were made to himself. The court said that a church cannot, for federal income tax purposes, consist of just one individual, in that the law requires a "group of people gathering together as part of an organized entity." *Richardson v. Commissioner*, 70 T.C.M. (CCH) 14, 16 (1995). Otherwise, the court added, "every individual taxpayer in the United States might declare himself to be a church in an attempt to avoid paying Federal income tax." *Id.*
[321] *Richardson v. Commissioner*, 70 T.C.M. (CCH) 14, 16 (1995).
[322] *Id.*
[323] IRC § 501(d).
[324] The law underlying these categories is discussed in *Tax-Exempt Organizations* ch. 9.

- Organizations that are engaged in scientific research[325]
- Organizations that are otherwise operated for the dissemination of scientific knowledge (such as publishing entities)[326]

Other Charitable Organizations. There are several other categories of charitable organizations:[327]

- Literary organizations[328]
- Organizations that seek to prevent cruelty to children or animals[329]
- Cooperative hospital service organizations[330]
- Cooperative educational service organizations[331]
- Amateur sports organizations[332]

Consequently, the organizations that are eligible charitable donees for purposes of the law of charitable giving are those that are charitable in the common law sense (most of which have been rendered charitable by statute, regulation, or IRS ruling) and those that have been encompassed by statutory definition.

In one instance, however, the IRS refused to allow a charitable contribution deduction for a gift made to a charitable organization, which had as its exempt purpose the preservation of local landmarks, because it was determined that the gift was ''earmarked for and primarily benefit[ed]'' a noncharitable recipient (a college fraternity).[333]

Requirement of Charitable Class. It is generally a requirement, as to tax deductibility of contributions, that those who are to benefit from a charitable activity must constitute a sufficiently large or indefinite class (often referred to as a *charitable class*), unless the benefits to a smaller class are incidental.[334] This is another way of saying that a charitable organization may not be operated for private benefit, other than insubstantially. Thus, for example, it is inadequate if the beneficiaries of the alleged charitable activities are specifically named or are solely relatives of the donor.[335] An organization established to benefit one individual

---

[325] Reg. § 1.501(c)(3)-1(d)(1)(i)(c).
[326] *Id.*
[327] The law underlying these categories is discussed in *Tax-Exempt Organizations* ch. 11.
[328] Reg. § 1.501(c)(3)-1(d)(1)(i)(e).
[329] Reg. § 1.501(c)(3)-1(d)(1)(i)(g).
[330] IRC § 501(e).
[331] IRC § 501(f).
[332] IRC § 501(c)(3) and (j).
[333] Priv. Ltr. Rul. 9247030. Also *Tripp v. Commissioner*, 337 F.2d 432 (7th Cir. 1964); *Phinney v. Dougherty*, 307 F.2d 357 (5th Cir. 1962); *Davidson v. Commissioner*, 60 F.2d 50 (2d Cir. 1932); Rev. Rul. 69-573, 1969-2 C.B. 125; Rev. Rul. 60-367, 1960-2 C.B. 73.
[334] The IRS wrote that ''restriction of charitable work to a small or identifiable class will cause such work to fail to meet the definition of charitable . . . unless such benefits are incidental to an identifiable public benefit.'' Priv. Ltr. Rul. 9702040. Also: ''A class of beneficiaries designated by the donor or by the donee's charter may be challenged where the class of prospective beneficiaries is so limited in size that the donee organization is considered to benefit specified individuals.'' Priv. Ltr. Rul. 9316051.
[335] Rev. Rul. 56-403, 1956-2 C.B. 307. A corporation was denied a charitable deduction for amounts given to a foundation established to provide educational opportunities for employees and their children because the foundation's educational benefits inured to only four children of the corporation's employees. *Charleston Chair Co. v. United States*, 203 F. Supp. 126 (E.D.S.C. 1962).

cannot be charitable even if it would be charitable if the same activities were undertaken for a charitable class.[336]

- A trust created for the benefit of an aged clergyman and his spouse was held to be a private trust that did not involve exempt activities, irrespective of the fact that the two beneficiaries served were needy.[337]
- A trust the purpose of which was to pay a certain sum to all individuals enrolled in a certain school on a certain date was held to be a private entity.[338]
- A bequest to a trust for scholarships at two universities, where the only potential recipients were individuals with the same surname as the decedent (about 600 families), was held not to be a charitable bequest.[339]

By contrast, a charitable organization established to award scholarships solely to members of a designated fraternity was ruled to be exempt as an educational organization.[340] Basically, when a class of individuals is involved as beneficiaries, the sufficiency of the class for purposes of ascertaining whether charitable activities are being engaged in is a matter of degree to be assessed on a case-by-case basis.[341] Traditional charitable classes include the impoverished, students, the elderly, and the disabled[342]; sometimes, the IRS looks to see whether a ''broad public interest'' is being served.[343] There are, of course, limitations within the bounds of reason on the IRS's reach in applying this doctrine. As one court

[336] E.g., *Wendy L. Parker Rehabilitation Foundation Inc. v. Commissioner*, 52 T.C.M. (CCH) 51 (1986).

[337] *Carrie A. Maxwell Trust, Pasadena Methodist Foundation v. Commissioner*, 2 T.C.M. (CCH) 905 (1943).

[338] Rev. Rul. 57-449, 1957-2 C.B. 622.

[339] Priv. Ltr. Rul. 9631004.

[340] Rev. Rul. 56-403, 1956-2 C.B. 307.

[341] A private foundation proposed to develop two parcels of property and sought a ruling from the IRS that the funds to be expended to that end would be considered qualifying distributions for purposes of IRC § 4942 (the private foundation mandatory charitable grant-making rules). The IRS acceded to that request with respect to only one of the properties, which was to be improved by creating a recreational facility available to the general public. As to the second property, however, which was to be developed by establishing a computer instruction facility, the IRS ruled that the funds would not be qualifying distributions because of the limitations on access to the property. Priv. Ltr. Rul. 9702040.

The IRS ruled that contributions to a fund established by a tax-exempt hospital were deductible as charitable contributions when the donors were the hospital, its employees, and employees of its affiliates; the fund provided emergency assistance to financially needy individuals who had suffered economic hardship due to accident, loss, or disaster. The more than 9,000 potential beneficiaries included 2,900 current employees of the hospital and 600 former employees. Priv. Ltr. Rul. 9316051. The IRS reconsidered this ruling because of its belief that it was inconsistent with the rules as to tax-exempt charitable organizations. Priv. Ltr. Rul. 9704028. Nonetheless, the IRS subsequently upheld the deductibility of contributions to this fund (the one in Priv. Ltr. Rul. 9316051), reiterating the presence of a charitable class and noting that the hospital would not be making any grants to the fund. Priv. Ltr. Rul. 9741047.

This policy may be changing again. Initially, the IRS ruled that a private foundation can make grants to one of these disaster relief and emergency hardship programs, when the grants are for charitable purposes and cause only incidental private benefit. Priv. Ltr. Rul. 9516047. Subsequently, however, the IRS held that grants of this nature are not for charitable purposes, amount to private inurement, result in self-dealing, are not qualifying distributions, and are taxable expenditures. Priv. Ltr. Rul. 199914040.

[342] E.g., Rev. Rul. 77-246, 1977-2 C.B. 190 (elderly and disabled recognized by the IRS as charitable classes); Rev. Rul. 76-244, 1976-1 C.B. 155 (organization undertaking home delivery of meals to the elderly and disabled held charitable).

[343] E.g., Rev. Rul. 75-196, 1975-2 C.B. 155 (law library held to be educational because access to it by lawyers was held to be a public benefit); Rev. Rul. 69-545, 1969-2 C.B. 117 (promotion of health held to be charitable activity because of overall benefit to the community).

observed: ''To our knowledge, no charity has ever succeeded in benefiting every member of the community. If to fail to so benefit everyone renders an organization noncharitable, then dire times must lie ahead for this nation's charities.''[344]

§ 3.4 PUBLIC CHARITIES AND PRIVATE FOUNDATIONS

The federal income tax deduction, or the extent of this deduction, for a contribution of money or property to a charitable organization often depends on the tax classification of the donee organization. From the perspective of the tax law, not all charitable organizations are the same. In general, the federal tax law categorizes *charitable* organizations that are eligible donees, for purposes of the charitable deduction, as being one of the following types:

- Public charitable organizations
- Private charitable organizations (private foundations)
- A hybrid of the two
- Other eligible donees[345]

The terms *public*and *private*, as used in this context, often generate confusion. The term *public* is not used in the sense of a governmental entity (as in a public school), nor is the term *private* used in the sense of business activity (as in private enterprise) or the counterpart of a governmental entity (such as a private school). Neither term has anything to do with the nature of a charitable organization's board of directors or trustees (as in a public board, rather than a private one). These terms, as used in the charitable giving and tax-exempt organizations settings, relate to how the charitable organization is financially supported.

Charitable organizations are presumed to be private foundations.[346] This presumption is rebuttable (if the facts so warrant) by a showing that the organization qualifies as one of the types of public charitable organizations or as one of the hybrid charitable organizations. Since there is no tax law advantage to being a private foundation, most charitable organizations strive to rebut this presumption, principally to avoid the private foundation rules,[347] to facilitate maximum charitable contribution deductions, and to escape the burdensome federal reporting obligations of private foundations.[348]

---

[344] *Sound Health Association v. Commissioner*, 71 T.C. 158, 185 (1978).

The requirement of a charitable class is usually applied only when assessing the status of a charitable organization. That is, this type of a class is usually not required with respect to religious or educational entities. As to the latter, for example, the exempt function is that of disseminating knowledge; there are many rulings holding that organizations conducting educational programs for a limited group qualify as IRC § 501 (c)(3) entities. E.g., Rev. Rul. 68-504, 1968-2 C.B. 211; Rev. Rul. 65-298, 1965-2 C.B. 163. Yet the IRS sometimes applies the charitable class requirement in the context of a putative educational organization. See text accompanied by *supra* note 340.

[345] This reference to *other charitable donees* is to organizations that are the subject of § 3.3, text accompanied by *supra* notes 270–273.

[346] IRC § 509(a).

[347] See *Tax-Exempt Organizations* ch. 12.

[348] See *Tax-Exempt Organizations* § 27.2(a)(v).

(a) Public Charitable Organizations

Public charitable organizations are the most favored of the categories of charitable organizations for charitable giving purposes. There are essentially four categories of public charitable organizations:

- The institutions
- Publicly supported organizations (donative entities)
- Publicly supported organizations (service provider entities)
- Supporting organizations

The Institutions. Some entities in the category of public charitable organizations are classified as *institutions* because they satisfy the requirements of at least one category of *public*institution. These entities are not private foundations—not because of how they are funded, but because of the nature of their operations.

CHURCHES

A church is a public charitable organization and thus is not a private foundation.[349]

The IRS has formulated a test that it uses to ascertain whether an organization qualifies as a *church*. The IRS position is that, to be a church for tax purposes, an organization must satisfy at least some of the following criteria: a distinct legal existence, a recognized creed and form of worship, a definite and distinct ecclesiastical government, a formal code of doctrine and discipline, a distinct religious history, a membership not associated with any other church or denomination, a complete organization of ordained ministers ministering to their congregations and selected after completing prescribed courses of study, a literature of its own, established places of worship, regular congregations, regular religious services, schools for religious instruction of the young, and schools for the preparation of its ministers.[350] The courts also generally adhere to these criteria.[351]

Thus, to avoid private foundation status as a church, the organization must be more than an organization that generally engages in religious activities.[352]

CONVENTIONS AND ASSOCIATIONS OF CHURCHES

A convention or association of churches is a public charitable organization and thus is not a private foundation.[353]

The IRS recognizes that the phrase *convention or association of churches* has a historical meaning generally referring to a cooperative undertaking by churches of the same denomination.[354] A tax-exempt organization, the membership of which is comprised of churches of different denominations, also qualifies as an association of churches.[355]

---

[349] IRC §§ 170(b)(1)(A)(i) and 509(a)(1).
[350] Internal Revenue Manual § 321.3.
[351] E.g., *American Guidance Foundation, Inc. v. United States*, 490 F. Supp. 304 (D.D.C. 1980). Also *St. Martin Evangelical Lutheran Church v. South Dakota*, 451 U.S. 772 (1981).
[352] See *Tax-Exempt Organizations* §§ 10.3 and 12.3(a).
[353] IRC §§ 170(b)(1)(A)(i) and 509(a)(1).
[354] Rev. Rul. 74-224, 1974-1 C.B. 61. See also *Chapman v. Commissioner*, 48 T.C. 358 (1967).
[355] *Id*. In general, see *Tax-Exempt Organizations* §§ 10.4 and 12.3(a).

Integrated Auxiliaries of Churches

An integrated auxiliary of a church is a public charitable organization and thus is not a private foundation.[356]

IRS regulations define an *integrated auxiliary of a church* as a tax-exempt organization the principal activity of which is exclusively religious and which is controlled by or associated with a church or a convention or association of churches.[357] Under these regulations, integrated auxiliaries of a church include men's and women's fellowship associations, mission societies, theological seminaries, and religious youth organizations. Schools of a general academic or vocational nature, hospitals, orphanages, homes for the elderly, and the like are not considered, by these regulations, to be integrated auxiliaries of churches, even though they have a religious environment or promote the teachings of a church.

Although some courts have upheld this approach by the IRS,[358] others have differed.[359]

Educational Institutions

An ''educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on'' is a public charitable organization and thus is not a private foundation.[360] This type of organization must have as its primary function the presentation of formal instruction.[361]

It is pursuant to these rules that institutions such as primary, secondary, preparatory, and high schools and colleges and universities derive public charitable organization status. These institutions also encompass federal, state, and other public schools that qualify under these rules, although their tax-exempt and public charitable organization status may be derived from their categorization as governmental agencies or instrumentalities.[362] An organization cannot achieve public charitable organization status as an operating educational institution, however, when it is engaged in both educational and noneducational activities (for example, a museum operating a school), unless the noneducational activities are merely incidental to the educational activities.[363]

Thus, to avoid private foundation status as an educational institution, the organization must be more than an organization that generally engages in educational activities.[364]

---

[356] IRC §§ 170(b)(1)(A)(ii) and 509(a)(1).
[357] Reg. § 1.6033-2(g)(5).
[358] E.g., *Parshall Christian Order v. Commissioner*, 45 T.C.M. (CCH) 488 (1983).
[359] E.g., *Tennessee Baptist Children's Homes, Inc. v. United States*, 604 F. Supp. 210 (M.D. Tenn. 1984). In general, see *Tax-Exempt Organizations* § 10.5.
[360] IRC §§ 170(b)(1)(A)(ii) and 509(a)(1).
[361] Reg. § 1.170A-9(b). Also Rev. Rul. 78-309, 1978-2 C.B. 123.
[362] See text accompanied by *infra* notes 381 and 382.
[363] Reg. § 1.170A-9(b).
[364] Educational institutions are discussed in greater detail in *Tax-Exempt Organizations* § 12.3(a); educational organizations in general are discussed at *id*. ch. 8.

Health Care Institutions

A hospital is a public charitable organization and thus is not a private foundation.[365]

A hospital is defined, for federal tax purposes, as an "organization the principal purpose or functions of which are the providing of medical or hospital care or medical education or medical research."[366] A hospital must promote the health of a class of persons broad enough to benefit the community and must be operated to serve a public rather than a private interest.[367] The term *hospital* includes federal hospitals, and state, county, and municipal hospitals that are instrumentalities of those governmental units; rehabilitation facilities; outpatient clinics; extended care facilities; community mental health and drug treatment centers; and cooperative hospital service organizations. The term does not, however, include convalescent homes, homes for children or the elderly, or institutions the principal purpose or function of which is to train handicapped individuals to pursue a vocation,[368] nor does it include free clinics for animals.[369]

For these purposes, the term *medical care* includes the treatment of any physical or mental disability or condition, whether on an inpatient or outpatient basis, provided the cost of the treatment is deductible[370] by the individual treated.[371]

Thus, to avoid private foundation status as a hospital, the organization must be more than an organization that generally engages in activities that promote health.[372]

Medical Research Organizations

A *medical research organization* is a public charitable organization and thus is not a private foundation.[373] It is an organization "directly engaged in the continuous active conduct of medical research in conjunction with a hospital."[374] The organization need not be formally affiliated with a hospital to be considered primarily engaged in the active conduct of medical research in conjunction with a hospital. There must, however, be a joint effort on the part of the research organization and one or more hospitals pursuant to an understanding that the organizations will maintain continuing close cooperation in the active conduct of medical research.[375]

The term *medical research* means the conduct of investigations, experiments, and studies to discover, develop, or verify knowledge relating to the causes, diagnosis, treatment, prevention, or control of physical or mental diseases and impairments of human beings. To qualify, the organization must have the appropriate equipment and professional personnel necessary to carry out its principal

---

[365] IRC §§ 170(b)(1)(A)(iii) and 509(a)(1).
[366] IRC § 170(b)(1)(A)(iii).
[367] Rev. Rul. 69-545, 1969-2 C.B. 117.
[368] Reg. § 1.170A-9(c)(1).
[369] Rev. Rul. 74-572, 1974-2 C.B. 82.
[370] IRC § 213.
[371] Reg. § 1.170A-9(c)(1). The rules concerning the tax qualification of hospitals are discussed in *Tax-Exempt Organizations* § 7.6(a).
[372] Organizations that generally promote health are discussed in *Tax-Exempt Organizations* § 7.6.
[373] IRC §§ 170(b)(1)(A)(iii) and 509(a)(1).
[374] IRC § 170(b)(1)(A)(iii).
[375] Reg. § 1.170A-9(c)(2)(vii).

function.[376] Medical research encompasses the associated disciplines spanning the biological, social, and behavioral sciences.[377]

CERTAIN SUPPORTING FOUNDATIONS

Certain supporting foundations are public charitable organizations and thus are not private foundations. These organizations are foundations that provide support for colleges and universities that are administered by governments.[378]

The organization must normally receive a substantial part of its support (exclusive of income received in the exercise or performance of its tax-exempt activities) from the United States or from direct or indirect contributions from the general public. It must be organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of a college or university (including a land grant college or university), which itself is a public charitable organization[379] and which is an agency or instrumentality of a state or a political subdivision of a state, or which is owned or operated by a state or political subdivision of a state or by an agency or instrumentality of one or more states or political subdivisions.[380]

GOVERNMENTAL UNITS

A governmental unit is a public charitable organization and thus is not a private foundation.[381] This category includes a state, a possession of the United States, or any political subdivision of either of the foregoing, or the United States or the District of Columbia.[382]

Publicly Supported Organizations—Donative Entities

GENERAL RULES

An organization is not a private foundation if it is a charitable entity that ''normally receives a substantial part of its support'' (other than income from a tax-exempt function) from a governmental unit[383] or from direct or indirect contributions from the general public.[384]

The primary way for a charitable organization to achieve nonprivate foundation status under these rules is for it to normally derive at least one-third of its support from qualifying public and/or governmental sources.[385] Thus, an organization qualifying as a publicly supported entity under these rules must maintain a support fraction, the denominator of which is total eligible support and the numerator of which is the amount of support from eligible public and/or governmental sources.

---

[376] Reg. § 1.170A-9(c)(2)(iii).
[377] The rules concerning medical research organizations are discussed in *Tax-Exempt Organizations* § 7.6(c).
[378] IRC §§ 170(b)(1)(A)(iv) and 509(a)(1).
[379] See § 3.4(a), text accompanied by *supra* notes 361–364.
[380] The rules concerning these supporting foundations are discussed in *Tax-Exempt Organizations* § 12.3(g)(v).
[381] IRC §§ 170(b)(1)(A)(v) and 509(a)(1); Reg. § 1.170A-9(d).
[382] IRC § 170(c)(1). The rules concerning governmental units are discussed in *Tax-Exempt Organizations* §§ 7.14, 12.3(a), and 19.19.
[383] See § 3.4(a), text accompanied by *supra* notes 381 and 382.
[384] IRC §§ 170(b)(1)(A)(vi) and 509(a)(1).
[385] Reg. § 1.170A-9(e)(2).

For these purposes, the term *support* means amounts received as gifts, grants, contributions, membership fees, net income from unrelated business activities, gross investment income,[386] tax revenues levied for the benefit of the organization and either paid to or expended on behalf of the organization, and the value of services or facilities (exclusive of services or facilities generally furnished to the public without charge) furnished by a governmental unit to the organization without charge.[387] All of the foregoing items are amounts that, if directly or indirectly received by the organization, constitute the denominator of the support fraction.

In computing the eligible amount of public support (the numerator of the support fraction), contributions from individuals, trusts, or corporations constitute public support to the extent that the total amount of contributions from any donor during the computation period does not exceed an amount equal to 2 percent of the organization's total support for the period.[388] Therefore, the total amount of support by a donor is included in full in the denominator of the support fraction and the amount determined by application of the 2 percent limitation is included in the numerator of the support fraction. The latter amount is the amount of support in the form of direct or indirect contributions from the general public. Donors who stand in a defined relationship to one another[389] must share a single 2 percent limitation.

This 2 percent limitation does not, however, generally apply to support received from other publicly supported organizations of the donative type, nor to grant support from governmental units. Thus, these types of support are, in their entirety, public support, as *indirect* contributions from the general public.[390] Because a charitable organization can be classified as not being a private foundation pursuant to a categorization other than a donative-type publicly supported organization (such as by being one of the institutions),[391] and nonetheless meet the requirements to be a donative-type publicly supported organization,[392] the 2 percent limitation does not apply with respect to contributions from these organizations. For example, financial support from a church is generally considered to be indirect public support in full, because churches derive substantial amounts of their support from the general public, even though their non-private foundation status is derived, as discussed,[393] from their institutional status as churches.[394] Nonetheless, the 2 percent limitation will apply with respect to support received from a donative-type publicly supported organization or governmental unit if the support represents an amount that was expressly or implicitly earmarked by a donor to the publicly supported organization or unit of government as being for, or for the benefit of, the organization asserting status as a donative-type publicly supported organization.[395]

---

[386] IRC § 509(e).
[387] IRC § 509(d); Reg. § 1.170A-9(e)(7)(i).
[388] Reg. § 1.170A-9(e)(6)(i).
[389] IRC § 4946(a)(1).
[390] Reg. § 1.170A-9(e)(6)(i).
[391] See § 3.4(a), text accompanied by *supra* notes 349–382.
[392] Rev. Rul. 76-416, 1976-2 C.B. 57.
[393] See § 3.4(a), text accompanied by *supra* notes 349–351.
[394] Rev. Rul. 78-95, 1978-1 C.B. 71.
[395] Reg. § 1.170A-9(e)(6)(v).

In constructing the support fraction, an organization must exclude from both the numerator and the denominator of the support fraction amounts received from the exercise or performance of its exempt purpose or function and contributions of services for which a charitable deduction is not allowable.[396] An organization will not be treated as meeting the support test, however, if it receives almost all of its support from gross receipts from related activities and an insignificant amount of its support from the general public (directly and indirectly) and governmental units.[397] The organization may exclude from both the numerator and denominator of the support fraction an amount equal to one or more *unusual grants*.[398]

In computing the support fraction, review must be made of the organization's support that is *normally* received. This means that the organization must meet the one-third support test for a period encompassing its most recent five years including the year involved, on an aggregate basis. When this is done, the organization will be considered as meeting the one-third support test for its current tax year and for the tax year immediately succeeding its current tax year.[399]

Facts and Circumstances Test

Notwithstanding the foregoing general rules, an organization may qualify as a donative-type publicly supported organization, even if it cannot satisfy the one-third requirement, by meeting a *facts and circumstances* test, as long as the amount normally received from public and/or governmental sources is substantial.[400] To meet this test, the organization must demonstrate the existence of three elements: (1) the total amount of public and/or governmental support normally received by the organization is at least 10 percent of its total support normally received; (2) the organization has a continuous and bona fide program for solicitation of funds from the general public, governmental units, or public charitable organizations; and (3) it satisfies all other pertinent facts and circumstances, including the percentage of its support from public and/or governmental sources, the "public" nature of the organization's governing board, the extent to which its facilities or programs are publicly available, its membership dues rates, and whether its activities are likely to appeal to persons having some broad common interest or purpose.[401]

Concerning the governing board factor, the organization's non-private foundation status will be enhanced when it has a governing body that represents the interests of the public, rather than the personal or private interests of a limited number of donors. As noted, one of the important elements of this facts and circumstances test is the availability of public facilities or services. Examples of entities meeting this requirement are a museum that holds its building open to the public, a symphony orchestra that gives public performances, a conservation organization that provides educational services to the public through the distribution of educational materials, and a home for the elderly that provides domiciliary or nursing services for members of the general public.[402]

---

[396] Reg. § 1.170A-9(e)(7)(i).
[397] Reg. § 1.170A-9(e)(7)(ii).
[398] Reg. § 1.170A-9(e)(6)(ii). E.g., Rev. Rul. 76-440, 1976-2 C.B. 58.
[399] Reg. § 1.170A-9(e)(4)(i).
[400] Reg. § 1.170A-9(e)(3).
[401] *Id.*
[402] *Id.*

COMMUNITY FOUNDATIONS

A community foundation (or community trust) may qualify as a donative-type public charitable organization if it attracts, receives, and depends on financial support from the general public on a regular, recurring basis. Community foundations are designed primarily to attract large contributions of a capital or endowment nature from a small number of donors. They are generally identified with a particular community or area and are controlled by a representative group of persons from that community or area. Individual donors relinquish control over the investment and distribution of their contributions and the income derived from the contributions, although donors may designate the purposes for which the assets are to be used, subject to change by the governing body of the community foundation.[403]

Publicly Supported Organizations—Service Provider Entities. An organization is not a private foundation if it is a charitable organization that is broadly, publicly supported and thus is responsive to the general public, rather than to the private interests of a limited number of donors or other persons.[404]

For a charitable organization to achieve non-private foundation status under these rules, it must normally receive more than one-third of its support from any combination of (1) gifts, grants, contributions, or membership fees;[405] and (2) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in activities related to its tax-exempt function,[406] as long as the support in either category is from permitted sources. *Permitted sources* are governmental units,[407] the charitable institutions,[408] donative-type public charitable organizations,[409] and persons other than disqualified persons[410] with respect to the organization. Thus, an organization seeking to qualify under this one-third support test for service-provider publicly supported organizations must construct a support fraction, with the amount of support received from these two categories of sources constituting the numerator of the support fraction and the total amount of support received by the organization being the denominator of the support fraction.[411] The organization may exclude from both the numerator and denominator of the support fraction an amount equal to one or more *unusual grants*.[412]

There is no limitation on the amount of support that may be taken into account in determining the numerator of the support fraction under these rules concerning gifts, grants, contributions, and membership fees, except that this support must, as noted, come from permitted sources. In computing the amount of support received from gross receipts that is allowable toward the one-third

---

[403] Reg. § 1.170A-9(e)(10)(i). These rules, concerning all three categories of donative-type public charitable organizations, are discussed in *Tax-Exempt Organizations* § 12.3(g).
[404] IRC § 509(a)(2); Reg. § 1.509(a)-3(a)(4). Also IRC § 170(b)(1)(A)(viii).
[405] IRC § 509(a)(2)(A)(i).
[406] IRC § 509(a)(2)(A)(ii).
[407] See § 3.4(a), text accompanied by *supra* notes 381 and 382.
[408] See § 3.4(a), text accompanied by *supra* notes 349–382.
[409] See § 3.4(a), text accompanied by *supra* notes 383–403.
[410] IRC § 4946. See *Tax-Exempt Organizations* § 12.2.
[411] IRC § 509(a)(2)(A); Reg. § 1.509(a)-3(a)(2).
[412] Reg. § 1.509(a)-3(c)(3).

requirement, gross receipts from related activities received from any person or from any bureau or similar agency of a governmental unit are includible in any tax year to the extent that the receipts do not exceed the greater of $5,000 or 1 percent of the organization's support for the year.[413]

The term *support*[414] (in addition to the two categories of public support referenced above) means (1) net income from unrelated business activities; (2) gross investment income;[415] (3) tax revenues levied for the benefit of the organization and either paid to or expended on behalf of the organization; and (4) the value of services or facilities (exclusive of services or facilities generally furnished to the public without charge) furnished by a governmental unit to the organization without charge. The term does not include any gain from the disposition of property that would be considered as gain from the sale or exchange of a capital asset, or the value of exemption from any federal, state, or local tax or any similar benefit.[416] These six items of support are combined to constitute the denominator of the support fraction.

To avoid private foundation classification under these rules, an organization also must normally receive not more than one-third of its support from the sum of (1) gross investment income,[417] including interest, dividends, payments with respect to securities loans, rents, and royalties; and (2) any excess of the amount of unrelated business taxable income over the amount of the tax on that income.[418] To qualify under this test, an organization must construct a *gross investment income fraction*, with the amount of gross investment income received constituting the numerator of the fraction and the total amount of support received being the denominator of the fraction.[419]

These support and investment income tests are computed on the basis of the nature of the organization's normal sources of support. An organization is considered as *normally* receiving one-third of its support from permitted sources and not more than one-third of its support from gross investment income for its current tax year and immediately succeeding tax year if, for its most recent five tax years including its current tax year, the aggregate amount of support received over the five-year period from permitted sources is more than one-third of its total support and the aggregate amount of support over the five-year period from gross investment income is not more than one-third of its total support.[420]

Supporting Organizations. Another category of charitable organization that is not a private foundation is the *supporting organization*.[421] Organizations that are deemed not to be private foundations because they are supporting organizations are those organizations which are not themselves one of the public institutions[422]

[413] Reg. § 1.509(a)-3(b)(1).
[414] IRC § 509(d).
[415] IRC § 509(e).
[416] IRC § 509(d).
[417] IRC § 509(e).
[418] IRC § 509(a)(2)(B).
[419] Reg. § 1.509(a)-3(a)(3).
[420] Reg. § 1.509(a)-3(c)(1)(i). These rules are discussed in *Tax-Exempt Organizations* § 12.3(iv).
[421] IRC § 509(a)(3); also IRC § 170(b)(1)(A)(viii).
[422] See § 3.4(a)(i).

or publicly supported organizations,[423] but are sufficiently related to organizations that are public or publicly supported entities so that the requisite degree of public control and involvement is considered present.[424]

A supporting organization must be organized, and at all times thereafter operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more qualified supported organizations.[425] This type of organization must be operated, supervised, or controlled by one or more qualified supported organizations, supervised or controlled in connection with one or more such organizations, or operated in connection with one or more such organizations.[426] Thus, the relationship between the supporting and supported organizations must be one of three types: *operated, supervised, or controlled by*, *supervised or controlled in connection with*, or *operated in connection with*.[427]

A supporting organization is not considered to be operated in connection with a supported organization unless the supporting organization (1) annually provides to each supported organization sufficient information to ensure that the organization is responsive to the needs or demands of the supported organization(s) and (2) is not operated in connection with any supported organization that is not organized in the United States.[428] An organization is not considered to be operated, supervised, or controlled by a qualified supported organization or operated in connection with a supported organization if the organization accepts a contribution from a person (other than a qualified supported organization) who, directly or indirectly, controls, either alone or with family members or certain controlled entities, the governing body of a supported organization.[429]

The distinguishing feature of the relationship between a supporting organization and one or more supported public charitable organizations encompassed by the phrase *operated, supervised, or controlled by* is the presence of a substantial degree of direction by one or more public charitable organizations over the policies, programs, and activities of the supporting organization—a relationship comparable to that of a parent and subsidiary.[430] The distinguishing feature of the relationship between a supporting organization and one or more supported public charitable organizations encompassed by the phrase *supervised or controlled in connection with* is the presence of common supervision or control by the persons supervising or controlling both the supporting organization and the supported public charitable organization (or organizations), to ensure that the supporting organization is responsive to the needs and requirements of the supported

[423] See § 3.4(a)(ii), (iii).

[424] Reg. § 1.509(a)-4(a)(5).

[425] IRC § 509(a)(3)(A); Reg. § 1.509(a)-4(a)(2). The term *supported organization* is defined in IRC § 509(f)(3).

[426] IRC § 509(a)(3)(B). These organizations are sometimes referred to as Type I, II, or III organizations, respectively. The Type III supporting organization is defined in IRC § 4943(f)(5)(A). Inasmuch as Type III supporting organizations are classified as either functionally integrated Type III supporting organizations or other Type III supporting organizations, there are four types of supporting organizations. In general, Reg. §§ 1.509 (a)-4(f)(4), (g)(1)(i).

[427] Reg. §§ 1.509(a)-4(a)(3), 1.509(a)-4(f)(2).

[428] IRC § 509(f)(1). If a Type III supporting organization was supporting a foreign supported organization on August 17, 2006, the second of these rules does not apply until the first day of the third tax year of the organization beginning after that date (IRC § 509(f)(1)(B)(ii)).

[429] IRC § 509(f)(2).

[430] Reg. §§ 1.509(a)-4(f)(4), 1.509(a)-4(g)(1)(i).

organization.[431] The distinguishing feature of the relationship between a supporting organization and one or more supported public charitable organizations encompassed by the phrase *operated in connection with* is that the supporting organization is responsive to and significantly involved in the operations of the supported public charitable organization.[432]

The supporting organization must engage solely in activities that support or benefit the supported organization.[433] These activities may include making payments to or for the use of, or providing services or facilities for, individual members of the charitable class benefited by the supported organization. The supporting organization need not pay over its income to the supported organization, but may carry on an independent program or activity that supports or benefits the supported organization.[434] A supporting organization may also engage in fundraising activities, such as solicitations, dinners, and unrelated trade or business activities, to raise funds for the supported organization or for permissible beneficiaries.[435]

The private foundation excess business holdings rules[436] are applicable to Type III supporting organizations, other than functionally integrated Type III supporting organizations.[437] A *functionally integrated Type III supporting organization* is a Type III supporting organization that is not required by the tax regulations[438] to make payments to supported organizations.[439] These business holdings rules also apply to a Type II supporting organization if the organization accepts a contribution from a person (other than a public charity, not a supporting organization) who controls, either alone or with family members and/or certain controlled entities, the governing body of a supported organization of the supporting organization.[440] Nonetheless, the IRS has the authority to not impose the excess business holdings rules on a supporting organization if the organization establishes that the holdings are consistent with the organization's tax-exempt status.[441]

A nonoperating private foundation may not treat as a qualifying distribution[442] an amount paid to a Type III supporting organization that is not a functionally integrated Type III supporting organization or to any other type of supporting organization if a disqualified person with respect to the foundation directly or indirectly controls the supporting organization or a supported

[431] Reg. §§ 1.509(a)-4(f)(4), 1.509(a)-4(h)(1).
[432] Reg. § 1.509(a)-4(f)(4).
[433] Reg. § 1.509(a)-4(e)(1), (2).
[434] Nonetheless, Congress has mandated the promulgation of new regulations (see Reg. § 1.509(a)-4(i)(3)(iii)) requiring Type III supporting organizations that are not functionally integrated Type III supporting organizations to make distributions of a percentage of either income or assets to supported organizations (Pension Protection Act of 2006, Pub. L. No. 109-280 § 1241(d)).
[435] Reg. § 1.509(a)-4(e)(2).
[436] See *Private Foundations*, ch. 7.
[437] IRC § 4943(f)(1), 3(A).
[438] See *supra* note 434.
[439] IRC § 4943(f)(5)(B).
[440] IRC § 4943(f)(1), 3(B).
[441] IRC § 4943(f)(2).
[442] See *Private Foundations*, ch. 6.

organization of the supporting organization.[443] An amount that does not count as a qualifying distribution under this rule is regarded as a taxable expenditure.[444]

A supporting organization can be created to support and benefit one or more tax-exempt social welfare organizations,[445] labor or agricultural organizations,[446] or business leagues (trade, business, or professional associations),[447] as long as the supported organization (or organizations) meets the one-third support test of the rules concerning the service-provider type of publicly supported organization.[448]

A supporting organization must not be controlled directly or indirectly by one or more disqualified persons (other than foundation managers), excluding public charitable organizations.[449]

The Department of the Treasury was directed by Congress to undertake a study on the organization and operation of supporting organizations, to consider whether (1) the deductions allowed for income, estate, or gift taxes for charitable contributions to supporting organizations are appropriate in consideration of the use of contributed assets or the use of the assets of such organizations for the benefit of the person making the charitable contribution, and (2) these issues are also issues with respect to other forms of charitable organizations or charitable contributions.[450]

The IRS announced that it is anticipating proposing rules concerning qualification of an organization as a Type III supporting organization.[451] These rules will define the term *functionally integrated* Type III supporting organization, impose a payout requirement on Type III supporting organizations that are not functionally integrated, and provide rules as to the information that Type III supporting organizations are to provide to their supported organization(s).

(b) Other Organizations That Are Not Treated as Private Foundations

Three other categories of charitable organizations[452] are treated as entities other than private foundations for purposes of the law of charitable giving. This means that contributions to these entities may be deductible up to the 50 percent limitation.[453] These categories are:

---

[443] IRC § 4942(g)(4). As to the second element of this rule, a payment also is not a qualifying distribution if the IRS determines by regulation that the distribution "otherwise is inappropriate" (IRC § 4942(g)(4)(ii)(II)).

[444] IRC § 4945(d)(4). See *Private Foundations*, ch. 9. A supporting organization that wishes to avoid these rules may make application to the IRS, pursuant to special procedures, to change its public charity status (Ann. 2006-93, 2006-48 I.R.B. 1017).

[445] That is, organizations that are tax-exempt by reason of IRC § 501(c)(4). See *Tax-Exempt Organizations* ch. 13.

[446] That is, organizations that are tax-exempt by reason of IRC § 501(c)(5). See *Tax-Exempt Organizations* ch. 16.

[447] That is, organizations that are tax-exempt by reason of IRC § 501(c)(6). See *Tax-Exempt Organizations* ch. 14.

[448] IRC § 509(a)(3), last sentence; Reg. § 1.509(a)-4(k).

[449] IRC § 509(a)(3)(C); Reg. § 1.509(a)-4(a)(4). These rules are discussed in *Tax-Exempt Organizations* § 12.3 (c).

[450] Pension Protection Act of 2006, Pub. L. No. 109-280 § 1226.

[451] REG-155929-06.

[452] That is, organizations that are described in IRC § 501(c)(3).

[453] See § 7.5(a), text accompanied by note 42.

- *Private operating foundations*.[454] This type of private foundation is an organization that would be a standard private foundation but for the fact that most of its earnings and much of its assets are devoted directly to the conduct of its charitable activities.[455]
- *Conduit foundations*.[456] This type of private foundation timely makes qualifying distributions (usually, grants)[457] that are treated as distributions out of corpus, in an amount equal in value to all contributions received in the year involved, whether as cash or property.[458]
- *Common fund foundations*.[459] This type of private foundation pools contribu tions received in a common fund but allows donors to retain the right to designate annually the organizations to which the income attributable to the contributions shall be given and to direct the organizations to which the corpus of the contributions is eventually to be given.[460]

(c) Private Foundations

A private foundation, then, is a charitable organization[461] that is not one of the foregoing types of charitable organizations. It is essentially a charitable organization that is funded from one source (usually, one individual, family, or corporation), that receives its ongoing funding from investment income (rather than a consistent flow of charitable contributions), and that makes grants for charitable purposes to other persons rather than conducting its own programs.

§ 3.5 UNRELATED BUSINESS RULES

The unrelated business income rules that are applicable to charitable and other tax-exempt organizations were enacted in 1950, were significantly enhanced in 1969,[462] and have been augmented by nearly every subsequent tax act. The objective of these rules is to prevent unfair competition between tax-exempt organizations and for-profit, commercial enterprises.[463] The rules are intended to place the unrelated business activities of a tax-exempt organization on the same tax basis as the nonexempt business with which it competes.

---

[454] IRC §§ 170(b)(1)(A)(vii) and 170(b)(1)(E)(i).
[455] IRC § 4942(j)(3). The rules concerning private operating foundations are discussed in *Private Foundations* § 3.1.
[456] IRC §§ 170(b)(1)(A)(vii) and 170(b)(1)(E)(ii).
[457] See *Private Foundations* § 6.5.
[458] The rules concerning conduit foundations are discussed in *Private Foundations* § 3.2. For this tax treatment to occur, the donee private foundation must make an election (Reg. § 1.170A-9(g)(2)(v)) to treat the qualifying distributions as distributions out of corpus, so as to substantiate the larger charitable deductions. In a situation in which the election was not made, because the foundation was unaware of it (despite the involvement of professional tax advisors), the IRS exercised its discretionary authority (Reg. § 301.9100-3) to grant an extension of time to make this election. Priv. Ltr. Rul. 200311033.
[459] IRC §§ 170(b)(1)(A)(vii) and 170(b)(1)(E)(iii).
[460] The rules concerning common fund foundations are discussed in *Private Foundations* § 3.3.
[461] That is, an organization described in IRC § 501(c)(3).
[462] IRC §§ 511–514.
[463] Reg. § 1.513-1(b).

(a) Introduction

Prior to enactment of the unrelated income rules, the federal law embodied the *destination of income test*.[464] Pursuant to this standard, the law merely required that the net profits of organizations be used in furtherance of exempt purposes. That is, the test did not consider the source of the profits, thereby tolerating forms of unfair competition. Thus, in adopting and expanding these rules, Congress has not prohibited commercial ventures by nonprofit organizations. Rather, it struck a balance, as the U.S. Supreme Court characterized the matter, between ''its two objectives of encouraging benevolent enterprise and restraining unfair competition.''[465]

Essentially, for an activity of a tax-exempt organization to be subject to tax, four tests must be satisfied. The activity must:

1. Constitute a trade or business,
2. Be regularly carried on,
3. Not be substantially related to the tax-exempt purposes of the organization, and
4. Not be specifically exempted (or have the income from the activity specifically exempted) from taxation.[466]

Nearly all types of tax-exempt organizations, including charitable ones, are subject to the unrelated income rules.[467] The unrelated income rules are also applicable ''in the case of any college or university which is an agency or instrumentality of any government or any political subdivision thereof, or which is owned or operated by a government or any political subdivision thereof, or by any agency or instrumentality of one or more governments or political subdivisions,'' as well as ''in the case of any corporation wholly owned by one or more such colleges and universities.''[468]

To be tax-exempt, an organization must be organized and operated primarily for exempt purposes.[469] The federal tax law allows an exempt organization to engage in a certain amount of activity unrelated to its exempt purposes.[470] When the organization derives net income from one or more unrelated business activities, known as *unrelated business taxable income*, it is subject to tax on that income. An organization's tax exemption will be revoked if an inappropriate portion of its activities is not in furtherance of an exempt purpose.[471]

Business activities may preclude initial qualification of an otherwise exempt organization as a charitable or other entity. This would occur through its failure to satisfy the operational test, which looks to see whether the organization is being operated principally for exempt purposes.[472] Likewise, an organization will

---

[464] The test is discussed in *Tax-Exempt Organizations* § 24.1.
[465] *United States v. American College of Physicians*, 475 U.S. 834 (1986).
[466] Reg. § 1.513-1(a).
[467] IRC § 511(a)(2)(A).
[468] IRC § 511(a)(2)(B).
[469] See *Tax Exempt Organizations* § 4.4.
[470] E.g., Reg. § 1.501(c)(3)-1(e)(1).
[471] E.g., Reg. § 1.501(c)(3)-1(c)(1).
[472] See *Tax-Exempt Organizations* § 4.5.

not meet the organizational test if its articles of organization empower it, as more than an insubstantial part of its activities, to carry on activities that are not in furtherance of its exempt purpose.[473]

(b) *Trade* or *Business* Defined

For purposes of the federal tax rules, the term *trade or business*, in this setting, includes "any activity which is carried on for the production of income from the sale of goods or the performance of services."[474] Accordingly, most activities that would constitute a trade or business under basic tax law principles[475] are considered a trade or business for purposes of the unrelated trade or business rules.[476]

This definition of *trade or business* is broadly encompassing and embraces nearly every activity of a tax-exempt organization. Absent a specific exemption,[477] only investment activities generally escape this classification.

In this sense, every tax-exempt organization is viewed as a bundle of activities, each of which is a trade or business. Thus, the IRS is empowered to examine each of the activities in the bundle in search of unrelated business endeavor. As Congress chose to state the principle, "an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization."[478] This is known as the *fragmentation rule*.

Congress also enacted a rule stating that, "[w]here an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit."[479]

(c) Regularly Carried On

To be considered an unrelated trade or business, an activity of a tax-exempt organization must be *regularly carried on* by the organization.[480]

Income from an activity of a tax-exempt organization is considered taxable only when, assuming the other criteria are satisfied, the activity is regularly carried on, as distinguished from sporadic or infrequent commercial transactions.[481] The factors determining whether an activity is regularly carried on are the frequency and continuity of the activity and the manner in which the activity is pursued.[482]

These factors must be evaluated in light of the purpose of the unrelated business income tax: to place tax-exempt organizations' business activities on the

[473] *Id*. § 4.3.
[474] IRC § 513(c).
[475] IRC § 162.
[476] Reg. § 1.513-1(b).
[477] See §§ 3.5(f), (g).
[478] IRC § 513(c).
[479] *Id*.
[480] IRC § 512(a)(1).
[481] Reg. § 1.513-1(c).
[482] Reg. § 1.513-1(c)(1).

same tax basis as those of their nonexempt business competitors. Thus, specific business activities of a tax-exempt organization will generally ''be deemed 'regularly carried on' if they manifest a frequency and continuity, and are pursued in a manner generally similar to comparable commercial activities of nonexempt organizations.''[483]

When income-producing activities are performed by commercial organizations on a year-round basis, the performance of these activities for a period of only a few weeks does not constitute the regular carrying on of a trade or business.[484] Similarly, occasional or annual income-producing activities, such as fundraising events, do not constitute a business regularly carried on. The conduct of year-round business activities, such as parking lot rental, for one day each week would, however, constitute the regular carrying on of a business.[485] When commercial entities normally undertake income-producing activities on a seasonal basis, the conduct of the activities by a tax-exempt organization during a significant portion of the season is deemed the regular conduct of that activity.[486]

A trade or business is regularly carried on if the attributes of the activity are similar to those of commercial activities of nonexempt organizations.[487]

(d) Concept of *Unrelated Business*

The term *unrelated trade or business* is defined to mean ''any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption.''[488] Thus, a regularly conducted trade or business is subject to tax, unless it is substantially related to accomplishment of the organization's exempt purpose.[489] To be substantially related, the activity must have a substantial causal relationship to the achievement of an exempt purpose.[490] The fact that an asset is essential to the conduct of an organization's exempt activities does not shield commercial income from taxation when that income was produced by that asset.[491] The income-producing activities must still meet the causal relationship test if the income is not to be subject to tax.[492] This issue arises when an organization owns a facility or other assets that are put to dual use. For example, the operation of an auditorium as an ordinary motion picture theater for public entertainment in the evening would be treated as an unrelated activity even though the theater is used exclusively for tax-exempt purposes during regular hours.[493]

---

[483] *Id.*
[484] Reg. § 1.513-1(c)(2)(i).
[485] *Id.*
[486] *Id.*
[487] Reg. § 1.513-1(c).
[488] IRC § 513(a).
[489] Reg. § 1.513-1(a).
[490] Reg. § 1.513-1(d)(2).
[491] Reg. § 1.513-1(d).
[492] Reg. § 1.513-1(d)(2).
[493] *Id.*

A related concept is that activities should not be conducted on a scale larger than is reasonably necessary for performance of the exempt functions.[494] Activities in excess of the needs of exempt functions constitute the conduct of an unrelated business.[495]

(e) *Unrelated Business Taxable Income*

As indicated, to be subject to the unrelated income rules, an activity must satisfy four tests. The first three of these tests is built into the definition of the phrase *unrelated business taxable income*. That term is defined as the ''gross income derived by any organization from any unrelated trade or business . . . regularly carried on by it, less the deductions allowed . . . [under federal tax law] which are directly connected with the carrying on of such trade or business.''[496]

Both this gross income and allowable deductions are computed in conformance with the *modifications* discussed below.[497]

Tax-exempt organizations are subject to tax on their unrelated business taxable income at the regular corporate tax rates, or at individual rates if the organization is not incorporated.[498]

(f) Exempted Activities

Certain business activities conducted by tax-exempt organizations are exempt from unrelated business taxation. These include:

- A trade or business ''in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.''[499]
- A trade or business carried on by the organization primarily for the ''convenience of its members, students, patients, officers, or employees.''[500] This exemption is available only to organizations that are charitable entities[501] or are governmental colleges and universities.[502]
- A trade or business ''which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.''[503]
- *Qualified public entertainment activities*,[504] which are ''any entertainment or recreational activity of a kind traditionally conducted at fairs or expositions promoting agricultural and educational purposes, including, but not limited to, any activity one of the purposes of which is to attract the public

---

494 Reg. § 1.513-1(d)(3).
495 *Id*.
496 IRC § 512(a)(1).
497 See § 3.5(g).
498 IRC § 511.
499 IRC § 513(a)(1).
500 IRC § 513(a)(2).
501 That is, organizations that are described in IRC § 501(c)(3).
502 That is, institutions that are described in IRC § 511(a)(2)(B).
503 IRC § 513(a)(3).
504 IRC § 513(d).

to fairs or expositions or to promote the breeding of animals or the development of products or equipment.''[505] This exemption is available only to charitable, social welfare, labor, and agricultural organizations.[506]

- *Qualified convention and trade show activities*,[507] which are ''any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows, including, but not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of displaying industry products or to stimulate interest in, and demand for, industry products or services, or to educate persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry.''[508] This exemption is available only to charitable, social welfare, labor, and agricultural organizations, and business leagues.[509]
- In the case of a charitable hospital, the furnishing of certain cooperative services to one or more small hospitals under certain circumstances.[510]
- The conduct of certain bingo games.[511]
- In the case of charitable and veterans' organizations, contributions to which are deductible for federal income tax purposes,[512] activities relating to the distribution of low-cost articles if the distribution of the articles is incidental to the solicitation of charitable contributions.[513]
- In the case of charitable and veterans' organizations, contributions to which are deductible for federal income tax purposes, any trade or business consisting of (1) exchanging, with another of these organizations, names and addresses of donors to or members of the organization; or (2) renting the names and addresses to another of these organizations.[514]

(g) Exempted Income

Certain types of income are exempt from the unrelated business income tax.[515]

---

[505] IRC § 513(d)(2)(A).

[506] That is, organizations described in IRC §§ 501(c)(3), (4), or (5), respectively. Social welfare organizations are the subject of *Tax-Exempt Organizations* ch. 13, and labor and agricultural organizations are the subject of *id*. ch. 16.

[507] IRC § 513(d).

[508] IRC § 513(d)(3)(A).

[509] That is, organizations described in IRC §§ 501(c)(3), (4), (5), or (6), respectively. Business leagues are the subject of *Tax-Exempt Organizations* ch. 14.

[510] IRC § 513(e).

[511] IRC § 513(f).

[512] See § 3.3.

[513] IRC § 513(h)(1)(A). The IRS is of the view that this exception is unavailable when the solicitation is in competition with for-profit vendors or is illegal. Tech. Adv. Mem. 9652004. Of course, the exception is not available when the monetary limitation is exceeded. E.g., *State Police Association of Massachusetts v. Commissioner*, 72 T.C.M. (CCH) 582 (1996).

[514] IRC § 513(h)(1)(B). When this exception is not available, such as when one of the parties is not a charitable organization, the resulting revenue is taxable unless it can be sheltered by means of another exception, such as by characterizing it as a royalty. See text accompanied by *infra* note 516. In this setting, even the exchange of mailing lists can give rise to taxable income. E.g., Tech. Adv. Mem. 9635001.

[515] IRC § 512(b).

Because the unrelated business income rules apply to active business conducted by tax-exempt organizations, most types of *passive* income are exempt from taxation. This exemption, euphemistically embraced by the concept of *modifications*, generally covers income such as dividends, interest, payments with respect to securities loans, annuities, royalties, most rents, capital gains, and gains on the lapse or termination of options written by the organization.[516]

The unrelated debt-financed income rules, however, override the general exception for passive income.[517] Also, interest, annuities, royalties, and rents derived from a controlled corporation may be taxable.[518] It should be noted that there are three exceptions pertaining to research income.[519] A specific deduction, of $1,000, is available for any type of unrelated business income.[520]

§ 3.6 FACTORS AFFECTING INCOME TAX DEDUCTIBILITY OF CHARITABLE GIFTS

Several factors affect the deductibility of charitable gifts:

- The transaction must be a gift[521]
- The recipient of the gift must be a charitable organization[522]
- The nature of the donor[523]
- The acceptance by the charitable organization of the money or other property that was the subject of the ostensible gift[524]
- When the donor is an individual, whether the donor itemizes deductions[525]
- The year of the gift
- The subject of the gift, whether money or property
- If the gift is of property, the nature of the property that is contributed, such as
  - Long-term capital gain property
  - Short-term capital gain property

---

[516] IRC §§ 512(b)(1), (2), (3), and (5). Most of the controversy in this context centers on the scope of the term *royalty*. E.g., *Sierra Club, Inc. v. Commissioner*, 86 F.3d 1526 (9th Cir. 1996).

[517] IRC §§ 512(b)(4) and 514. The unrelated debt-financed income rules are the subject of *Tax-Exempt Organizations* § 24.12.

[518] IRC § 512(b)(13).

[519] IRC §§ 512(b)(7), (8), and (9).

[520] IRC § 512(b)(12). In general, Hopkins, *The Tax Law of Unrelated Business for Nonprofit Organizations* (Hoboken, NJ: John Wiley & Sons, 2005).

[521] See § 3.1.

[522] See § 3.3.

[523] See § 3.2.

[524] In one instance, an attempted bequest of a half-interest in real property failed to qualify for the estate tax charitable contribution deduction because the charitable recipient of the interest failed to accept it. Tech. Adv. Mem. 9443001.

[525] An individual must itemize deductions to claim a charitable contribution deduction. See § 2.6. In one case, the business expense deduction for payments was denied because the payments were charitable gifts; however, the charitable deduction was denied because the individual taxpayer did not itemize deductions. *Irwin v. Commissioner*, 72 T.C.M. (CCH) 1148 (1996).

   - Ordinary income property
   - Inventory
- If the gift is of property, whether the donor legally owns it[526]
- If the gift is of property, the value of the property contributed[527]
- The public charity/private foundation status of the charitable recipient[528]
- The nature of the recipient if it is an organization other than a public charitable organization or a private foundation
- The use to which the contributed property is put, such as unrelated use of tangible personal property,[529] or specific charitable uses (for example, there are rules concerning gifts of inventory)[530]
- The nature of the interest in the money or property contributed; that is, whether the gift is of an outright interest or a partial interest[531]
- Whether a business expense deduction has been allowed for the property that is the subject of the gift[532]
- Compliance with the recordkeeping, reporting, and other substantiation requirements[533]

Each charitable contribution can be tested against the above criteria to determine its deductibility for federal income tax purposes.[534]

§ 3.7 GRANTOR TRUST RULES

Several instances of the federal tax law concerning charitable giving require application of the *grantor trust* rules. These rules apply with respect to grantors and others who are treated as substantial owners of the property in the trust for tax purposes—that is, those persons in relation to a trust over which they have retained substantial dominion and control.[535] The rules tax to the grantor the income of the grantor trust; technically, the income of the trust (along with appropriate tax deductions[536] and tax credits) is attributed to the grantor.[537]

[526] See § 3.1(d-1).
[527] See § 10.1.
[528] See § 3.4.
[529] See § 4.6.
[530] See § 9.3.
[531] See ch. 5 and pt. Four.
[532] See § 10.7.
[533] See chs. 21 and 22.
[534] One entity that is not entitled to a charitable contribution deduction under any circumstance is a partnership. IRC § 703(a)(2)(C). Instead, when a gift is made from a partnership, each partner takes into account his, her, or its distributive share of the deduction. IRC § 702(a)(4); Reg. §§ 1.702-1(a)(4), 1.703-1(a)(2)(iv). In general, see § 6.14.
[535] IRC §§ 671–679.
[536] This principle includes the charitable contribution deduction. Reg. § 1.671-2(c). For example, a charitable contribution made by a trust which is attributed to the grantor (an individual) is aggregated with the grantor's other charitable contributions to determine their deductibility under the percentage limitations (see ch. 7). Reg. § 1.671-2(c).
[537] IRC § 671.

A *grantor* is a person (including a corporation[538]) who transfers property to a trust.[539]

There are five circumstances in which a grantor is regarded as an owner of some portion of a trust and thus is taxed on the income of the trust[540]:

1. A grantor is treated as the owner of any portion of a trust in which he or she has a reversionary interest in either the corpus of or the income from the trust if, as of the inception of that portion of the trust, the value of the interest exceeds 5 percent of the value of the portion.[541]
2. A grantor is treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income from it is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.[542] This general rule does not apply, however, to a power to determine the beneficial enjoyment of the corpus or of the income from it if the corpus or income is irrevocably payable for a charitable purpose.[543] The power to choose between charitable beneficiaries or to affect the manner of their enjoyment of a beneficial interest does not cause the grantor to be treated as an owner of a portion of the trust.[544]
3. A grantor is treated as the owner of any portion of a trust when certain administrative powers over the trust exist and the grantor can or does benefit under these powers.[545] These powers are the power to deal for less than adequate and full consideration; the power to borrow without adequate interest or security; the power to borrow trust funds; and a general power of administration.
4. A grantor is treated as the owner of any portion of a trust if the grantor or a nonadverse party[546] has a power to revoke the trust or return the corpus to the grantor.[547]

---

[538] Reg. § 1.671-2(e).

[539] Generally, the grantor of a trust is the person who donates the principal to the trust. *Bixby v. Commissioner*, 58 T.C. 757 (1972); Rev. Rul. 87-127, 1987-2 C.B. 156; Priv. Ltr. Rul. 9338015. The IRS published final and temporary regulations providing guidance as to the qualification of persons as grantors of trusts. T.D. 8890.

[540] Reg. § 1.671-1(a).

[541] IRC § 673.

[542] IRC § 674(a).

[543] IRC § 674(b)(4).

[544] Reg. § 1.674(a)-1(b)(1)(iii). The IRS ruled that an arrangement, by which the "presumptive remaindermen" of three charitable lead trusts would serve as "charitable appointers" (those who designate the income beneficiary charities) following the death of the trusts' grantor, would not cause the trusts to be treated as owned by the grantor. Priv. Ltr. Rul. 200029033.

[545] IRC § 675.

[546] A *nonadverse party* is a person who is not an adverse party. IRC § 672(b). An *adverse party* is a person having a substantial beneficial interest in a trust that would be adversely affected by the exercise or nonexercise of the power which he or she possesses with respect to the trust. IRC § 672(a); Reg. § 1.672(a)-1(a). A person having a general power of appointment over trust property is deemed to have a beneficial interest in the trust. IRC § 672(a); Reg. § 1.672(a)-1(a).

[547] IRC § 676.

5. A grantor is treated as the owner of any portion of a trust if the grantor or a nonadverse party has the power to distribute income to or for the benefit of the grantor or his or her spouse.[548]

In some instances, a person other than a grantor is treated as a substantial owner of a portion of a trust.[549] These rules also may apply with respect to foreign trusts having one or more U.S. beneficiaries.[550]

The IRS, on June 6, 2007, proposed regulations providing guidance as to the portion of a trust that is properly includible in a grantor's gross estate[551] if the grantor has retained the use of property in a trust or the right to an annuity, unitrust, or other income payment from such trust for life,[552] for any period not ascertainable without reference to the death of the grantor or for a period that does not in fact end before the grantor's death.[553] These proposed regulations are based on guidance provided by the IRS in 1976[554] and in 1982.[555] The agency, in an effort to ensure ''similar tax [law] treatment for similarly situated taxpayers,'' concluded that one provision of the Internal Revenue Code[556] (rather than another[557]) will be applied in the future to these interests, although the IRS reserved the possibility that other provisions of the Code[558] may be applied in ''appropriate circumstances.''

[548] IRC § 677. The IRS examined a proposed trust agreement and concluded that the grantor would not be treated as the owner of the trust, although the agency observed that actual operation of the trust could lead to a different conclusion. Priv. Ltr. Rul. 199927010, corrected by Priv. Ltr. Rul. 200003059. The IRS reviewed the operations of an ostensible charitable remainder trust (see ch. 12) and, finding various inappropriate payments out of trust income, concluded that the trust cannot qualify as a charitable remainder trust but rather is a grantor trust, with the trustee being owner of the trust. Chief Couns. Adv. Mem. 200628026.
[549] IRC § 678.
[550] IRC § 679.
[551] IRC §§ 2036, 2039. See § 8.3(a).
[552] See §§ 9.22, 9.23.
[553] REG-119097-05.
[554] Rev. Rul. 76-273, 1976-2 C.B. 268.
[555] Rev. Rul. 82-105, 1982-1 C.B. 133.
[556] IRC § 2036.
[557] IRC § 2039.
[558] Including IRC § 2039.

CHAPTER FOUR

Gifts of Money and Property

§ 4.1 **Gifts of Money** **131**

§ 4.2 **Gifts of Property in General** **132**

§ 4.3 **Gifts of Long-Term Capital Gain Property in General** **134**

§ 4.4 **Gifts of Ordinary Income Property** **134**
- (a) Ordinary Income Property Defined 134
- (b) Deduction Reduction Rule 136
- (c) Special Rules of Inapplicability 138

§ 4.5 **Certain Gifts of Capital Gain Property** **138**
- (a) General Deduction Reduction Rule 138
- (b) Qualified Appreciated Stock 139

§ 4.6 **Gifts of Property for Unrelated Use** **141**
- (a) Special Rule 141
- (b) Unrelated Use 142
- (c) Recapture of Deduction 143

§ 4.7 **Variations in Applying Property Rules** **144**

§ 4.8 **Step Transaction Doctrine** **145**

§ 4.9 **Charitable Pledges** **150**

This chapter summarizes the federal tax law concerning the determination of the income tax charitable deduction for contributions of money or property, when the donor is not retaining or creating any interest in the item being transferred. The calculation of this deduction must be made under these rules before application of the general percentage limitations.[1] Contributions of money or property, when the donor is creating an interest in the item being transferred, are subject to other rules.[2]

§ 4.1 GIFTS OF MONEY

An individual or corporation may make a contribution of money—usually U.S. currency—to a charitable organization. This deduction is based on the amount of funds being transferred.

[1] See ch. 7.

[2] See Part Four.

EXAMPLE 4.1

> X, an individual, makes a contribution of $1,000 to a charitable organization during calendar year 2005. Consequently, X has a federal income tax charitable contribution deduction based on the $1,000 amount for that year.

A gift of money in the form of currency of a country other than the U.S. (such as a contribution of a coin collection) may be treated as a gift of property.

When a contribution is made in the form of money, there is no valuation problem, as there can be in connection with contributions of property. Gifts of money are nonetheless subject to the substantiation requirements.[3]

§ 4.2 GIFTS OF PROPERTY IN GENERAL

The law of charitable giving becomes more complex in the case of a donor who makes a contribution of property, rather than a contribution of money.

At the outset, a determination must be made as to the value of the property.[4] This value is known as the *fair market value* of the property. The process of valuing property for these purposes is discussed elsewhere.[5]

In many instances, the federal income tax charitable contribution deduction for contributions of property is based upon the fair market value of that property. There are instances, however, when that value must be reduced for purposes of computing the charitable deduction. Generally, when this reduction in the deduction is required, the amount that is deductible is the amount equal to the donor's basis in the property. The deduction reduction rules are discussed elsewhere.[6]

Because the deduction for a gift of property is often based on the fair market value of the property, a donor can benefit when the property has increased in value since the date on which the donor acquired the property. The property is said to have *appreciated* in value; property in this circumstance is known as *appreciated property*. When certain requirements are satisfied, a donor is entitled to a charitable deduction based on the full fair market value of the property.

This rule—allowance of the charitable deduction based on full value of an item of property—is one of the rules in the tax law that is most beneficial to donors. It is particularly so when one considers that the donor in this circumstance is not required to recognize any gain on the transfer.[7] The gain is the amount that would have been recognized had the donor sold the property; it is sometimes referred to as the *appreciation element*.

The donor's ability to have a charitable deduction based upon the fair market value of the property and not recognize gain on the appreciation element in the

---

[3] See § 21.3.
[4] Reg. § 1.170A-1(c)(1).
[5] See § 10.1.
[6] See §§ 4.4–4.6. In certain circumstances, the charitable deduction may be as much as twice basis (see § 9.3).
[7] E.g., *Campbell v. Prothro*, 209 F.2d 331 (5th Cir. 1954); *White v. Brodrick*, 104 F. Supp. 213 (D. Kan. 1952); Rev. Rul. 55-531, 1955-2 C.B. 520; Rev. Rul. 55-275, 1955-1 C.B. 295; Rev. Rul. 55-138, 1955-1 C.B. 223, modified by Rev. Rul. 68-69, 1968-1 C.B. 80.

property is viewed by some as an unwarranted benefit to donors and a violation of tax policy. Indeed, in some instances, recognition of gain is required.[8]

Likewise, a loss is not recognized when an item of property is contributed to a charity. In this circumstance, the donor should sell the property, experience the loss, and contribute the sales proceeds to charity. (By contrast, the donor of appreciated property is usually best advised to contribute the property to a charitable organization, rather than sell the property and donate the after-tax proceeds to the charity.)

The donor's ability to take a charitable deduction for a contribution of property, based upon the fair market value of the property, depends on several factors. Chief among these are the:

- Nature of the property contributed
- Tax classification of the charitable donee
- Use to which the charitable donee puts the property

As to the first of these factors, the federal tax law categorizes items of property as follows:

- Long-term capital gain property
- Short-term capital gain property
- Ordinary income property

As to the second of these factors, the federal tax law classifies entities as to which deductible charitable contributions can be made as follows:

- Public charitable organizations
- Private foundations
- Governmental bodies
- Other types of tax-exempt organizations (such as veterans' organizations)[9]

As to the third of these factors, the federal tax law divides the use to which a charitable organization puts donated property as follows:

- A use that is related to the donee organization's tax-exempt purpose (*related use*)
- A use that is not related to the donee organization's tax-exempt purpose (*unrelated use*)[10]

The extent to which a contribution of property is deductible for federal income tax purposes is dependent upon the interplay of these factors, plus:

- the value of the property,[11]

---

[8] The most common example of this is the rule in connection with bargain sales (see § 9.19). Another instance would be gifts of property that is subject to debt (see § 9.20).

[9] See § 3.4(b).

[10] See § 3.5.

[11] See § 10.1.

- the percentage limitations,[12] and
- compliance with the substantiation rules.[13]

§ 4.3 GIFTS OF LONG-TERM CAPITAL GAIN PROPERTY IN GENERAL

When a donor makes a contribution of *long-term capital gain property* to a public charitable organization, the charitable deduction is generally based on the full fair market value of the property.[14] There generally is no need for the donor to recognize the capital gain element.[15] This rule is also generally applicable when the donee is a governmental entity.

EXAMPLE 4.2

Y, an individual, makes a contribution of 10 shares of publicly traded securities to a charitable organization during calendar year 2005. These shares, which constitute long-term capital gain property in the hands of Y, have a total fair market value of $3,000. Consequently, Y has a federal income tax charitable contribution deduction based on the $3,000 amount for that year.

The rule is not applicable when the donee is a charitable organization other than a public charitable organization. In that instance, the charitable deduction generally is confined to the donor's basis in the property.[16]

§ 4.4 GIFTS OF ORDINARY INCOME PROPERTY

The federal tax law places limitations on the deductibility of property that, if sold, would give rise to gain that is not long-term capital gain. This type of property, which is termed *ordinary income property*, includes *short-term capital gain property*.

Federal tax law provides a rule requiring the modification of what would otherwise be the charitable deduction for a contribution of property that is ordinary income property.

(a) Ordinary Income Property Defined

The categories of property for charitable giving purposes are discussed elsewhere.[17] Again, ordinary income property is property that has appreciated in value, any portion of the gain on which would give rise to ordinary income (or

[12] See ch. 7.
[13] See §§ 21.1–21.4.
[14] Reg. § 1.170A-1(c)(1).
[15] As one court stated (somewhat more expansively than is actually the law): "Congress, in an effort to encourage contributions to charitable organizations, has seen fit to permit a donor to deduct the full value of any gift of appreciated property without reporting as income from an exchange the appreciation in the value of the property which is thereby transferred." *Sheppard v. United States*, 361 F.2d 972, 977-78 (Ct. Cl. 1966). Also, it is a "well-established rule that a gift of appreciated property does not result in income to the donor." *Greene v. United States*, 13 F.3d 577, 584 (2d Cir. 1994). In general, Greif, "Charitable Contributions of Appreciated Long-Term Securities," 11 *Exempt Org. Tax Rev.* (no. 6) 1224 (June 1995).
[16] See § 4.4(b).
[17] See § 2.12.

short-term capital gain) if the property had been sold by the donor at its fair market value at the time of the charitable gift. Ordinary income is income that is not long-term capital gain. For these purposes, ordinary income and short-term capital gain are regarded as the same. Thus, ordinary income property is property that, if sold at its fair market value by the donor at the time of its contribution to a charitable organization, would generate a gain that is not long-term capital gain.[18]

Examples of ordinary income property are:

- Property held by the donor primarily for sale to customers in the ordinary course of a trade or business (inventory)[19]
- A capital asset held for a period of time that is less than the period required to cause the property to become long-term capital gain property (short-term capital gain property)
- A work of art created by the donor
- A manuscript created by the donor
- Letters and memoranda prepared by or for the donor
- Stock acquired in a nontaxable transaction which, if sold, would generate ordinary income[20]
- Stock in a collapsible corporation which, if sold, would generate ordinary income[21]
- stock in certain foreign corporations which, if sold, would generate ordinary income[22]
- Property used in a trade or business,[23] treated as a capital asset, if gain would have been recognized, upon sale of the property by the donor at its fair market value at the time of the contribution, as ordinary income by reason of the application of recapture rules[24]

The term *ordinary income property* does not include an income interest in respect of which a federal income tax charitable contribution deduction is allowed.[25]

It is the position of the IRS that, when individuals purchase items with the intent of retaining them for the requisite capital gain holding period[26] and thereafter donating them to a charitable organization for the purpose of generating a charitable contribution deduction (in an amount greater than the acquisition price), the individuals are engaged in a *charitable donation venture*.[27] The

[18] Reg. § 1.170A-4(b)(1).
[19] See §§ 2.13, 9.3.
[20] This type of stock, known as *section 306 stock*, is described in IRC § 306(a). The IRS summarized the tax treatment of a charitable gift of section 306 stock in Priv. Ltr. Rul. 8930001.
[21] IRC § 341.
[22] IRC § 1248.
[23] IRC § 1231(b).
[24] IRC § 170(e)(1), last sentence; Reg. § 1.170A–4(c)(4). The recapture rules are the subject of IRC §§ 617(d)(1), 1245(a), 1250(a), 1252(a), and 1254(a).
[25] Reg. § 1.170A-4(b)(1).
[26] See § 2.16.
[27] E.g., *Pasqualini v. Commissioner*, 103 T.C. 1, 5 (1994).

consequence of this view is that the properties held for contribution purposes are items of inventory of the venture and thus are forms of ordinary income property.[28] This position, however, is being rejected in the courts.[29]

(b) Deduction Reduction Rule

Often, as noted, the rule for the deduction arising from a gift of property to a charitable organization is that the amount of the deduction is equal to the amount of the fair market value of the property at the time of the gift.[30] In the case of a charitable gift of ordinary income property, however, the amount of the charitable contribution for the gift of the property must be reduced by the amount of gain that would have been recognized as gain, which is not long-term capital gain, if the property had been sold by the donor at its fair market value, determined at the time of the contribution to the charitable organization.[31] The amount of gain that is taken into account in making this reduction is sometimes termed the *ordinary income element*.

Consequently, this deduction reduction rule basically means that a donor's deduction for a contribution of an item of ordinary income property to a charitable organization is confined to the donor's basis in the property. The amount that is deductible is the fair market value of the property, reduced by the amount that is equal to the ordinary income element.[32] In one case, a company that contributed its film library to a charitable organization was advised by the IRS that its charitable contribution deduction was zero, in that the library was akin to letters and memoranda and, thus, not a capital asset. Because the costs associated with establishing the library were expensed as incurred, the basis in the property was zero. The value of the property contributed had to be reduced by its full amount.[33]

---

[28] In one instance, the IRS ruled that an individual, who purchased books at a volume discount from a company located in a country where the retail price was legally fixed and then imported them into the U.S., warehoused the books for a period just beyond the capital gain holding period, and then donated them to charitable organizations, was engaged in an activity tantamount to the activities of a book dealer, so that the books were held to be ordinary income property. Rev. Rul. 79-419, 1979-2 C.B. 107. In another instance, the IRS ruled that an individual who raised ornamental plants as a hobby, and each year donated a large number of them to various charitable organizations, was engaged in activities substantially equivalent to those of commercial dealers, so that the contributed property was held to be ordinary income property. Rev. Rul. 79-256, 1979-2 C.B. 105. The IRS also so ruled in an instance involving an individual, not an art dealer, who purchased a substantial part of the total limited edition of a particular lithograph print and donated the prints to various art museums. *Id*.

[29] E.g., *Pasqualini v. Commissioner*, 103 T.C. 1, 5 (1994) (Christmas cards acquired for purpose of giving them to a religious organization held to be capital assets); *Sandler v. Commissioner*, 52 T.C.M. (CCH) 563 (1986) (gravesites acquired to donate to a church three times in five years held to be capital assets, even though donor was engaged in business of selling like property commercially); *Hunter v. Commissioner*, 51 T.C.M. (CCH) 1533 (1986) (limited edition prints acquired for charitable giving purposes held to be capital assets). In contrast is *Lindsley v. Commissioner*, 47 T.C.M. (CCH) 540 (1983) (parcels of land contributed by real estate broker to charitable organization held to be ordinary income property).

[30] IRC § 170(a); Reg. § 1.170A-1(c)(1).

[31] IRC § 170(e)(1)(A); Reg. § 1.170A-4(a)(1).

[32] In one instance, this charitable deduction reduction rule was held inapplicable because the property involved was held for at least one year, the property was a capital asset (and thus not, as the IRS contended, held primarily for sale to customers in the ordinary course of a business), and any gain that it would have generated would have been long-term capital gain. *Duval v. Commissioner*, 68 T.C.M. (CCH) 1375 (1994).

[33] Tech. Adv. Mem. 200119005.

This rule applies:

- Irrespective of whether the donor is an individual or a corporation
- Irrespective of the tax classification of the charitable organization that is the donee (for example, public or private charity)[34]
- Irrespective of whether the charitable contribution is made to or for the use of a charitable organization[35]
- To a gift of ordinary income property prior to application of the appropriate percentage limitation(s)[36]

EXAMPLE 4.3

A is an individual. On June 15, 2005, A contributed to a charitable organization shares of stock having a fair market value of $5,000. A acquired the stock on March 1, 2005, for the purchase price of $3,000. A's charitable deduction, computed to the extent of this deduction reduction rule, was $3,000. The amount of this deduction was equal to A's basis in the stock. More technically, A was required to reduce the potential charitable deduction ($5,000) by the ordinary income element ($2,000). This result was required because A did not hold the stock long enough for the shares to become long-term capital gain property rather than short-term capital gain property.

EXAMPLE 4.4

B, an individual, contributed to a charitable organization intangible property to which certain recapture rules[a] apply. The property had a fair market value of $60,000 and an adjusted basis of $10,000. If the property had been sold by B at its fair market value at the time of the contribution, $20,000 of the gain of $50,000 ($60,000–$10,000) would have been treated as ordinary income (because of the recapture rule) and the remainder ($30,000) would have been long-term capital gain. B's contribution of $60,000 had to be reduced by $20,000.[b]

[a] IRC § 1245

[b] Reg. § 1.170A–4(a).

EXAMPLE 4.5

C is a corporation, in the business of selling appliances. In 2009, C contributed certain appliances, having a fair market value of $25,000, to a charitable organization. C acquired these appliances in 2008 for $15,000. C's charitable deduction, computed to the extent of this deduction reduction rule, was $15,000. (If C had donated these appliances for the benefit of the ill or the needy, or infants, a greater charitable contribution deduction might have been available.)[a]

[a] See § 9.3.

[34] See § 3.4.
[35] See § 10.2.
[36] See ch. 7.

(c) Special Rules of Inapplicability

This deduction reduction rule does not apply to reduce the amount of the charitable contribution when, by reason of the transfer of the contributed property, ordinary income or capital gain is recognized by the donor in the same tax year in which the contribution is made.[37] Thus, if recognition of the income or gain occurs in the same tax year in which the contribution is made, this rule is inapplicable when income or gain is recognized upon:

- the transfer of an installment obligation to a charitable organization,[38]
- the transfer of an obligation issued at a discount to a charitable organization,[39] or
- the assignment of income to a charitable organization.[40]

Also, this deduction rule does not apply to a charitable contribution by a nonresident alien individual or a foreign corporation of property, the sale or other disposition of which within the United States would have resulted in gain that is not effectively connected with the conduct of a trade or business in the United States.[41]

§ 4.5 CERTAIN GIFTS OF CAPITAL GAIN PROPERTY

In general, contributions of long-term capital gain property to public charitable organizations are deductible, with the federal income tax charitable contribution deduction computed on the basis of the fair market value of the property.[42]

When contributions are made to a charitable organization that is not a public charitable organization, however, a deduction reduction rule applies. Nonetheless, this rule does not apply with respect to gifts to:

- A private operating foundation
- A pass-through foundation
- A common fund foundation[43]

(a) General Deduction Reduction Rule

The general deduction reduction rule is as follows: When a charitable gift of capital gain property is made, the amount of the charitable deduction that would otherwise be determined must be reduced by the amount of gain that would have been long-term capital gain if the property contributed had been sold by the

[37] Reg. § 1.170A-4(a), last paragraph.
[38] IRC § 453(d).
[39] IRC § 454(b).
[40] Reg. § 1.170A-4(a), last paragraph.
[41] Reg. § 1.170A-4(c)(5), last sentence. This type of gain is the subject of IRC § 871(a) or § 881.
[42] See § 2.3.
[43] IRC § 170(e)(1)(B)(ii), by cross-reference to the three types of private foundations referenced in IRC § 170(b)(1)(E). The law concerning these three entities is discussed in § 3.4.

donor at its fair market value, determined at the time of the contribution, when the gift is to or for the use of a private foundation (with the above three exceptions).[44]

In these circumstances, if the contributed property is capital gain property, the charitable deduction that would otherwise be determined must be reduced by the amount of the unrealized appreciation in value. The charitable deduction under these rules is confined to the basis in the property.

EXAMPLE 4.6

X owned a painting that he purchased for $25,000 and that had a value of $50,000. In X's hands, the property was long-term capital gain property. X contributed this painting to a private nonoperating foundation. X's charitable deduction computed under this rule was $25,000. If the painting had been donated to a private operating foundation, however, the charitable deduction (to the extent of this rule) would have been $50,000.

This rule applies:

- Irrespective of whether the donor is an individual or a corporation
- Irrespective of whether the charitable contribution is made to or for the use of a charitable organization[45]
- To a gift of property prior to application of the appropriate percentage limitation(s)[46]

(b) Qualified Appreciated Stock

An exception to the deduction reduction rule is that it does not apply in the case of a contribution of qualified appreciated stock.[47] That is, when this exception is applicable, the charitable deduction for a contribution of stock to a private foundation is based on the fair market value of the stock at the time of the gift.

Basically, the term *qualified appreciated stock* means any stock

- for which (as of the date of the contribution) market quotations are readily available on an established securities market, and
- that is capital gain property.[48]

In the sole case on the point, a court held that stock contributed to a private foundation did not give rise to a charitable deduction based on its fair market value, because the stock did not constitute qualified appreciated stock.[49] The stock involved was that of a bank holding company. The shares were not listed on the New York Stock Exchange, the American Stock Exchange, or any city or

---

[44] IRC § 170(e)(1)(B)(ii); Reg. § 1.170A-4(b)(2)(i).
[45] See § 10.2.
[46] See ch. 7.
[47] IRC § 170(e)(5)(A).
[48] IRC § 170(e)(5)(B).
[49] *Todd v. Commissioner*, 118 T.C. 334 (2002).

regional stock exchange, nor were the shares regularly traded in the national or any regional over-the-counter market for which published quotations are available. The shares were not those of a mutual fund. A brokerage firm occasionally provided a suggested share price based on the new asset value of the bank. The procedure for someone wishing to purchase or sell shares of the corporation was to contact an officer of the bank or a local stock brokerage firm specializing in the shares. An attempt would be made to match a potential seller with a potential buyer; the shares were not frequently sold. The court held that the stock could not constitute qualified appreciated stock because the market quotations requirement had not been satisfied.[50]

The IRS ruled that stock to be contributed to a private foundation constituted qualified appreciated stock, with the agency concluding that market quotations for the stock are *readily available* on an established securities market due to the accessibility to them on Internet financial sites.[51] The stock in this instance was not traded on a stock exchange; nonetheless, these sites are "well known and heavily accessed." The market quotations for this stock were found to be *published*, in that "enabling virtually anyone in the world with access to the Internet to view current and historical market quotations for [this] stock means that the possibility is maximized that someone would detect a situation in which the market quotations are not reasonable." The IRS concluded that the market quotations for this stock are *readily available*, noting the "ease with which anyone can access current and historical market quotations on the [Over-the-Counter Bulletin Board (OTCBB)] Internet site and other financial Internet sites." The OTCBB was deemed by the IRS to be an *established securities market*; the stock involved was found to be capital gain property.

The term *qualified appreciated stock* does not include any stock of a corporation contributed by a donor to a private foundation to the extent that the amount of stock contributed (including prior gifts of the stock by the donor) exceeds 10 percent (in value) of all of the outstanding stock of the corporation.[52] In making this calculation, an individual must take into account all contributions made by any member of his or her family.[53]

The IRS, from time to time, issues private letter rulings as to whether stock constitutes qualified appreciated stock.[54]

---

[50] The court concluded that the market quotations requirement has the same meaning for the purpose of defining the phrase *qualified appreciated stock* and in determining when securities are publicly traded so as to exempt a donor from the appraisal requirements (see § 21.5, text accompanied by note 125).

[51] Priv. Ltr. Rul. 200702031.

[52] IRC § 170(e)(5)(C)(i).

[53] IRC § 170(e)(5)(C)(ii). The term *member of the family* has the same meaning as that referenced in IRC § 267(c)(2), which is that the family of an individual "include[s] only his [or her] brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants." IRC § 267(e)(4).

For purposes of applying this 10 percent limitation, the fact that the private foundation subsequently disposed of qualified appreciated securities is irrelevant (the stock contributed is still subject to the limitation that securities contributed from an estate are not attributable to an individual for purposes of computing the limitation (because an income tax charitable contribution deduction was not claimed or allowable, IRC § 170(e)(1)(B)(ii)), and, in applying the limitation, securities are valued as of the time of their original contribution (i.e., they are not revalued when subsequent contributions are made). Priv. Ltr. Rul. 200112022.

[54] E.g., Priv. Ltr. Rul. 9247018.

§ 4.6 GIFTS OF PROPERTY FOR UNRELATED USE

Another special rule concerning calculation of the charitable deduction potentially applies when a donor makes a contribution of tangible personal property to a charitable organization.

(a) Special Rule

The special rule is: When a charitable gift of tangible personal property is made, the amount of the charitable deduction that would otherwise be determined must be reduced by the amount of gain that would have been long-term capital gain if the property contributed had been sold by the donor at its fair market value, determined at the time of the contribution, when:

- The use by the charitable donee is unrelated to the donee's tax-exempt purpose or, when the donee is a governmental unit, if the use to which the contributed property is put is for a purpose other than an exclusively public purpose,[55] or
- The property is applicable property that is sold, exchanged, or otherwise disposed of by the donee before the last day of the tax year in which the contribution was made and with respect to which the donee has not made the requisite certification.[56]

In these circumstances, when the contributed property is capital gain property, the charitable deduction that would otherwise be determined must be reduced by the amount of the unrealized appreciation in value.[57]

This rule applies:

- Irrespective of whether the donor is an individual or a corporation
- Irrespective of the tax classification of the charitable organization that is the donee (for example, public or private charity)[58]
- Irrespective of whether the charitable contribution is made to or for the use of a charitable organization[59]
- To a gift of tangible personal property prior to application of the appropriate percentage limitation(s)[60]

When tangible personal property is put to a related use by the recipient charitable organization, the charitable deduction is based on the fair market value of the property (that is, there is no deduction for the capital gain element).

---

[55] IRC § 170(e)(1)(B)(i)(I); Reg. § 1.170A-4(b)(2)(ii).
[56] IRC § 170(e)(1)(B)(i)(II). See § 4.6(c).
[57] For this purpose, a fixture that is intended to be severed from real property is treated as tangible personal property. Reg. § 1.170A-4(b)(2), last sentence.
[58] See § 3.3.
[59] See § 10.3.
[60] See ch. 7.

(b) Unrelated Use

The term *unrelated use* means a use of an item of contributed property:

- by a charitable organization that is not related to the purpose or function constituting the basis of the tax exemption for the charitable organization, or
- by a governmental unit that is for a purpose other than an exclusively public purpose.[61]

EXAMPLE 4.7

X owned a painting that he purchased for $25,000 and that had a value of $50,000. In X's hands, the property was long-term capital gain property. X contributed this painting to an educational institution, which used the painting for educational purposes by placing it in its library for display and study by art students. Because this use was a related use, X's charitable deduction computed under this rule was $50,000.[a]

[a] Reg. § 1.170A–4(b)(3)(i).

If a charitable donee sells an item of tangible personal property donated to it, this deduction reduction rule is triggered, because sale of the property is not a related use of the property. Thus, donors of tangible personal property should exercise caution when contemplating a gift of the property, particularly when the donor knows the property is going to be promptly sold (such as a gift to support an auction).

EXAMPLE 4.8

This example is based on the facts of Example 4.7. Instead of the educational uses made of the painting, however, the educational institution decided to promptly sell the painting and use the proceeds of sale for educational purposes. This use of the property was an unrelated use and X's charitable deduction computed under this rule was $25,000 ($50,000 reduced by the long-term capital gain element of $25,000). This is the case even though the proceeds of the sale were put to a related use.

If furnishings contributed to a charitable organization are used by it in its offices and buildings in the course of carrying out its functions, the use of the property is not an unrelated use. If a set or collection of items of tangible personal property is contributed to a charitable organization or governmental unit, the use of the set or collection is not an unrelated use if the donee sells or otherwise disposes of only an insubstantial portion of the set or collection. The use by a trust of tangible personal property contributed to it for the benefit of a charitable organization is an unrelated use if the use by the trust is one that would have been unrelated if used directly by the charitable organization.[62]

[61] Reg. § 1.170A-4(b)(3)(i). See § 3.5.
[62] *Id.* The last of these rules is of particular importance in the context of planned giving, where property contributed is often given to a trust, such as a charitable remainder trust (see, in particular, ch. 12).

A donor who makes a charitable contribution of tangible personal property to or for the use of a charitable organization or governmental unit may treat the property as not being put to an unrelated use by the donee if:

- the donor establishes that the property is not in fact put to an unrelated use by the donee,[63] or
- at the time of the contribution or at the time the contribution is treated as made, it is reasonable to anticipate that the property will not be put to an unrelated use by the donee.[64]

In the case of a contribution of tangible personal property to or for the use of a museum, if the object donated is of a general type normally retained by the museum or other museums for museum purposes, it is considered reasonable for the donor to anticipate, unless the donor has actual knowledge to the contrary, that the object will not be put to an unrelated use by the donee, whether or not the object is later sold or exchanged by the donee.[65]

(c) Recapture of Deduction

The tax benefit arising from charitable contributions of tangible personal property, with respect to which a fair market value deduction is claimed and which is not used for charitable purposes, must, in general, be recovered. This recapture rule applies to *applicable property*, which is tangible personal property that has appreciated in value that has been identified by the donee organization as for a use related to the donee's tax-exempt purpose or function and for which a charitable deduction of more than $5,000 has been claimed.[66]

If a donee organization disposes of applicable property within three years of the contribution of the property (known as an *applicable disposition*[67]), the donor is subject to an adjustment of the tax benefit. If the disposition occurs in the tax year of the donor in which the contribution was made, the donor's deduction generally is confined to the basis in and not the fair market value of the property. If the disposition occurs in a subsequent year, the donor must include as ordinary income for its tax year in which the disposition occurs an amount equal to the excess (if any) of (1) the amount of the deduction previously claimed by the donor as a charitable contribution with respect to the property, over (2) the donor's basis in the property at the time of the contribution.[68]

There is no adjustment of the tax benefit, however, if the donee organization makes a certification to the IRS, by written statement signed under penalties of perjury by an officer of the organization.[69] This statement must (1) certify that the use of the property by the donee was related to the purpose or function constituting the basis for the donee's exemption and describe how the property was used

[63] Reg. § 1.170A-4(b)(3)(ii)(a).
[64] Reg. § 1.170A-4(b)(3)(ii)(b).
[65] *Id.*
[66] IRC § 170(e)(7)(C).
[67] IRC § 170(e)(7)(B).
[68] IRC § 170(e)(7)(A). This rule took effect for contributions made after September 1, 2006. Prior law rules continue to apply to contributions of exempt use property for which a deduction of $5,000 or less is claimed.
[69] IRC § 170(e)(7)(D).

and how the use furthered the exempt purpose or function, or (2) state the intended use of the property by the donee at the time of the contribution and certify that the use became impossible or infeasible to implement. The organization must furnish a copy of the certification to the donor.

A penalty of $10,000 is applicable to a person who identifies applicable property as having a use that is related to a purpose or function constituting the basis for the donee's tax exemption knowing that it is not intended for such a use.[70]

§ 4.7 VARIATIONS IN APPLYING PROPERTY RULES

The rules contained in this section and the previous sections may be illustrated by Examples 4.9, 4.10, and 4.11.

EXAMPLE 4.9

On July 1, 2009, C, an individual, made the following charitable contributions, all of which were to a public charitable organization, PC, except in the case of nonqualified appreciated stock to a private foundation, PF:

Property	Fair Market Value	Adjusted Basis	Recognized Gain if Sold
Ordinary income property	$50,000	$35,000	$15,000
Property that, if sold, would produce long-term capital gain			
(1) Stock that is a capital asset, contributed to			
(i) PC	25,000	21,000	4,000
(ii) PF	15,000	10,000	5,000
(2) Tangible personal property that is a capital asset, put to unrelated use by PC	12,000	6,000	6,000
Total	$102,000	$72,000	$30,000

EXAMPLE 4.10

After making the necessary reductions required by the above rules, the amount of charitable contributions allowed (before application of the general percentage limitations[a]) was as follows:

Property	Fair Market Value	Reduction	Contribution Allowed
Ordinary income property	$50,000	$15,000	$35,000
Property that, if sold, would produce long-term capital gain			
(1) Stock contributed to			
(i) PC	25,000	-0-	25,000

[70] IRC § 6720B. Other penalties may also apply, such as the penalty for aiding and abetting the understatement of tax liability (IRC § 6701). See § 10.14.

(ii) PF	15,000	5,000	10,000
(2) Tangible personal property	12,000	6,000	6,000
Total	$102,000	$26,000	$76,000[b]

[a] See ch. 7.
[b] This example is based on Reg. § 1.170A-4(d), Examples (1)(a) and (b).

EXAMPLE 4.11

This example is based on the facts in Example 4.10, except that C is a corporation. The amount of charitable contributions allowed (before application of the general percentage limitations) would have been as follows:

Property	Fair Market Value	Reduction	Contribution Allowed
Ordinary income property	$50,000	$15,000	$35,000
Property that, if sold, would produce long-term capital gain			
(1) Stock contributed to			
(i) PC	25,000	-0-	25,000
(ii) PF	15,000	5,000	10,000
(2) Tangible personal property	12,000	6,000	6,000
Total	$102,000	$26,000	$76,000[a]

[a] This example is based on Reg. § 1.170A-4(d), Examples (1)(c).

§ 4.8 STEP TRANSACTION DOCTRINE

This chapter has stated throughout the general rule that a contribution of appreciated capital gain property to a public charitable organization is deductible on the basis of the fair market value of the property and the capital gain element is not taxable to the donor.[71]

If, however, the donee charitable organization sells the property soon after the contribution is made, the donor may be placed in the position of having to recognize, for federal income tax purposes, the capital gain element. This can happen when, under the facts and circumstances surrounding the gift, the donee was legally obligated to sell the gift property to a purchaser that was prearranged by the donor. In this situation, the law regards the transaction as a sale of the property by the ''donor'' to the third-party purchaser and a gift of the sales proceeds to the charitable organization.[72]

This is the *step transaction doctrine*, under which two or more ostensibly independent transactions (here, the gift and subsequent sale) are consolidated and treated as a single transaction for federal tax purposes. The key to avoiding this tax-adverse outcome is to be certain that the charitable organization was not

[71] See § 4.2.
[72] E.g., *Martin v. Machiz*, 251 F. Supp. 381 (D. Md. 1966); *Magnolia Dev. Corp. v. Commissioner*, 19 T.C.M. (CCH) 934 (1960).

legally bound at the time of the gift to sell the property to the prospective purchaser.[73]

The step transaction rule has been, and continues to be, the subject of considerable litigation. Several court opinions illustrate the nature of this controversy. In one, the court ruled that a gift to a charitable organization of the long-term capital gains in certain commodity futures contracts gave rise to a charitable contribution deduction, and that the gifts and subsequent sales of the contracts were not step transactions within a unified plan.[74]

The case concerned an individual who formed a private operating foundation in the early 1970s and had been president of it since the date it was established. From time to time, he contributed futures contracts to the foundation and claimed charitable contribution deductions for these gifts. In 1974, he obtained a private letter ruling from the IRS that the charitable contributions deductions were proper and that no gain need be recognized when the foundation sold the contracts.

In 1981, however, the federal tax law was changed. Beginning that year, all commodities futures contracts acquired and positions established had to be marked to market at year-end and the gains (or losses) had to be characterized as being 60 percent long-term capital gains (or losses) and 40 percent short-term gains (or losses), regardless of how long the contracts had been held.[75] This posed a problem for this individual because the charitable deduction for a gift of short-term capital gain property is confined to the donor's basis in the property;[76] there is no deduction for the full fair market value of the property (as there is for most gifts of long-term capital gain property).[77] He solved the problem by donating only the long-term gain portion of the futures contracts.

In 1982, this individual entered into an agreement under which he contributed the long-term capital gains of selected futures contracts from his personal accounts at a brokerage house and retained for himself the short-term capital gains. For the most part, the selected contracts were sold on the same day the gift was made, and the portions of the proceeds representing the long-term capital gains were transferred to an account of the foundation at the same brokerage house. The donor chose the futures contracts to be donated according to the funding needs of the foundation and the amount of unrealized long-term capital gains inherent in the contracts. Once the contracts were transferred to a special account, they were to be immediately sold, pursuant to a standing instruction. On audit

---

[73] This sidestep of the step transaction doctrine has its basis in *Palmer v. Commissioner*, 62 T.C. 684 (1974), *aff'd on another issue*, 523 F.2d 1308 (8th Cir. 1975), to which the IRS agreed in Rev. Rul. 78-197, 1978-1 C.B. 83. In *Palmer*, a gift of stock in a closely held corporation to a charitable organization, followed by a prearranged redemption, was not recharacterized as a redemption between the donor and the redeeming corporation and a later gift of the redemption proceeds to the charity. This was the outcome, although the donor held voting control over both the corporation and the charitable organization. The IRS lost the case because the charity was not legally bound to redeem the stock, nor was the corporation in a position to compel the redemption.

[74] *Greene v. United States*, 806 F. Supp. 1165 (S.D.N.Y. 1992). This case also involved application of the rules concerning anticipatory assignments of income (see § 3.1(g)). This case was affirmed in an opinion containing an extensive discussion of the step transaction doctrine as it applies in the charitable giving setting. 13 F.3d 577 (2d Cir. 1994). Also see § 3.1(h), last sentence of note 201.

[75] IRC § 1256(a)(3).

[76] IRC § 170(e)(1)(A). See § 4.4(b).

[77] See § 4.3.

for 1982, the IRS took the position that the full amount of the capital gains on the sales of these contracts was includable in this individual's taxable income. The IRS also disallowed the charitable deductions for that year and prior years. The IRS's position rested on two arguments: (1) the transfers of a portion of the gain to the foundation were a taxable anticipatory assignment of income;[78] and (2) the step transaction doctrine should apply, thereby collapsing separate interrelated transactions into a single transaction for tax purposes.

The step transaction doctrine was inapplicable in this instance, the individual argued, because no prearrangements were made with respect to the gifts. He maintained that he donated all of his interest in the long-term capital gain portions of the futures contracts, free and clear. The IRS, by contrast, contended that the gift transfers should be treated together with the later future sales and division of proceeds as a single transaction. The government argued that this individual's plan was to meet the foundation's operating needs by selling selected futures contracts with unrealized appreciation of equal amounts. Rather than donating cash, this argument went, he tried to donate the futures contracts with a restriction that he would keep the short-term capital gains on their sale.

The court said that the question in the case was "[H]ow related were the decisions to sell the futures to their donation?"[79] The court looked to the matter of control and found that the donation agreements and powers of attorney executed by the individual supported his position that the trustees of the foundation had control over the sale of the futures contracts once they were transferred into the broker's special account. Thus, the court concluded that the issue of the donor's control over the sale of the contracts "was not such that the donations and sales could be viewed as step transactions encompassed within a unified plan."[80]

As this case illustrated, the question posed by the step transaction doctrine involves the relationship among various seemingly independent transactions. In this case, the question was: How related were the decisions to sell the futures contracts to the contribution of them? Had some prearrangement existed by which the individual donated selected contracts to cover the charitable organization's operating expenses, and had he received in return short-term gains without having to pay taxes on the full amount of the futures contracts, the transfers could have been viewed as a step transaction within a larger plan. In this connection, one court held:

> If, by means of restrictions on a gift to a charitable donee, either explicitly formulated or implied or understood, the donor so restricts the discretion of the donee that all that remains to be done is to carry out the donor's prearranged plan . . . for designation of the stock, the donor had effectively realized the gain inherent in the appreciated property.[81]

As to this case, the individual claimed that the sales were not prearranged but rather were the prudent acts of the trustees of a charitable organization in need of operating funds. The IRS argued that the standing instruction reflected a prearranged plan to use the charity to sell the futures contracts, cover its needs with

---

[78] See § 3.1(g).

[79] *Greene v. United States*, 806 F. Supp. 1165, 1172 (S.D.N.Y. 1992).

[80] *Id*. at 1173.

[81] *Blake v. Commissioner*, 697 F.2d 473 (2d Cir. 1982), *aff'g* 42 T.C.M. (CCH) 1336 (1981).

the long-term gains, and enable the individual to keep the short-term gains without having to pay taxes on the entire proceeds of the sale. The court held that there was no evidence to suggest that the individual was the source of the standing instruction and thus that his control over the sale of the contracts was not such that the contributions and sales could be viewed as step transactions encompassed within a unified plan.

In a similar case, a court held that contributions of appreciated futures contracts to a charitable organization controlled by an individual did not result in income to the individual when the contracts were sold shortly after they had been donated.[82] The court dismissed the importance of control between the business and the recipient charitable organization and the fact that everyone involved anticipated that the gifted property would be sold or otherwise liquidated. Wrote the court: ''Only through such a step could the purpose of the charitable contribution be achieved.''[83]

In another instance, an individual made annual gifts, for 10 consecutive years, to a university of closely held stock in a corporation of which he was the majority shareholder, an officer, and a director. He retained a life interest in the gift property and confined his charitable contribution deduction to the value of the remainder interest. Each year, the university tendered stock to the corporation for redemption; each year, the corporation redeemed it. There was no contract evidencing this cycle of events. The university invested the redemption proceeds in income-producing securities and made quarterly disbursements to the donor.

The IRS argued that the donor employed the university as a tax-free conduit for withdrawing funds from the corporation and that the redemption payments by the corporation to the university were in reality constructive dividend payments to the donor. The court on appeal nicely framed the dispute: ''[O]ur aim is to determine whether [the donor's] gifts of the [c]orporation's shares [to the university] prior to redemption should be given independent significance or whether they should be regarded as meaningless intervening steps in a single, integrated transaction designed to avoid tax liability by the use of mere formalisms.''[84]

The IRS wanted the court to ''infer from the systematic nature of the gift-redemption cycle'' that the donor and donee had ''reached a mutually beneficial understanding.''[85] But the court declined to find any informal agreement between the parties; it also declined to base tax liability on a ''fictional one'' created by the IRS.[86] The court so held even though the donor was the majority shareholder of the corporation, so that his vote alone was sufficient to ensure redemption of the university's shares. The court wrote that ''foresight and planning do not transform a non-taxable event into one that is taxable.''[87]

In still another instance, an individual donated promissory notes issued by a company he controlled to three charitable foundations several weeks prior to their redemption. A court held that he did not realize income in connection with these gifts or the subsequent redemption of the notes by the company. The court

---

[82] *S.C. Johnson & Son, Inc. v. Commissioner*, 63 T.C. 778 (1975).
[83] *Id.* at 780.
[84] *Grove v. Commissioner*, 490 F.2d 241, 246 (2d Cir. 1973).
[85] *Id.*
[86] *Id.* at 247.
[87] *Id.*

observed: ''A gift of appreciated property does not result in income to the donor so long as he gives the property away absolutely and parts with title thereto before the property gives rise to income by way of a sale.''[88]

In one more instance involving facts of this nature, the court took note of the fact that the concept of a charitable organization originated before and independently of the sale, the deed of trust for the property contributed was executed before and independent of the sale, and at the time the deed of trust was executed, ''no mutual understanding or meeting of the minds or contract existed between the parties.''[89]

There are cases to the contrary, however, holding that the transfer of the property to a charitable organization ''served no business purpose other than an attempt at tax avoidance.''[90]

In the end, perhaps the matter of the doctrine comes down to this: ''Useful as the step transaction doctrine may be in the interpretation of equivocal contracts and ambiguous events, it cannot generate events which never took place just so an additional tax liability might be asserted.''[91]

The step transaction doctrine occasionally appears in IRS private letter rulings as well. In one instance, an individual planned to fund a charitable remainder trust[92] with a significant block of stock of a particular corporation. It was anticipated that the trust would sell most, if not all, of this stock in order to diversify its assets. The stock first had to be offered to the corporation, under a right of first refusal, which allowed the corporation to redeem the stock for its fair market value. The donor was the sole initial trustee of the trust.

The IRS focused on whether the trust would be legally bound to redeem the stock. Although it did not answer that question, it assumed that to be the case and also assumed that the trust could not be compelled by the corporation to redeem the stock. Thus, the IRS held that the transfer of the stock by the donor to the trust, followed by the redemption, would not be recharacterized for federal income tax purposes as a redemption of the stock by the corporation followed by a contribution of the redemption proceeds to the trust. The IRS also held that the same principles would apply if the stock were sold rather than redeemed. This holding assumed that the donor had not prearranged a sale of the stock before contributing it to the trust under circumstances in which the trust would be obligated to complete the sales transaction.[93]

In another situation, an individual planned to contribute a musical instrument to a charitable remainder trust. The instrument was used in the donor's profession; the donor was not a dealer in this type of instrument, nor was it depreciated for tax purposes. Again, the issue was presented: If the trust

[88] *Humacid Co. v. Commissioner*, 42 T.C. 894, 913 (1964). This observation is well quoted (e.g., *Grove*, 490 F.2d at 246; *Carrington v. Commissioner*, 476 F.2d 704, 708 (5th Cir. 1973)).

[89] *Martin v. Machiz*, 251 F. Supp. 381, 390 (D. Md. 1966).

[90] *Magnolia Dev. Corp. v. Commissioner*, 19 T.C.M. (CCH) 934, 937 (1960). Also *Palmer v. Commissioner*, 468 F.2d 705 (10th Cir. 1972); *Tatum v. Commissioner*, 400 F.2d 242 (5th Cir. 1968); *Friedman v. Commissioner*, 346 F.2d 506 (6th Cir. 1965).

[91] *Sheppard v. United States*, 361 F.2d 972, 978 (Ct. Cl. 1966). Also *Behrend v. United States*, 73-1 U.S.T.C. ¶ 9123 (4th Cir. 1972); *Fox v. Commissioner*, 27 T.C.M. (CCH) 1001 (1968).

[92] See ch. 12.

[93] Priv. Ltr. Rul. 9452020.

subsequently sold the instrument for a gain, would that gain have to be recognized by the donor? The IRS presumed that there was no prearranged sales contract legally requiring the trust to sell the instrument following the gift. With this presumption, the IRS was able to hold that any later gain on a sale of the instrument would not be taxable to the donor.[94]

§ 4.9 CHARITABLE PLEDGES

The making of a pledge does not give rise to a federal income tax charitable contribution deduction. The deduction that is occasioned, such as it may be, is determined as of the time the pledge is satisfied.[95]

The enforceability of a pledge is a matter of state law. Some states require the existence of consideration as a prerequisite to the existence of an enforceable pledge; other states will enforce a pledge on broader, social grounds.

Usually, a pledge is made by a potential donor in the form of a written statement—a promise to the potential charitable donee of one or more contributions in the future. An example of the rule is that a pledge of a stock option to a charitable organization produces an income tax charitable deduction in the year in which the charitable donee, having acquired the option, exercises it.[96] Another illustration of this is a *funding agreement*, under which a person commits in writing to make multiple contributions to a charitable organization over a stated period, for purposes such as general operations or endowment: The charitable contribution arises in each year of actual payment.[97]

As one court case reflects, however, a charitable pledge can arise in other ways. A trustee of a small college and his colleagues were concerned about the long-term financial viability of the institution. He wanted to substantially augment the college's endowment fund. To that end, he caused a company (of which he was the president) to issue (in 1981) to the college a zero-coupon original-issue discount bond, with a term of 50 years and a $20 million face amount, payable upon maturity in 2031 (unless the bond was retired early). The purchase price of the bond was $23,066 (representing the 1981 present value of $20 million, payable in 50 years, discounted semi-annually using a 14 percent annual interest rate). The company was obligated to maintain a sinking fund sufficient to retire the bond at full maturity; it had the option to retire the bond at a discount after July 1986. The president of the company personally arranged for contributions to the school to cover the purchase price of the bond.

The company is on the accrual basis of accounting. The total interest that is to accrue over the term of the bond (the original issue discount) is $19,976,934. One-fiftieth of the total discount is $399,539. That amount is what the company annually transferred to the sinking fund and deducted as interest accrued on

[94] Priv. Ltr. Rul. 9452026. An application of the step transaction doctrine, albeit not entailing a charitable contribution, was made available when a court disregarded a series of transactions entered into by a family involving the purchase of ranch properties and subsequent tax-free exchanges of these properties with family-controlled entities. *True v. United States*, 190 F.3d 1165 (10th Cir. 1999).

[95] Rev. Rul. 55-410, 1955-1 C.B. 297.

[96] E.g., Priv. Ltr. Rul. 200202034.

[97] E.g., Priv. Ltr. Rul. 200241044.

indebtedness.[98] The mechanics of this transaction were dynamic. The accrued interest would have been taxable to a commercial taxpayer; the college, however, being tax-exempt, was excused from this tax liability. In 2031, it will receive $20 million for a 1981 outlay of $23,066. The company could have retired the bond as early as August 1, 1986; the retirement payment would have been $45,377, with the company enjoying about $2 million in tax deductions. (Even if the IRS recaptured a tax deficiency attributable to the company's deductions for interest accrued but not paid, the company would have had the use of that money to invest in the meantime.) The IRS asserted, however, and a court agreed, that the transaction lacked a business purpose other than tax avoidance, and disallowed the deductions.[99] The court concluded that the bond was a legitimate indebtedness for tax purposes and that the transaction had some economic substance for the company. The court made an evaluation of the company's motive for the transaction and found that it was (other than tax benefits) a means to provide the college with an investment that would substantially enhance its endowment. The court wrote that this motive, ''while admirable, is wholly unlike the economically self-interested purpose that taxpayers must demonstrate.''[100]

Thus, in the absence of any other economic, commercial, or business purpose for the bond transaction, the court found that it lacked the requisite independent business purpose and disregarded the debt form of the transaction for tax purposes. Did the company contribute the $19,976,934 to the college? The answer is no, because no payments have yet been made to the institution (even accrual basis donors must actually make payments on a timely basis).[101] Thus, the issue is one of timing, with the bond documentation reflecting a pledge. It would seem that, once made, any payments to the school would be deductible as a charitable gift (assuming all other requirements were met). After all, the court found that the company's motive underlying the transaction was not a business purpose, but was one of substantial economic disinterest.

When the charitable organization involved is a private foundation,[102] the matter of a charitable pledge can be more complicated if the pledger is a disqualified person[103] with respect to the foundation. The principal difficulty is with the rules concerning self-dealing.[104] The making of a pledge by a disqualified person to a private foundation, in and of itself, is not an act of self-dealing.[105] Likewise, the making of a pledge that, when it ripens into a contribution, requires a facility or organization to be named after the disqualified person, is not an act of self-dealing, because the benefit to the disqualified person is incidental and tenuous.[106] Under some circumstances, however, the satisfaction of a pledge by a disqualified person to a private foundation can be self-dealing. In one instance, for example, a private foundation paid the dues of a disqualified person to a church,

---

[98] IRC § 163(a).
[99] *Peerless Indus., Inc. v. United States*, 94-1 U.S.T.C. ¶ 50,043 (E.D. Pa. 1994).
[100] *Id.* at 83,174.
[101] IRC § 170(a)(2).
[102] See § 3.4.
[103] *Id.*, note 410.
[104] IRC § 4941 (see *Private Foundations* Ch. 5).
[105] Reg. § 53.4941(d)-2(c)(3).
[106] Reg. §§ 53.4941(d)-2(f)(2), 53.4941(d)-2(f)(4), Example (4).

thereby enabling him to maintain his membership in and otherwise participate in the religious activities of the congregation. The dues payment was ruled to constitute self-dealing, with the IRS concluding that the private foundation's payment of the dues ''result[ed] in a direct economic benefit to the disqualified person because that person would have been expected to pay the membership dues had they not been paid by the foundation.''[107]

[107] Rev. Rul. 77-160, 1977-1 C.B. 351, 352. In general, Lyon, ''Charitable Giving—Pledges v. Letters of Intent,'' 42 *Exempt Org. Tax Rev.* (no. 3) 347 (Dec. 2003).

CHAPTER FIVE

Fundamentals of Planned Giving

§ 5.1 **Introduction** **154**

§ 5.2 **Appreciated Property Gifts** **154**

§ 5.3 **Planned Gifts: Core Concepts** **155**

§ 5.4 **Charitable Remainder Trusts** **157**

- (a) General Rules 157
- (b) Charitable Remainder Annuity Trusts 158
- (c) Charitable Remainder Unitrusts 160
- (d) Tax Treatment of Distributions 161
- (e) Tax Treatment of Charitable Remainder Trusts 162
- (f) Remainder Trust Agreements 162
- (g) Gift Tax Aspects 163
- (h) Estate Tax Aspects 163

§ 5.5 **Pooled Income Funds** **164**

- (a) General Rules 164
- (b) Valuation and Assignment of Units 166
- (c) Distribution of Income 166
- (d) Determining the Charitable Deduction 167
- (e) Tax Treatment of Income Distributions and Pooled Income Funds 167
- (f) Selection of Trustee 168
- (g) Pooled Income Fund Instruments 168
- (h) Seeding 169

§ 5.6 **Charitable Gift Annuities** **170**

§ 5.7 **Charitable Lead Trusts** **170**

- (a) General Rules 171
- (b) Income Tax Charitable Deduction (If Any) 172
- (c) Determining the Charitable Deduction 172
- (d) Tax Treatment of Lead Trust 173
- (e) Testamentary Use of Lead Trusts 173
- (f) Private Foundation Rules 173

§ 5.8 **Planned Giving: Other Forms** **174**

§ 5.9 **Planned Giving and Securities Laws** **174**

An analysis of the law of charitable giving would be incomplete without substantial attention to the various forms of *planned giving*. At the same time, there is more to the law of charitable giving than planned giving. The purpose of this chapter is to place the concept of planned giving in its appropriate context. The chapters of Parts Two and Three can be read with this concept in perspective. The details of planned giving are the subject of Part Four.

Planned giving has, over the years, been made to seem deeply mysterious and very complicated, with the result that managers of many charitable organizations, and those who assist them in the fundraising process, are fearful of it. Most charitable organizations think about planned giving from time to time but many of them put off implementing a planned giving program to another day—a tomorrow that never comes.

This chapter summarizes the concept of planned giving and introduces its basic forms. As noted, the details associated with each of the planned giving techniques are discussed in Part Four.

§ 5.1 INTRODUCTION

Donors and the charitable organizations they support commonly expect gifts to be in the form of outright transfers of money or property. For both parties, a gift is usually a unilateral transaction, in a financial sense, with the donor parting with the contribution and the donee charitable organization acquiring it. The advantages to the donor in these instances are confined to the resulting charitable contribution deduction and the personal enhancement derived from making the gift.

There are, however, forms of charitable giving that provide far greater financial and tax advantages to the donor. This type of giving is frequently referred to as *planned giving* and sometimes *deferred giving*.

It is somewhat difficult to create a ''bright-line'' (that is, clearly delineating) test for differentiating between planned gifts and other charitable gifts. Of course, small and modest outright gifts of money or property do not qualify as planned gifts. Beyond that, opinions differ. Some assert that any gifts made by means of a will are planned gifts; others disagree. Some believe that gifts of insurance policies are planned gifts; others say they are not. Wherever the line is drawn, it can be said that a planned gift is a charitable gift that is integrated with the donor's overall financial (including estate) plans.

§ 5.2 APPRECIATED PROPERTY GIFTS

One of the chief principles underlying (and creating) the advantages of charitable contributions of securities, real estate, and other property is that the deductible amount is generally equal to the full fair market value of the property at the time of the gift.[1] This means that the amount of appreciation in the property (the amount exceeding the donor's basis), which would be taxed as capital gain if the property were sold, escapes regular income taxation. For this favorable result to occur, the property must constitute long-term capital gain property.[2] Percentage limitations apply regarding the extent of annual gift deductibility (depending mainly on whether the donee is a public charity or a private foundation,[3] on the carryover rules concerning the deductibility of excess gift amounts,[4] and on

[1] See § 4.2.
[2] See the discussion of this term in §§ 2.16(a), 4.3.
[3] See § 3.4.
[4] See ch. 7.

special rules that apply in computing the deduction for gifts of tangible personal and other forms of property).[5]

Consequently, the key to wise charitable giving is to give property that is long-term capital gain property and that has substantially appreciated in value. The greater the appreciation, the greater the charitable deduction and other income tax savings. The appreciated-property gift is, therefore, a fundamental concept of planned giving.

§ 5.3 PLANNED GIFTS: CORE CONCEPTS

There are two basic types of planned gifts. One type is made by means of a will, whereby the gift is derived from a decedent's estate (as a bequest or devise). The other type involves a gift made during the donor's lifetime, using a trust or other agreement.

These gifts are sometimes called *deferred gifts*, because actual receipt of the contribution by the charity is deferred until the happening of some event (usually the donor's death). But the term *deferred giving* has fallen out of favor, as some donors (to the chagrin of the gift-seeking charity) are under the impression that it is their tax benefits that are being deferred.

A planned gift usually is a contribution of a donor's interest in money or an item of property, rather than an outright gift of the entirety of the money or property. (The word *usually* is used because gifts using insurance do not neatly fit this definition and because some treat an outright gift of property through an estate as a planned gift.) Technically, this is a gift of a *partial interest* in property. Thus, planned giving usually is partial interest giving.[6] Further, an item of property has within it two *interests*. an income interest and a remainder interest.

The *income interest* within an item of property is a function of the income generated by the property. A person may be entitled to all of the income from a property or to only some portion of the income; for example, income equal to 6 percent of the fair market value of the property, even though the property is producing income at the rate of 9 percent. This person is said to have the (or an) income interest in the property. Two or more persons (such as husband and wife) may have income interests in the same item of property, and these interests may be held concurrently or consecutively. An income interest is capable of being accorded a present value at the time the interest is created.

The *remainder interest* within an item of property is the projected value of the property, or the property produced by reinvestment, at some future date. That is, the remainder interest in property is an amount equal to the then value of the property (or its offspring) when it is to be received at a subsequent point in time. As an illustration, if A gives B a portfolio of securities, telling B that he or she can hold the

---

[5] See ch. 4.

[6] The general rule is that a gift of a partial interest in property to a charitable organization, made by a form other than a trust, is not deductible as a charitable contribution. IRC § 170(f)(3)(A). The three exceptions to this rule (IRC § 170(f)(3)(B)) are discussed in § 9.6 and ch. 15. A charitable contribution of a partial interest (remainder interest) in trust must, to be deductible as a charitable gift, be made by means of a charitable remainder trust or pooled income fund. IRC § 170(f)(2)(A); see chs. 12 and 13. A charitable contribution of a partial interest (income interest) in trust must, to be deductible as a charitable gift, be made in accordance with IRC § 170(f)(2)(B). See ch. 16.

securities for a period of 10 years and have the income from the portfolio during that time, following which the securities must be returned to A, B has the income interest in the securities and A has the remainder interest. Thus, while A has made a gift to B of the income interest, A has retained the remainder interest in the property. In planned giving, usually the donor (here, A) retains the income interest and the charitable organization involved is the donee of the remainder interest.

These interests are measured by the value of the property, the age of the donor(s), and the period of time during which the income interests will exist. The actual computation is usually made by means of interest rates and actuarial tables promulgated by the Department of the Treasury.

An income interest or a remainder interest in property may, then, be contributed to charity. It is, however, unusual for a deduction to be available for a charitable gift of an income interest in property. By contrast, the charitable contribution of a remainder interest in an item of property will—assuming all of the technical requirements are met—give rise to a (frequently sizable) charitable contribution deduction.

When a gift of a remainder interest in property to a charitable organization is made, the charity usually will not acquire title to that remainder interest until the income interests have expired. Nonetheless, the donor receives the charitable deduction for the tax year in which the remainder interest in the property for the recipient charity is established. When a gift of an income interest in property to a charity is made, the charity acquires that interest immediately and retains it until such time (sometimes measured by a term of years) as the remainder interest commences. Again, any resulting charitable deduction is available for the tax year in which the income interest in the property for the charity is established.

Basically, the federal tax law requires that a planned gift be made by means of a trust if a charitable deduction is to be available. The trust used to facilitate a planned gift is known as a *split-interest trust* because the trust is the mechanism for satisfying the requirements with respect to the income and remainder interests.[7] That is, the trust is the medium for splitting the property into its two component interests. Split-interest trusts are charitable remainder trusts, pooled income funds, and charitable lead trusts. There are some exceptions to the general requirement for use of a split-interest trust in planned giving. The principal one is the charitable gift annuity, which uses a contract rather than a trust. Individuals may give a remainder interest in their personal residence or farm to charity and receive a charitable deduction without utilizing a trust.[8] Further, a contribution of an undivided portion of one's entire interest in property is not regarded as a contribution of a partial interest in property.[9]

Still, a person contemplating a planned gift to a charitable organization usually makes the gift by means of a split-interest trust. When one or more of the planned gift techniques are utilized, charitable giving can result in many financial advantages to the donor, particularly when appreciated property (such as securities or real estate) is used.

---

[7] IRC § 4947(a)(2).

[8] IRC § 170(f)(3)(B)(i). See § 15.2.

[9] IRC § 170(f)(3)(B)(ii). See § 15.3. In general, Brown, "All About Planned Giving," 117 *Trusts & Estates* 744 (1978).

A donor, although desirous of supporting a particular charitable organization, may be unwilling or unable to fully part with property, either because of a present or perceived need for the income that the property provides and/or because of the capital gains taxes that the donor would incur if the property were sold. The planned gift is likely to be the answer in this situation, because the donor may satisfy his or her charitable desires and yet continue to receive income, perhaps on an enhanced basis, from the property. Moreover, the donor receives a charitable contribution deduction for the gift of the remainder interest, which will reduce or eliminate the tax on the income from the gift property. Also, there is no regular income tax on the capital gain inherent in the property. Further, if the gift property is not generating sufficient income, the trustee of the split-interest trust may dispose of the property and reinvest the proceeds in more productive property, which will enable the donor to receive more income from the property than was the case prior to the making of the gift.

§ 5.4 CHARITABLE REMAINDER TRUSTS

The most widespread form of planned giving involves a split-interest trust known as the *charitable remainder trust*.[10] The term is nearly self-explanatory: the entity is a trust, in which has been created a remainder interest that is destined for one or more charitable organizations. Each charitable remainder trust arrangement is specifically designed for the particular circumstances of the donor(s), with the remainder interest in the gift property designated for one or more charitable organizations.

One or more income interests are also created in a charitable remainder trust; thus, the charitable remainder trust is a split-interest trust.

(a) General Rules

A qualified charitable remainder trust must provide for a specified distribution of income, at least annually, to one or more beneficiaries (at least one of which is not a charitable organization) for life or for a term of no more than 20 years, with an irrevocable remainder interest to be held for the benefit of, or paid over to, the charitable organization.[11] These beneficiaries are the holders of the income interests and the charitable organization has the remainder interest; these interests are defined with particularity in the charitable remainder trust agreement.

The manner in which the income interests in a charitable remainder trust are ascertained depends on whether the trust is a *charitable remainder annuity trust* or a *charitable remainder unitrust*. In the case of the charitable remainder annuity trust, the income payments are in the form of a fixed amount (hence the term *annuity*). In the case of the charitable remainder unitrust, the income payments are in the form of an amount equal to a fixed percentage of the fair market value of the assets in the trust.

The charitable remainder annuity trust provides the advantage of a fixed return. The charitable remainder unitrust becomes attractive in the face of inflation,

[10] The charitable remainder trust is the subject of ch. 12. Also Callister, "Charitable Remainder Trusts: An Overview," 51 *Tax Law* (no. 3) 549 (Spring 1998).
[11] IRC § 664.

as the amount paid out is a function of the annual measurement of the value of the trust's assets.

When the annuity interest or unitrust interest is payable over a term of years, any person (including an individual, corporation, trust, or partnership) can be a beneficiary. When the term is for someone's life, however, only an individual (or a charity) can be a beneficiary. If these rules are not followed, the charitable deduction will not be allowed, or will be allowed only if state law causes immediate acceleration of the remainder interest.

All categories of charitable organizations—both public charities and private foundations[12]—are eligible to be remainder beneficiaries of as many charitable remainder trusts as they can muster. The allowability of the charitable deduction will vary, however, as respects the type of charitable organization that is the donee, because of the percentage limitations.[13]

Usually, a bank or similar financial institution serves as the trustee of a charitable remainder trust. These institutions should have the capacity to administer the trust, make appropriate investments, and timely adhere to all income distribution and reporting requirements. It is common, however, for the charitable organization that is the remainder beneficiary to act as trustee. If the donor or a related person is named the trustee, the *grantor trust* rules may apply, with the gain from the sale by the trust of appreciated property taxed to the donor.[14]

Conventionally, once the income interest expires, the assets in a charitable remainder trust are distributed to the charitable organization that is the remainder beneficiary. The assets (or a portion of them) may, however, be retained in the trust. If a retention occurs, the trust will be classified as a private foundation, unless it can sidestep those rules.

(b) Charitable Remainder Annuity Trusts

One basic type of charitable remainder trust is, as noted, the charitable remainder annuity trust.

Specific Rules. When an annuity trust is utilized, the donor (or other income beneficiary or beneficiaries) annually receives income in the form of a fixed amount, called a *sum certain*. This stated dollar amount is the same either as to each recipient or as to the total amount payable for each year of the payment period. The amount may be expressed as a fraction or a percentage of the initial net fair market value of the property irrevocably passing in trust.

A federal income tax charitable deduction is available for the creation of a remainder interest for a charity, by means of a charitable remainder annuity trust, when nine basic criteria are satisfied:

1. The trust must be structured to pay an annuity to or for the use of one or more noncharitable beneficiaries.
2. Each noncharitable beneficiary must be alive at the time the trust is established.

[12] See § 3.4.
[13] See ch. 7.
[14] IRC §§ 671–677.

3. The annuity must be equal to at least 5 percent of the initial net fair market value of the gift property.
4. The trust cannot qualify if the annuity for a year is greater than 50 percent of the initial net fair market value of the trust's assets.
5. The annuity must be payable at least annually.
6. The annuity must be payable either for a term of years (up to 20) or for the life of the noncharitable beneficiary (or beneficiaries).
7. The trust cannot pay any amounts, other than the annuities, to or for the use of any person other than the charitable organization that is the remainder beneficiary.
8. The value of the remainder interest must be at least 10 percent of the initial net fair market value of all property placed in the trust.
9. The remainder interest created by the trust must be transferred to or for the use of the charitable organization(s) involved or retained by the trust for such use.

There are other requirements, but these are the fundamental ones.

A donor cannot make any additional contributions to a charitable remainder trust. A donor may, however, create as many charitable remainder annuity trusts as may be desired.

A trust does not qualify as a charitable remainder annuity trust if any person has the power to alter the amount to be paid to any named person, other than the charitable beneficiary, if that power would cause any person to be treated as the owner of the trust, or any portion of it, under the grantor trust rules. The trust may not be subject to a power to invade, alter, amend, or revoke for the beneficial use of a person other than a charitable organization.

According to the IRS, there cannot be a federal income tax charitable deduction for a transfer to a charitable remainder annuity trust when there is more than a 5 percent probability that a noncharitable beneficiary will receive annuity payments to the extent that the trust becomes depleted, therefore leaving nothing for the charity holding the remainder interest.

(ii) Determining the Charitable Deduction. The charitable deduction resulting from a contribution by means of a charitable remainder annuity trust is determined by use of monthly interest rates and tables promulgated by the Department of the Treasury. (Once that potential deduction is determined, the actual deduction depends on compliance with the general charitable giving rules.) These tables yield a number called a *factor*, which when multiplied by the total amount transferred into the trust provides the deductible portion.

Three elements must be taken into account in determining this charitable deduction:

1. The age of the income beneficiary (or ages of the income beneficiaries) if the term of the trust is measured by a life (or lives), or the term of the trust, if it is for a stated period of years.
2. The annuity percentage.

3. The date or dates during the year when payment to the income beneficiary (or beneficiaries) will be made.

As to the first element, it is necessary to know the beneficiary's date of birth, in that the age to use is that closest to his or her birth date.

(c) Charitable Remainder Unitrusts

The other basic type of charitable remainder trust is, as noted, the charitable remainder unitrust.

Specific Rules. When a unitrust is utilized, the donor (or other income beneficiary or beneficiaries) annually receives income in an amount equal to a fixed percentage of net fair market value of the trust assets, valued annually (a *unitrust amount*). A percentage is *fixed* if it is the same either as to each recipient or as to the total percentage payable in each year of the payment period.

A federal income tax charitable deduction is available for the creation of a remainder interest for a charity, by means of a charitable remainder unitrust, when nine basic criteria are satisfied. (Some of these elements are the same as for a charitable remainder annuity trust, as they are common to all charitable remainder trusts.) These criteria are:

1. The trust must be structured to pay a unitrust amount to or for the use of one or more noncharitable beneficiaries.
2. Each noncharitable beneficiary must be alive at the time the trust is established.
3. The unitrust amount must be equal to at least 5 percent of the net fair market value of the trust property, valued annually.
4. The trust cannot qualify if the unitrust amount for a year is greater than 50 percent of the value of the trust's assets, determined annually.
5. The unitrust amount must be payable at least annually.
6. The unitrust amount must be payable either for a term of years (up to 20) or for the life of the noncharitable beneficiary (or beneficiaries).
7. The trust cannot pay any amounts, other than the unitrust amount, to or for the use of any person other than the charitable organization that is the remainder beneficiary.
8. The value of the remainder interest in each item of property placed in the trust must be at least 10 percent of the value of that property.
9. The remainder interest created by the trust must be transferred to or for the use of the charitable organization involved or retained by the trust for that use.

Again, there are other requirements, but these are the fundamental ones.

A donor can make additional contributions to a charitable remainder unitrust. A trust does not qualify as a charitable remainder unitrust if any person has the power to alter the amount to be paid to any named person, other than the

charitable beneficiary, if that power would cause any person to be treated as the owner of the trust, or any portion of it, under the grantor trust rules.

The trust may not be subject to a power to invade, alter, amend, or revoke for the beneficial use of a person other than a charitable organization.

In appropriate circumstances, it may be preferable to use the *income only* type of charitable remainder unitrust. With this trust, the income payments may be only the actual income (if any) of the trust (up to the otherwise required minimum 5 percent of annual value). Additionally, a unitrust may provide for income payments in subsequent years to constitute or include make-up payments, so as to bring the income payments over the multiyear period involved to the amounts that would have been paid had the standard fixed percentage approach been used. This type (or these types) of unitrust is advantageous in situations in which the income generated by the gift property at the time of the gift is not sufficient to satisfy the general payout requirement, and the make-up option is appropriate when it is anticipated that the income from the property will increase or that the trust will be able to dispose of the property and reinvest the proceeds in more productive assets. Under certain circumstances, an income-only unitrust or make-up option unitrust can be converted (flipped) to a standard charitable unitrust.

Determining the Charitable Deduction. As with the charitable remainder annuity trust, the federal income tax charitable deduction resulting from a contribution by means of a charitable remainder unitrust is determined by use of Treasury Department interest rates tables. Likewise, the deductible portion of the transfer is ascertained through the determination and application of a factor.

Four elements of fact must be taken into account in determining this charitable deduction:

1. The age of the income beneficiary (or ages of the income beneficiaries) if the term of the trust is measured by a life (or lives), or the term of the trust, if it is to be for a stated period of years
2. The unitrust amount percentage
3. The date of valuation of the trust's assets
4. The date or dates during the year when payment to the income beneficiary (or beneficiaries) will be made

(d) Tax Treatment of Distributions

A noncharitable beneficiary of distributions from a charitable remainder trust is taxed on the payments in accordance with the types of revenue experienced by the trust. This tax scheme is represented by four tiers of potential tax treatment, which characterize the amounts paid to income beneficiaries (whether as annuity amounts or unitrust amounts). These tiers are:

1. The payments are characterized as ordinary income, to the extent the trust has ordinary income for the current year and undistributed ordinary income from prior years.

2. The payments are characterized as capital gain, to the extent the trust has any capital gain for the current year and any undistributed capital gain from prior years. This capital gain will be taxed as ordinary income, except that the recipient can first offset long-term capital gain with long-term capital loss and short-term capital gain with short-term capital loss.[15]
3. The payments are *other income*—principally, tax-exempt income, such as interest on municipal bonds (see below)—to the extent the trust has any other income for the current year and any undistributed other income from prior years.
4. Finally, the payments are characterized as a nontaxable distribution of corpus.

The determination of the character of amounts distributed is made as of the end of the appropriate tax year of the trust. (This tax structure is different from that normally used to characterize distributions from trusts, which causes the payments to proportionately reflect the types of revenue experienced by the trust.)

Thus, the charitable remainder trust rules first force upon the noncharitable beneficiaries the least favorable tax treatment of their payments. This result can, however, be alleviated in the early years by the charitable deduction occasioned by the gift (assuming the donor is the income beneficiary).

(e) Tax Treatment of Charitable Remainder Trusts

Qualified charitable remainder trusts are exempt from federal income taxation. These trusts are subject to an excise tax in the full amount of any unrelated business taxable income[16] that they receive.

(f) Remainder Trust Agreements

A charitable remainder trust, like any trust, is established upon the execution of a trust agreement. The law contains a battery of stringent requirements that must be strictly adhered to if the trust is to qualify as a charitable remainder trust. When these requirements are not satisfied, there generally cannot be any charitable deduction for a gift to the trust. There are, however, special rules pursuant to which a charitable remainder trust can be reformed and thus qualify for the charitable deduction. Further, a defective trust cannot be exempt as a charitable remainder trust.

Certain provisions of the private foundation rules are applicable to charitable remainder trusts.[17] A qualified charitable remainder trust must name a specific charitable organization as the (or a) remainder beneficiary. Under appropriate circumstances, a substitute remainder beneficiary may be designated by the

---

[15] There are varying rates of taxation of capital gains; thus, distributions of capital gain property from a charitable remainder trust may entail more than one rate of taxation. See § 12.5.
[16] See § 3.5.
[17] See § 3.4.

donor, a noncharitable beneficiary, or the trustee. The trust instrument must also make provision for an alternative charitable organization remainder beneficiary.

Nearly all of the foregoing requirements of law must be reflected in the trust agreement, if the trust is to constitute a qualified charitable remainder trust.

The IRS has developed prototype charitable remainder trust forms.

(g) Gift Tax Aspects

Generally, the federal gift tax charitable deduction rules with respect to charitable remainder trusts are the same as the federal income tax charitable deduction rules.[18] A federal gift tax return may be required, however, although the charitable deduction will preclude the tax.

When there is a single noncharitable beneficiary of a charitable remainder trust, and that beneficiary is not the donor, the donor has made a potentially taxable gift of the current value of the income interest. (When the donor is also the sole income beneficiary, there is no gift, inasmuch as the tax law does not recognize the concept of an individual donating to himself or herself.) The $11,000 annual gift tax exclusion ($22,000, in the case of a two-spouse gift) is available, however, as well as the general unified estate and gift tax credit. When the nondonor beneficiary is the donor's spouse, the gift will qualify in full for the unlimited marital deduction.

When there are two noncharitable beneficiaries of a charitable remainder trust, and one of the beneficiaries is not a donor, the result is a gift to the other beneficiary of the current value of his or her income interest. The value of the gift will depend on whether the donor or the other beneficiary is the principal beneficiary. Again, the annual gift tax exclusion and the unified credit are available, as is the marital deduction (when the other beneficiary is the donor's spouse).

Care must be exercised with respect to the tax status of the remainder beneficiary. Although any charitable organization is an eligible beneficiary for gift tax purposes, the scope of the gift tax definition of *charity* is narrower.

(h) Estate Tax Aspects

If an individual creates a charitable remainder trust during his or her lifetime and is not an income beneficiary, the value of the gift(s) is added to the donor's taxable estate and any gift tax paid is credited against any estate tax.[19]

When an individual creates a charitable remainder trust during his or her lifetime and has an income interest in it for any period that does not terminate before his or her death, the value of the trust principal will be included in the estate. Even if the decedent did not retain an income interest, the value of the trust principal will be part of the gross estate if he or she retained a testamentary power to revoke the donee's interest.

Again, the marital deduction is available and the same considerations apply with respect to the charitable donee.

---

[18] See § 8.2.
[19] See § 8.3.

§ 5.5 POOLED INCOME FUNDS

Another planned giving technique is the gift to a pooled income fund.[20] Like a charitable remainder trust, a pooled income fund is a form of split-interest trust, under which a remainder interest is contributed to charity and the income is paid over to noncharitable beneficiaries. As the name reflects, however, the pooled income fund involves a pool of gifts rather than gifts from a single source.

(a) General Rules

A donor to a qualified pooled income fund[21] receives a charitable contribution deduction for the gift to a charitable organization of the remainder interest in the donated property. By the transaction, income interests in one or more noncharitable beneficiaries are created, with the remainder interest in the gift property designated for the charity that maintains the fund.

The pooled income fund basic instrument (trust agreement or declaration of trust) is written to facilitate gifts from an unlimited number of donors; thus, the essential terms of the transaction are established in advance for all participants. That is, there is no tailoring of the terms of the transfer to fit any one donor's particular circumstances (as is the case, for example, with the charitable remainder trust). The pooled income fund is, literally, a pooling of gifts. These gifts may be of a considerably lesser amount than those to a charitable remainder trust, and are generally confined to cash and readily marketable securities (other than tax-exempt bonds).

A pooled income fund receives gifts from a number of donors, with each donor contributing an irrevocable remainder interest in the gift property to or for the use of an eligible charity. Each donor creates an income interest for the life of one or more beneficiaries, who must be living at the time of the transfer. The properties transferred by the donors must be commingled in the fund (to create the necessary pool).

Each income interest beneficiary must receive income at least once each year, determined by the rate of return earned by the fund for the year. Beneficiaries receive their proportionate share of the fund's income. The income share is based on the number of units owned by the beneficiary in the fund; each unit must be based on the fair market value of the assets when transferred.

Thus, a pooled income fund is essentially an investment vehicle, the funding of which is motivated by charitable intents. The operation of the fund is similar to the operation of a mutual fund. There are, however, three important exceptions. First, the capital in a pooled income fund is held by the trustee(s) (which may be, or include, the charity involved) and cannot be sold or redeemed by a donor or an income beneficiary. Second, realized capital gains are reinvested as additions to principal and are not distributed to a donor or an income beneficiary. Third, upon termination of all designated income interests, the full value of the units assigned to an item of gift property are transferred to or retained for the benefit of the charity involved.

---

[20] The pooled income fund is the subject of ch. 13.

[21] IRC § 642(c)(5).

A pooled income fund must be *maintained* by one or more charitable organizations. This maintenance requirement means that the charity must exercise control over the fund; the organization does not have to be the trustee of the fund (although it can be), but it must have the power to remove and replace the trustee. An income beneficiary of, or donor to, the fund may not be a trustee. A donor may be a trustee or officer of the charitable organization that maintains the fund, however, provided that he or she does not have the general trustee's responsibilities toward the fund.

Unlike other forms of planned giving, only certain categories of charitable organizations may maintain a pooled income fund. Most types of public charities can maintain such a fund, although private foundations and some nonprivate foundations cannot.[22]

For a contribution of a remainder interest to a charitable organization, made by means of a pooled income fund, to be deductible, nine elements (of which some have been described) must be present. These are:

1. The donor must transfer an irrevocable remainder interest in the property.
2. The remainder interest must be transferred to or for the use of a charitable organization that is qualified as at least one of the types of public charities.
3. The donor must create, by means of the transfer to the fund, an income interest for the life of one or more noncharitable beneficiaries.
4. The property that is the subject of the gift must be commingled with property transferred by other donors.
5. There must be no investments by the fund in tax-exempt securities.
6. The fund must consist only of amounts transferred in compliance with the pooled income fund requirements of law.
7. The fund must be maintained by the charitable organization to which the remainder interest is contributed.
8. A donor or a beneficiary of an income interest in a pooled income fund cannot be a trustee of the fund.
9. The income paid each year to the income beneficiaries is determined by the rate of return earned by the fund for the year.

The deductible portion of a transfer of property to a pooled income fund is determined by reference to interest rates and actuarial tables promulgated by the Department of the Treasury.

The same general tax advantages of gifts to charitable remainder trusts are available for gifts to pooled income funds. This is particularly true when the gift is made using fully marketable and appreciated securities. The pooled income fund transfer may accommodate a smaller amount (value) of securities than a transfer to a remainder trust. If fixed income is an important consideration, however, the charitable remainder annuity trust (see above) or the charitable gift annuity (see below) will be preferable to a gift to a charitable remainder unitrust or pooled income fund.

[22] The distinctions between public and private charities are summarized in § 3.4.

(b) Valuation and Assignment of Units

A pooled income fund is divided into units, each of which represents an interest in the fund equal in value to each of the other units. The fair market value of the assets of a pooled income fund is frequently determined as of the first business day of each fiscal year and as of the first business day of each of the other three fiscal year quarters.

The value of a unit is determined by dividing the fair market value of the fund's assets on the determination day by the number of outstanding units. Gifts generally are added to the fund on the next determination day following receipt, and the income interest in the gifts is assigned a number of units determined by dividing the fair market value of the gift on that day by the value of a unit determined on that day. If a donor provides for two or more beneficiaries to receive income with respect to his or her gift concurrently, the units assigned to the income interest in the gift will be allocated proportionately among the concurrent beneficiaries so that they will share the income interest in the gift as specified by the donor.

The charitable organization involved should reserve the right, in appropriate circumstances, to add gifts to the fund on a day other than a determination day, in which case a special valuation of units is made on that day.

Once determined, the number of units assigned to the income interest (or share thereof) in a gift will not change, but the value of a unit will change as the value of the fund's assets changes. When principal amounts are severed from the fund and transferred to the charitable organization, the units assigned or allocated thereto are cancelled.

(c) Distribution of Income

The documents associated with a pooled income fund should specify the timing of the distribution of income. For example, if the calendar year is the fiscal period, donors may be notified that distributions of the income of the fund will be made quarterly, on or about the 15th day of the month following the close of each calendar quarter (that is, about the 15th of January, April, July, and October) in each year, to income beneficiaries in proportion to their respective income interests. All income must be distributed annually; to the extent that any portion of the income for a taxable year has not been fully distributed by the four above-described quarterly payments, then an additional make-up payment must be made within the first 65 days of the taxable year next following.

Each unit outstanding for less than the entire year will be entitled to receive a fractional payment based on the portion of the year for which it was outstanding. Realized and unrealized appreciation or depreciation of principal should not be taken into account in determining income. Therefore, the following items should be treated as principal and not income: (1) gains and losses from the sale, exchange, redemption, or other disposition of investment assets; (2) stock dividends, stock splits, and similar distributions; (3) capital gain dividends of regulated investment companies (mutual funds); (4) liquidating distributions; and (5) any other dividends or distributions not deemed to be taxable as income under the federal tax laws.

The income payable with respect to each unit will depend, of course, on the income earned by the pooled income fund; the charitable organization cannot predict what that income will be.

(d) Determining the Charitable Deduction

As noted earlier, a planned gift is predicated on the fundamental concept that an item of property carries with it an income interest and a remainder interest. Most deductible planned gifts involve a contribution of a remainder interest in property to a charitable organization.

Such is the case with a gift to a charitable organization by means of a pooled income fund. As always, a first step is to determine the fair market value of the property being transferred. Once that is done, the *present value* of the income interest retained or designated by a donor is ascertained. The difference between the value of the property and the value of the income interest is the value of the remainder interest. The amount of the charitable deduction occasioned by a transfer of cash or property to a pooled income fund is based on the value of the remainder interest in the property (that is, the fair market value of the property less the value of the income interest).

The present value of the income interest in property contributed to a pooled income fund generally depends on two elements: the age of the income beneficiary (or beneficiaries) and the rate of return experienced by the pooled income fund. The rate of return used to value the income interest is determined by reference to the highest rate of return experienced by the fund for any of the three years of the fund preceding the year in which the transfer is made. When a pooled income fund has not been in existence for three years in advance of the year of a gift, a 9 percent rate of return must be presumed.

The Department of the Treasury has developed tables to use in determining the present value of remainder interests in property transferred to pooled income funds. These tables, which are gender neutral, establish factors used with respect to income beneficiaries of various ages and rates of return.

(e) Tax Treatment of Income Distributions and Pooled Income Funds

A beneficiary of income distributions from a pooled income fund is taxed on the payments in accordance with the tax rules that apply to the types of net income experienced and distributed by the fund. Thus, the tax treatment of distributions to income beneficiaries from pooled income funds is determined in accordance with the standard trust rules. The rules governing the taxation of distributions to income beneficiaries from charitable remainder trusts (which, as noted above, characterize the receipts as ordinary income, capital gain, and/or nontaxable return of capital) are inapplicable to distributions from pooled income funds.

Unlike charitable remainder trusts, pooled income funds are not formally tax-exempt. A pooled income fund, however, is allowed a deduction for distributions of income to beneficiaries and for long-term capital gains that have been permanently set aside for charitable purposes. (Therefore, a pooled income fund is taxable on all income, including short-term capital gain, which is not distributable to beneficiaries.) Consequently, a pooled income fund is essentially tax-exempt.

(f) Selection of Trustee

As noted, a pooled income fund must be maintained by the charitable organization that is the recipient of the remainder interests in the cash or properties contributed. While this means that the charitable organization must retain the ability to select the trustee (or trustees) of a pooled income fund, it does not mean that the charitable organization must be the (or a) trustee.

Some charitable organizations designate, in the instrument that creates the pooled income fund, a financial institution as trustee of the fund. This can create a problem if the charitable organization and the financial institution subsequently part ways. A more prudent approach is to enable the charitable organization to name the trustee in a separate agreement and/or to be a co-trustee with the financial institution. In this way, if a new financial institution is selected, the pooled income fund organizational instrument need not be altered.

(g) Pooled Income Fund Instruments

The document by which a pooled income fund is created is either termed a *declaration of trust* or, when a basic contractual relationship with a trustee is embodied in the document, a *trust agreement*. The provisions of a pooled income fund instrument must, to ensure the availability of the charitable deductions, comply with the various operating rules. The IRS has issued sample provisions for pooled income fund organizational documents.

A pooled income fund declaration of trust or trust agreement must contain provisions:

- Requiring that the property transferred to a pooled income fund by each donor be commingled with, and invested or reinvested with, other property transferred to the fund by other donors
- Prohibiting a pooled income fund from accepting or investing in tax-exempt securities
- Prohibiting the fund from having, as a trustee, a donor to the fund or a beneficiary (other than the charitable organization that receives the remainder interests) of an income interest in any property transferred to the fund
- Directing the trustee of the pooled income fund to distribute income currently or within the first 65 days following the close of the tax year in which the income is earned
- Stating that the income interest of any designated beneficiary shall either terminate with the last regular payment made before the death of the beneficiary or be prorated to the date of his or her death
- Stating that, upon termination of the income interest(s) retained or created by a donor, the amount severed from the fund must either be paid to, or retained for the use of, the designated charity
- Prohibiting the fund from engaging in any act of self-dealing
- Requiring such distributions as are necessary to enable the fund to satisfy the private foundation mandatory payout requirements

- Prohibiting the fund from retaining any excess business holdings
- Prohibiting the fund from making any jeopardizing investments
- Prohibiting the fund from making any taxable expenditures

A pooled income fund life agreement (the document by which the gift is evidenced) must: (1) specify at the time of the transfer the particular beneficiary or beneficiaries to whom the income is payable, and the share of income distributable to each person so specified; and (2) contain an acknowledgment by the donor that he or she has read the explanatory brochure of the pooled income fund prior to execution of the life income agreement.

Still other provisions may (and generally should) appear in one or both of the pooled income fund instruments. Thus, a pooled income fund declaration of trust, and in many instances the life income agreement, may or should contain one or more of the following provisions: (1) a formal name of the pooled income fund; (2) a statement of the purposes of the fund; (3) a statement of the maintenance requirement; (4) a summary of the general terms and conditions applicable to pooled income fund gifts; (5) authorization of the remainderman of the fund to invest its properties in the fund (see below); (6) a summary of the methods of valuation of the pooled income fund and the dates on which the valuation shall be determined; (7) a summary of the unit plan or other method of evidencing an income interest in the fund; (8) an explanation of the considerations with respect to the timing of the making of a gift to the fund; (9) a statement as to whether the fund is on the cash or accrual method of accounting; (10) a definition of the receipts of the fund that are chargeable to income and to principal; (11) a summary of the procedures for computing and distributing income for the income beneficiaries of the fund; (12) a discussion of the treatment of property in the fund upon termination of the income interest in it; (13) a statement of the identity and powers of the trustee(s) of the fund; (14) a statement as to whether the fund is to use the calendar year or another fiscal year; (15) a statement as to whether the pooled income fund declaration of trust can be amended; and (16) a provision stating that a unit of participation is entitled to share in the income of the fund in a lesser amount than would otherwise be determined under the general unit plan rules, provided that the income otherwise allocable to the unit is paid within the tax year it is received by the charity to or for which the remainder interest is contributed.

(h) Seeding

Generally, the investment practices of a pooled income fund must be in conformance with the conventional charitable trust law requirements. Although the law states that a fund can include only amounts received from transfers that meet the statutory tests, the charity may combine the assets of the fund with the organization's endowment assets for investment purposes, as long as adequate records are maintained to show the separate nature of the two categories of assets.

A charitable organization may begin operation of its pooled income fund by seeding the fund, in whole or in part, with its own assets. This may have to be done, for example, when the trustee is a financial institution that demands an initial deposit in the fund and there are inadequate gifts at the outset. Thereafter, as

gifts come in, the assets can be withdrawn from the fund. Income beneficiaries do not participate in the earnings from nongift assets in the fund.

§ 5.6 CHARITABLE GIFT ANNUITIES

Another planned giving vehicle is the *charitable gift annuity*.[23] Unlike the charitable remainder trust and the pooled income fund, the charitable gift annuity is not based upon use of a split-interest trust. Rather, the annuity is reflected in an agreement between the donor and donee, where the donor agrees to make a gift and the donee agrees, in return, to provide the donor (and/or someone else) with an annuity.

The donor, in the process of creating a charitable gift annuity, is in fact engaging in two transactions, albeit with one payment: the purchase of an annuity and the making of a charitable gift. It is the latter that gives rise to the charitable deduction. One sum is transferred; the amount in excess of that necessary to purchase the annuity is the charitable gift portion. It is because of the dual nature of the transaction that the charitable gift annuity transfer constitutes a bargain sale.[24]

As with the annuity paid out of a charitable remainder annuity trust, the annuity resulting from the creation of a charitable gift annuity arrangement is a fixed amount paid at regular intervals. The amount paid depends on the age of the beneficiary, determined at the time the contribution is made. Because of rules in the area of unrelated-debt financing, however, the period of a charitable gift annuity is properly for one or two lives, rather than for a term of years.

A portion of the annuity paid is tax-free, being a return of capital. When appreciated securities are given, there will be capital gain on the appreciation that is attributable to the value of the annuity. If the donor is the annuitant (receiver of the annuity), the capital gain can be reported ratably over the individual's life expectancy. The tax savings occasioned by the charitable contribution deduction may, however, shelter from taxation the capital gain resulting from the creation of a charitable gift annuity.

Because the arrangement is by contract between donor and donee, all of the assets of the charitable organization are on the line for ongoing payment of the annuities. (By contrast, with most planned giving techniques the resources for payment of income are confined to those in a split-interest trust.) That is why a few states impose a requirement that charities establish a reserve for the payment of gift annuities and why many charitable organizations are reluctant to embark upon a gift annuity program. Charitable organizations that are reluctant to commit to the ongoing payment of annuities can, however, eliminate the risk by reinsuring them.

§ 5.7 CHARITABLE LEAD TRUSTS

The foregoing forms of planned giving have this common element: the donor transfers to a charitable organization the remainder interest in the property, with

---

[23] Gifts by means of a charitable gift annuity are the subject of ch. 14.
[24] See § 9.19.

one or more noncharitable beneficiaries retaining the income interest. The reverse may occur, however, and that is the essence of the *charitable lead trust*.[25]

(a) General Rules

A charitable lead trust is a vehicle by which property transferred to it is apportioned into an income interest and a remainder interest. Like the charitable remainder trust and the pooled income fund, it is a split-interest trust. Pursuant to a charitable lead trust, an income interest in property is contributed to a charitable organization, either for a term of years or for the life of one individual or the lives of more than one individual. The remainder interest in the property is reserved to return, at the expiration of the income interest (the *lead period*), to the donor or some other noncharitable beneficiary or beneficiaries; often the property passes from one generation (the donor's) to another.

The charitable lead trust can be used to accelerate into one year a series of charitable contributions that would otherwise be made annually, with a corresponding single-year deduction for the "bunched" amount of charitable gifts.

In some sets of circumstances, a charitable deduction is available for the transfer of an income interest in property to a charitable organization. There are stringent limitations, however, on the deductible amount of charitable contributions of these income interests.

A charitable lead trust can be funded by a donor or donors during lifetime, as well as by means of transfers from an estate.

The charitable lead trust is frequently used to transfer property from one member of a family to another, usually from one generation to the next. For example, a father may establish a charitable lead trust, providing income from the trust to a charitable organization for a term of years, with the trust corpus to thereafter pass to his daughter. This type of transfer may be subject to a gift tax, but the actual tax cost of the gift is substantially reduced because of the reduction in the amount transferred to the ultimate beneficiary by the value of the income interest contributed to a charitable organization. If a charitable lead trust is used to shift property to a generation other than the immediate next one, the transfer may be subject to the generation-skipping transfer tax.

The income interest created for a charitable organization by means of a charitable lead trust is defined in one of two ways. The income interest may be stated as a guaranteed annuity or as an annual payment equal to a fixed percentage of the fair market value of the trust property, valued annually. These interests have the same names as in the charitable remainder trust context; the first of these interests is an *annuity interest* and the other is a *unitrust interest*.

An annuity interest or a unitrust interest in property may, as discussed above, be created by means of a charitable remainder trust. These interests are subject to minimum amounts that must be payable to the income beneficiaries. An income interest created by a charitable lead trust, however, is not governed by any minimum or maximum payout requirement.

---

[25] Gifts by means of the charitable lead trust are the subject of ch. 16. Also Blattmachr, "A Primer on Charitable Lead Trusts: Basic Rules and Uses," 134 *Trusts & Estates* (no. 4) 48 (April 1995).

Also, as discussed, an income interest in property created by means of a charitable remainder trust may be measured by a term of years. The income interest term established by a charitable remainder trust cannot be longer than 20 years. By contrast, there is no restriction in federal law on the length of the term during which the income interest is payable to a charitable organization out of a charitable lead trust.

(b) Income Tax Charitable Deduction (If Any)

A transfer of money or property to a charitable lead trust may or may not result in a current ''front-end'' income tax charitable contribution deduction for the donor.

If certain conditions are met, a charitable deduction will be available for the value of an income interest created by means of a charitable lead trust. These conditions are principally twofold. First, as noted, the income interest must be in the form of an annuity interest or a unitrust interest. When this is done, the charitable contribution deduction is available for federal income, gift, and estate tax purposes, if the other requirements are satisfied. Second, the donor must be treated as the owner of the income interest, pursuant to the grantor trust rules. (This is a federal tax law requirement, with the donor being the grantor.) This latter requirement means that the income as received by the charitable lead trust is taxed to the donor/grantor (unless municipal bonds are used—see above).

A charitable lead trust may be established so that there is no income tax charitable contribution deduction for the income interest involved. Under this approach, the trust is written so that the grantor trust rules are inapplicable; this is accomplished by causing the donor to not be considered the owner of the income interest. The tax consequence of such a charitable lead trust is that the donor forgoes a charitable contribution deduction at the front end, but he or she concurrently avoids taxation on the income of the trust for each of the years that the trust is in existence. In this situation, even though there is no charitable deduction, there is nonetheless a ''deduction'' in the sense that the income generated by the property involved is outside the stream of taxable income flowing to the donor.

From an income tax standpoint, the facts and circumstances of each case must be evaluated to ascertain whether a charitable lead trust is appropriate for an individual (or family) and, if so, whether the charitable contribution deduction should be utilized. A person with a year of abnormally high income may find considerable advantage in a charitable lead trust that yields a charitable deduction, because that deduction will be of greatest economic advantage in relation to the higher income taxation, and the trust income subsequently attributable to the donor will be taxable in a relatively lower amount. Conversely, the charitable lead trust without the deduction is sometimes utilized in support of a charitable organization by an individual when outright contributions by him or her to the organization cannot be fully deductible because of the percentage limitations on annual charitable contribution deductions.

(c) Determining the Charitable Deduction

The Department of the Treasury promulgates interest rates and tables to use in valuing remainder interests created by charitable remainder trusts, both annuity

trusts and unitrusts. These tables are also used to value an income interest that is stated as an annuity or unitrust interest.

(d) Tax Treatment of Lead Trust

A qualified charitable remainder trust is an entity that generally is exempt from federal income taxation. A charitable lead trust, however, is not exempt from income taxation. Consequently, the tax treatment accorded a charitable lead trust depends on whether the grantor trust rules are applicable.

If the grantor trust rules are applicable, so that the donor is treated as the owner of the trust, the income of the trust will be taxable to the donor and not to the trust. This means that the trust will not have any income tax liability.

If the grantor trust rules are inapplicable, so that the donor is not treated as the owner of the trust, the income of the trust will be taxable to the trust. In this situation, the charitable lead trust is allowed an unlimited charitable deduction for the payments from it (pursuant to the trust agreement) to the charitable organization that is the income beneficiary.

(e) Testamentary Use of Lead Trusts

Like the other forms of planned giving, a charitable lead trust can be used to benefit a charitable organization out of the assets of a decedent's estate. That is, the income interest thereby created for a charitable organization can be transferred as a charitable bequest by means of such a trust. The remainder interest would be reserved for one or more noncharitable beneficiaries, such as the decedent's heirs.

In this situation, a charitable deduction is available to the estate. Again, the deduction is for the present value of the income interest being transferred to a charitable organization.

When a federal estate tax charitable deduction becomes available, there is no need for anyone to recognize the income of the charitable lead trust. That is, there is no application of the equivalent of the grantor trust rules, whereby an individual is considered the owner of the trust, in this context.

(f) Private Foundation Rules

As is the case with many types of trusts used in the planned giving context, a charitable lead trust, being a split-interest trust, is treated as a private foundation for certain purposes.

In general, the private foundation rules that pertain to a charitable lead trust are those concerning termination of private foundation status, governing instrument requirements, self-dealing, excess business holdings, jeopardizing investments, and taxable expenditures.[26] A charitable lead trust, however, is exempt from the excess business holdings and jeopardizing investments rules when the amounts in the trust for which a charitable contribution deduction was allowed (namely, the income interest) have an aggregate value of no more than 60 percent of the total fair market value of all amounts in the trust.

---

[26] See § 3.4.

§ 5.8 PLANNED GIVING: OTHER FORMS

There are, in addition to the above four forms of planned giving, other forms of this type of giving. These include:

- Charitable contributions out of an estate[27]
- Charitable contributions of life insurance[28]
- Charitable contributions of a life interest in an individual's personal residence or farm[29]

§ 5.9 PLANNED GIVING AND SECURITIES LAWS

The applicability of federal and state securities laws to the planned giving activities of charitable organizations is limited.[30] This limitation, which is provided by means of reference to the maintenance of certain charitable income funds, was stimulated by litigation alleging that these funds are investment companies subject to the registration and other requirements of the Investment Company Act of 1940.[31] Overall, this legislation provides certain exemptions under the federal securities laws for charitable organizations that maintain charitable income funds.

A *charitable income fund* is a fund maintained by a charitable organization exclusively for the collective investment and reinvestment of one or more assets of a charitable remainder or similar trust; of a pooled income fund; contributed in exchange for the issuance of charitable gift annuities; of a charitable lead trust; of the general endowment fund or other funds of one or more charitable organizations; or of certain other trusts the remainder interests of which are revocably dedicated to or for the benefit of one or more charitable organizations.[32] The Securities and Exchange Commission (SEC) has the authority to expand the scope of the exemptive provisions of the legislation to include funds that may include assets not expressly defined.

A fund that is excluded from the definition of an investment company must provide, to each donor to a charity by means of the fund, at the time of donation, written information describing the material terms of operation of the fund.[33] This disclosure requirement is not, however, a condition of exemption from the Investment Company Act. Thus, a charitable income fund that fails to provide the requisite information is not subject to the securities laws, although the fund may be

---

[27] None of these forms requires a split-interest trust for its creation, although split-interest trusts can be created as part of an individual's estate. See ch. 8.
[28] This form of planned giving is discussed in ch. 17.
[29] This form of planned giving is discussed in § 15.2.
[30] 15 U.S.C. § 80a-51. This legislation was enacted as the Philanthropy Protection Act of 1995, 109 Stat. 682, Pub. L. No. 104-62, 104th Cong., 1st Sess. (1995).
[31] *Richie v. American Council on Gift Annuities,* Civ. No. 7:94-CV-128-X. Despite the clarity of this legislative history, the courts (most recently the U.S. Court of Appeals for the Fifth Circuit) were reluctant to terminate this litigation, on the ground that the organization involved (the American Council on Gift Annuities) was not a charitable organization and that it conspired with for-profit entities to establish payout rates. This matter went to the Supreme Court, which, on December 8, 1997, sent the case back to the Fifth Circuit for reconsideration in light of legislation enacted in 1997. The litigation, however, has ended; see § 14.8, note 35.
[32] 15 U.S.C. § 80a-3(c)(10).
[33] 15 U.S.C. § 80a-7(e).

subject to an enforcement or other action by the SEC. Charitable organizations have flexibility in determining the contents of the required disclosure.

This exemption in the Investment Company Act is also grafted onto the Securities Act of 1933, although charitable income funds are not exempted from that law's antifraud provisions.[34] A similar rule operates with respect to the Securities Exchange Act of 1934.[35]

The Securities Exchange Act was also amended to provide that a charitable organization is not subject to the Act's broker-dealer regulation solely because the organization trades in securities on its own behalf, or on behalf of a charitable income fund, or the settlers, potential settlers, or beneficiaries of either. This protection is also extended to trustees, directors, officers, employees, or volunteers of a charitable organization, acting within the scope of their employment or duties with the organization. Similar exemptions are provided for charitable organizations and certain persons associated with them, in connection with the provision of advice, analyses, or reports, from the reach of the Investment Advisors Act of 1940 (other than its antifraud elements).[36]

Interests in charitable income funds excluded from the definition of an investment company, and any offer or sale of these interests, are exempt from any state law that requires registration or qualification of securities. No charitable organization or trustee, director, officer, employee, or volunteer of a charity (acting within the scope of his or her employment or duties) is subject to regulation as a dealer, broker, agent, or investment adviser under any state securities law because the organization or person trades in securities on behalf of a charity, charitable income fund, or the settlers, potential settlers, or beneficiaries of either. These rules do not alter the reach or scope of state antifraud laws.

There was an opt-out provision, in that a state had the opportunity to enact a statute specifically stating that this federal law does not prospectively preempt the laws of the state.[37] This statute had to be enacted at any time during the three-year period ending on December 7, 1998.

Prior to the enactment of this legislation, the applicability of the Securities Act, the Securities Exchange Act, and the Investment Company Act to charitable income funds was addressed by the staff of the SEC. This administrative approach can be traced back to 1972, when the American Council on Education received a no-action letter as to pooled income funds, which was predicated on the fact that these entities are the subject of federal tax law and are subject to the oversight of the IRS.[38] One of the principal conditions of this no-action assurance was that each prospective donor receive written disclosures fully and fairly describing the fund's operations. (Also, the SEC staff has consistently maintained that the antifraud provisions of the securities laws apply to the activities of these funds and their associated persons.) This no-action position has always been rationalized by the view that the primary purpose of those who transfer money and property to these funds do so to make a charitable gift, rather than to make an investment.

---

[34] 15 U.S.C. § 77c(a)(4).
[35] 15 U.S.C. § 78c(e).
[36] 15 U.S.C. § 80b-3(b)(4).
[37] 15 U.S.C. § 80a-3a.
[38] See H. Rep. 104-333, 104th Cong., 1st Sess. (1995), at 6–7.

Until this litigation ensued, the oversight by the IRS and the no-action position of the SEC worked in tandem rather nicely. As the lawsuit illustrated, however, a favorable letter from the SEC staff does not insulate the recipient of it from liability asserted by a private litigant who alleges that the same transaction violates the securities laws. For the most part, this legislation codifies the approach taken over the past 38 years by the staff of the SEC.

PART THREE

Charitable Giving in General

CHAPTER SIX

Timing of Charitable Deductions

§ 6.1 **Gifts of Money in General** 181
§ 6.2 **Gifts of Money by Check** 181
§ 6.3 **Gifts of Money by Credit Card** 183
§ 6.4 **Gifts of Money by Telephone** 184
§ 6.5 **Gifts of Securities** 184
§ 6.6 **Gifts of Copyright Interest** 186
§ 6.7 **Gifts by Means of Notes** 187
§ 6.8 **Gifts by Letters of Credit** 187
§ 6.9 **Gifts of Property Subject to Option** 188
§ 6.10 **Gifts of Stock Options** 189
§ 6.11 **Gifts of Credit Card Rebates** 190
§ 6.12 **Gifts of Tangible Personal Property** 191
§ 6.13 **Gifts of Real Property** 191
§ 6.14 **Gifts by C Corporations** 192
§ 6.15 **Gifts by S Corporations** 193
§ 6.16 **Gifts by Partnerships** 194
§ 6.17 **Gifts by Means of Internet** 196

The general rule is that a federal income tax charitable contribution deduction arises at the time of, and for the year in which, the deduction is actually paid.[1] A significant exception to this rule is the body of law concerning the tax deductibility of contributions carried over to a year subsequent to the one in which the gift was made; in this situation, the contribution is actually paid in one year but the allowable charitable deduction arises in, and is treated for tax purposes as paid in, another year.[2] The mere making of a pledge will not result in an income tax charitable deduction.[3] Of course, a mere intent to make a charitable gift does not generate a contribution deduction.[4]

The matter of the timing of a federal income tax charitable contribution deduction concerns the tax year for which the gift is deductible. To determine this year, the federal tax law follows the concept of *title*; that is, the contribution is for the year in which title to the item that is the subject of the gift passes from the

[1] IRC § 170(a)(1); Reg. § 1.170A-1(a)(1). See also *Christensen v. Commissioner*, 40 T.C. 563 (1963).
[2] See ch. 7.
[3] Reg. § 1.170A-1(a)(1). See also Rev. Rul. 75-348, 1975-2 C.B. 75; Rev. Rul. 55-410, 1955-1 C.B. 297; *Mann v. Commissioner*, 35 F.2d 873 (D.C. Ct. App. 1929). See § 4.9.
[4] *Glynn v. Commissioner*, 76 T.C. 116 (1981), *aff'd* in unpublished opinion (1st Cir. 1982).

donor to the donee. Title to property generally passes when all of the rights to and interests in the property have been properly transferred.

The element that is critical to the passage of title in an item of property is *delivery*, for delivery is the way title in property is actually transferred from one person to another.[5] Consequently, a charitable contribution deduction generally comes into being on the date the gift property is delivered by the donor to the charitable donee.[6] This general rule assumes a number of elements, including:

- The absence of a condition (to occur either before or after the transfer) that defeats, or will defeat, the clear passage of title to the donee,[7] unless
  - The condition is so remote as to be negligible,[8] or
  - The condition is one that entails a legitimate restriction on the donee's use of the gift property (such as a confining of the use of the gift for scholarship purposes or for the acquisition of a building for use by the charitable donee in its charitable activities).
- Compliance with the substantiation requirements.[9]

When the mails are used, the United States Postal Service is considered the agent of the recipient. Thus, when a contribution is mailed, the date of gift is usually the date the item is placed in the U.S. mail system.

The concept of delivery, however, does not necessarily mean that the donee must take actual physical possession of the property before a gift of the property becomes deductible. Title may pass when the charitable donee has the right or entitlement to possession of the property. One court wrote that the "donee simply must have the right to interrupt the donor's possession and the right to have physical possession of the property during each year following the donation . . . ."[10] This can involve forms of *constructive delivery*, but the donor must give up custody, control, and management of the property; otherwise, the gift transaction is not "complete."[11]

---

[5] E.g., Rev. Rul. 69-93, 1969-1 C.B. 139 (holding that title to real estate is transferred on the date that the "deed passed," not on the previous date when the parties executed a contract for the sale of the property). The U.S. Tax Court held that a sale of land occurred when the "title was finally approved and the deed of conveyance was signed passing title and the right of possession to the vendee." *Wurtsbaugh v. Commissioner*, 8 T.C. 183, 189 (1947).

[6] Reg. § 1.170A-1(b), which states that "[o]rdinarily, a contribution is made at the time delivery is effected."

[7] The subject of conditional gifts is addressed in § 10.3.

[8] Reg. § 1.170A-1(e), which states: "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. 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."

[9] See § 21.1.

[10] *Winokur v. Commissioner*, 90 T.C. 733, 740 (1988).

[11] E.g., *LaGarde v. Commissioner*, 76-1 U.S.T.C. ¶ 9248 (N.D. Ala. 1975); *Mellon v. Commissioner*, 36 B.T.A. 977 (1937). See also *Murphy v. Commissioner*, 61 T.C.M. (CCH) 2935 (1991). Instances in which the "donor" retained too much dominion and control over the property that was the subject of the gift are *Woods v. Commissioner*, 58 T.C.M. (CCH) 673 (1989), *aff'd* in unpublished opinion (6th Cir. 1991); *Stjernholm v. Commissioner*, 58 T.C.M. (CCH) 389 (1989), *aff'd* in unpublished opinion (10th Cir. 1991); *Roughen v. Commissioner*, 54 T.C.M. (CCH) 510 (1987).

§ 6.1 GIFTS OF MONEY IN GENERAL

A charitable contribution of U.S. currency is deductible for the year in which the money is mailed or otherwise delivered to the charitable donee. This rule pertains to situations in which the gift is made in cash, rather than by check. Of course, the title to the money passes at the time the ownership of the currency changes hands. Actions indicating intent to make a gift of money, such as instructions to a bookkeeper, are insufficient; the deduction arises in the year of actual payment.[12]

§ 6.2 GIFTS OF MONEY BY CHECK

Gifts of money are usually made by means of a check, if only as a matter of recordkeeping. In this context, the general rules cited above apply. That is, title to the funds passes, and thus a charitable gift is made, at the time the check is mailed or otherwise delivered to the charitable donee.[13] This rule also applies when the gift is made using a third-party check. In addition to these assumptions, however, this rule assumes that the check evidencing the contribution clears the bank involved in due course.[14] Thus, a ''gift'' of a bad check is no gift at all.

Therefore, charitable gifts by check made at year end may be deductible for the year in which the check was written, even though the check evidencing the gift does not clear the account involved until early in the subsequent year. This rule is reflected in the *relation-back doctrine*.

The relation-back doctrine is usually not applied in cases involving noncharitable gifts. A court, however, decided a case pertaining to the timing of a noncharitable gift; some aspects of the opinion relate to the timing—for deductibility purposes—of the making of charitable gifts.[15]

The case concerned an individual who died in 1987. He intended to make gifts to his heirs and their spouses during his lifetime. He executed a wide-ranging power of attorney making his son his attorney-in-fact for a variety of purposes, including the making of gifts. On December 14, 1985, his son drew four checks against his father's savings account, in the amount of $10,000 each, including one check for himself and one for his wife. These two checks were deposited on December 31, 1985; the checks cleared the drawee bank on January 2, 1986. There were sufficient funds in the account to allow these checks to clear. In 1986, the son drew another set of checks payable to the same four donees in the same amounts. These checks were cashed in 1986. When the IRS audited the estate, it took the position that both sets of gifts were made in 1986. Although it was, of course, the intent of the donor to make gifts qualifying for the annual per-donee gift tax exclusion[16] in both years, the consequence was—from the IRS's

---

[12] *Nehring v. Commissioner*, 131 F.2d 790 (7th Cir. 1942). See also *Jordan v. United States*, 297 F. Supp. 1326 (W.D. Okla. 1969).

[13] Reg. § 1.170A-1(b). See also *Estate of Witt v. Fahs*, 160 F. Supp. 521 (S.D. Fla. 1956); *Estate of Spiegel v. Commissioner*, 12 T.C. 524 (1949).

[14] The IRS wrote that a charitable contribution in the form of a check is deductible in the tax year in which the check was delivered, ''provided the check is honored and paid and there are no restrictions as to time and manner of payment thereof.'' Rev. Rul. 54-465, 1954-2 C.B. 93.

[15] *Estate of Metzger v. Commissioner*, 100 T.C. 204 (1993), *aff'd*, 94-2 U.S.T.C. ¶ 60,179 (4th Cir. 1994).

[16] See § 8.2(h).

viewpoint—the making of gifts of $20,000 to each donee in 1986. The IRS sought to impose the gift tax on these gifts.

As noted at the outset, the general rule is that a gift is complete when the donor has so parted with dominion and control as to leave him or her with no power to change its disposition. This determination is generally a matter of state law. The personal representative argued, on the basis of language in the power of attorney, that the gifts were perfected in 1985, when the checks were delivered to the donees and deposited in their accounts. The IRS contended that, under the law of the state, a gift by check is complete only after the check is presented for payment and accepted by the drawee bank; its position was that the gifts could have been revoked. On this point, the court initially followed state law. Because the drawee bank did not accept the checks for payment until January 2, 1986, the court found that the gift was incomplete as of the close of 1985. That is, the court held that the donor retained dominion and control over the checks until they were accepted by the bank in 1986.

The court then considered the applicability of the relation-back doctrine. Under this doctrine, the payment of the checks in one year (here, 1986) relates back to the delivery and deposit of the checks in the previous year (here, 1985). The IRS argued that this doctrine should not be applied in cases other than those involving charitable gifts. The court reviewed the various cases on the point and concluded that there is ''no reason for refusing to apply the relation-back doctrine to noncharitable gifts where the taxpayer is able to establish: (1) The donor's intent to make a gift, (2) unconditional delivery of the check, and (3) presentment of the check within the year for which favorable tax treatment is sought and within a reasonable time of issuance.''[17] The court wrote that the ''practical realities of everyday commerce'' warrant this result.[18]

Thus, because the court was willing to apply the relation-back doctrine in connection with these facts, and because the checks were presented for payment in 1985 and they were promptly paid, the acceptance of the checks by the drawee bank in 1986 related back to the deposit of them in 1985. Therefore, the first set of gifts was treated as annual exclusion gifts for 1985, so that no taxes were due with respect to them.

Nonetheless, the general rules concerning gifts apply. Thus, the IRS declared that ''a gift is not consummated by the mere delivery of the donor's own check or note. The gift of a check does not become complete until it is paid, certified, or accepted by the drawee, or is negotiated for value to a third person.''[19] For example, in one instance, when checks were written immediately prior to an individual's death, there were inadequate funds in the account, and the checks were not presented for payment until approximately eight months after death. The value of the noncharitable gift of the checks was held by the IRS to be includible in the decedent's estate.[20]

---

[17] *Estate of Metzger v. Commissioner*, 100 T.C. 204, 215 (1993).
[18] *Id.*
[19] Rev. Rul. 67-376, 1967-2 C.B. 351.
[20] Priv. Ltr. Rul. 8706011.

A charitable gift involving a postdated check becomes deductible as of the date of the check, assuming that all other requirements are satisfied.[21] A check involving a charitable gift that has not cleared the bank prior to the death of the donor gives rise to a federal income tax charitable contribution deduction as of the time the check was delivered to the donee.[22]

A postdated check is essentially a promissory note; the rules concerning gifts by promissory notes are discussed below.[23]

§ 6.3 GIFTS OF MONEY BY CREDIT CARD

An income tax charitable contribution can be made, and be deductible, by means of a credit card. When a gift is made using a bank-based credit card, the contribution is deductible for the year the donor charges the gift on the account (rather than for the year when the account including the charged amount is paid).[24] In reaching this conclusion, the IRS concluded that the credit card holder, by using the card to make the contribution, became immediately indebted to a third party (the bank) in such a way that the cardholder could not thereafter prevent the charitable organization from receiving payment. This is because the credit card draft received by the charitable organization from the credit card holder is immediately creditable by the bank to the organization's account as if it were a check.

In this regard, the IRS analogized this situation to that in which a charitable contribution is made using borrowed funds. The IRS reasoned as follows: "Since the cardholder's use of the credit card creates the cardholder's own debt to a third party, the use of a bank credit card to make a charitable contribution is equivalent to the use of borrowed funds to make a contribution."[25] The general rule is that when a deductible payment is made with borrowed money, the deduction is not postponed until the year in which the borrowed money is repaid.[26] These expenses must be deducted in the year they are paid and not when the loans are repaid.

Gifts by means of a bank credit card are to be distinguished from gifts by means of a promissory note and the like.[27] The issuance of a promissory note (or debenture bond) represents a mere promise to pay at some future date, and delivery of the note (or bond) to a charitable organization is not a requisite "payment."[28]

---

[21] *Griffin v. Commissioner*, 49 T.C. 253, 261 (1967), in which the Tax Court wrote: "A postdated check is not a check immediately payable but is a promise to pay on the date shown. It is not a promise to pay presently and does not mature until the day of its date, after which it is payable on demand the same as if it had not been issued until that date although it is, as in the case of a promissory note, a negotiable instrument from the time issued."

[22] *Estate of Spiegel v. Commissioner*, 12 T.C. 524 (1949). Consequently, these funds should not be in the donor's estate for estate tax purposes. *Estate of Belcher v. Commissioner*, 83 T.C. 227 (1984). This rule does not apply, however, with respect to gifts by check written to noncharitable donees. *McCarthy v. United States*, 86-2 U.S. T.C. ¶ 13,700 (7th Cir. 1986).

[23] See § 6.7.

[24] Rev. Rul. 78-38, 1978-1 C.B. 67. This ruling revoked Rev. Rul. 71-216, 1971-1 C.B. 96, which held that a person making a contribution to a qualified charitable organization by a charge to a bank credit card is entitled to a charitable contribution deduction for the amount contributed in the tax year in which the donor paid the amount to the bank.

[25] Rev. Rul. 78-38, 1978-1 C.B. 67, 68.

[26] *Granan v. Commissioner*, 55 T.C. 753 (1971).

[27] See § 6.7.

[28] Rev. Rul. 78-38, 1978-1 C.B. 67.

§ 6.4 GIFTS OF MONEY BY TELEPHONE

A deductible income tax charitable contribution can be made by means of the telephone. This can occur through use of a pay-by-phone account maintained at a financial institution. When the gift is made by transfer from this type of account, which the donor has initiated by telephone, the deduction arises on the date the financial institution makes the payment to the charitable organization.[29] In this instance, the financial institution is acting as the agent of the donor.[30]

§ 6.5 GIFTS OF SECURITIES

There are some items of property as to which the law has constructed a formal system for the transfer of title. This is the case in connection with stocks, bonds, and other securities (which are forms of intangible personal property). A security usually is evidenced by a certificate, and title to the underlying security can be transferred by an endorsement on the certificate, indicating transfer of the security from one person to another. Transfers of securities are usually effected by brokers.

Thus, a person may make a contribution of a security to a charitable organization, and create a federal income tax contribution deduction, when the properly endorsed certificate evidencing the security is delivered to the charitable organization. Delivery can also be accomplished by such a transfer to an agent of the charitable donee.

When the properly endorsed certificate is mailed to a charitable organization or an agent of the organization, the deduction arises as of the date on which the certificate was mailed. When the certificate is unconditionally delivered to the corporation that issued the security or to a broker acting on behalf of the donor, for purposes of arranging for transfer of title to the security to the charitable donee, the charitable deduction comes into being on the date the transfer of the security is formally recorded by the issuing corporation.[31] When the certificate is delivered to a broker representing the charitable donee, however, the deduction arises as of the date of delivery.[32] Mere notation on the records of the transferee charitable organization of a contribution of securities is not sufficient to cause effective transfer of title.[33]

Court cases illustrate the intricacies of these rules. In one instance, an individual decided to contribute some stock to several charities, wanting to make these gifts before a payment of money for some of the shares pursuant to a tender offer and before accrual of the right to dividend income from the shares. The donor sent a letter to a trust company withdrawing the stock from a trust and requesting delivery of the stock to a bank. On the same day, the donor wrote to the bank

---

[29] Rev. Rul. 80-335, 1980-2 C.B. 170.

[30] E.g., *Commissioner v. Bradley*, 56 F.2d 728 (6th Cir. 1932).

[31] Reg. § 1.170A-1(b). Of course, in applying this rule, it must be shown that the intermediate transferee is, in fact, an agent of the donor; e.g., *Ferguson v. Commissioner*, 99-1 U.S.T.C. ¶ 50, 412 (9th Cir. 1999), *aff'g* 108 T.C. 244 (1997); *Estate of Sawade v. Commissioner*, 795 F.2d 45 (8th Cir. 1986); *Greer v. Commissioner*, 70 T. C. 294 (1978), *aff'd on another issue*, 634 F.2d 1044 (6th Cir. 1980); *Londen v. Commissioner*, 45 T.C. 106 (1965). Whether a person is, in fact, an agent of another is a question of state law. See, e.g., § 10.2.

[32] E.g., *Morrison v. Commissioner*, 53 T.C.M. (CCH) 251 (1987).

[33] *McCall v. United States*, 72-1 U.S.T.C. ¶ 9263 (D.S.C. 1972).

identifying the charitable donees. Further, on the same day, the donees were sent a memorandum directing them to instruct the bank as to the disposition of the stock (that is, whether the donees wanted to accept the tender offer or retain the stock). The final offer was made about one week later, with the actual transfer of the shares on the corporation's books made approximately one month following the sending of the letters and memorandum by the donor. In the interim, dividends were declared; they were sent to the charities by the bank. The donor claimed a charitable deduction for the gifts of the securities and did not report the dividends as income.

The IRS concluded that the donor had control of the stock when it was sold and therefore attributed the capital gain on the sale of the securities to the donor. The dividend income was also found to be gross income to the donor. The issues were litigated, with the donor prevailing. The court found that the donor had established a voluntary trust for the donees, using an independent party (the bank) as trustee. This, said the court, effectively removed any potential for the exercise of control by the donor "despite the failure to accomplish titular transfer on the corporate books."[34] The federal income tax regulation on the point[35] was held to be inapplicable, inasmuch as delivery was neither to the donor's agent nor to the issuing corporation or its agent. Thus, delivery was held to be effected upon tender of the stock by the bank to the offeror, which was prior to the stock sale dates and the dividend declaration date. The consequence of all this was that the donor was held to have the charitable deduction for the gifts of the stock, and not to have any capital gain or dividend income tax liability.

By contrast, in another case capital gain in the property was ruled to be taxable to the donors of appreciated securities to charitable organizations. This was because, by the date the gifts were completed, the securities had ripened from interests in a viable corporation into a fixed right to receive money, by means of an ongoing tender offer or a pending merger agreement. Therefore, despite the gifts, the gain in the stock was taxable to the donors.[36]

The donors owned 18 percent of a privately held corporation, as to which they served as several of its officers and directors. These securities were obtained in 1985. On July 28, 1988, the corporation entered into a merger agreement. The transaction was planned and negotiated by one of the donors. The resulting tender offer was the subject of a letter sent to all shareholders on August 3, 1988. The stock price set for the offer embodied a 24 percent premium over the market price for a share of the corporation's stock as of July 1988.

The tender offer (and thus the merger agreement) was conditioned on the acquisition of at least 85 percent of the outstanding shares of the corporation by the expiration date of the tender offer, originally set for August 30, 1988. This minimum tender condition was waivable at the discretion of the acquiring entity. Certain of the donors were expected to continue to have extensive involvement in managing the business, including being executive committee and board members. The tender offer started on August 3, 1988, and was successfully completed on September 9, 1988. By August 31, 1988, more than 50 percent of the stock had

---

[34] *Richardson v. Commissioner*, 49 T.C.M. (CCH) 67, 73 (1984).
[35] See Reg. § 1.170A-1(b).
[36] *Ferguson v. Commissioner*, 99-1 U.S.T.C. ¶ 50, 412 (9th Cir. 1999).

been tendered. On September 12, 1988, acquisition of more than 95 percent of the stock was announced.

During the course of the tender offer, the donors transferred some of their stock in the corporation to three charities. Two of them were family foundations created on August 26, 1988. Various letters to the stockbroker authorizing the transfers were ostensibly executed in August 1988. The date the broker formally transferred title to the securities to the charities was September 8, 1988. Final letters of authorization were signed the next day.

The donors contended that the date of delivery of the stock directly to the charities was September 8, 1988—the date the broker prepared the documentation formally transferring title to the securities. They also contended, however, that the stockbroker was acting as agent for the charities, so that the dates of delivery of the stock were in August 1988. Both arguments were rejected by the court. The gift completion date was found to be September 9, 1988, with no transfer that was legally binding and irrevocable until then, and it was held that the stockbroker did not function as agent for the charities before that date.

The courts determined that the stock in this case had ripened from an interest in a viable corporation to a fixed right to receive cash by August 31, 1988—the date by which more than one-half of the stock had been tendered. That is, by that date, the courts held, it was practically certain that the tender offer and the merger would be successfully completed. The donors argued, unsuccessfully, that the stock did not ripen until September 12, 1988, because the tender offer and the merger could have been derailed. The likelihood of that happening was viewed by the courts as remote and hypothetical at best. Thus, because the fixed right to receive the money ripened as of August 31, 1988, and the gifts did not formally become effective until September 9, 1988, the gain was taxable to the donors.[37]

§ 6.6 GIFTS OF COPYRIGHT INTEREST

Another item of intangible personal property that, to be transferred, must be passed in a formal manner, is a copyright interest. A determination as to whether a properly completed transfer of a copyright interest occurred is essentially governed by state law, but only after certain federal law restrictions are satisfied.[38] The federal requirements involve a written transfer instrument signed by the donor as owner.[39] A copyright certificate is issued; however, possession of the certificate does not constitute ownership of the copyright itself.[40]

---

[37] This opinion, with its focus on ripening of stock into a fixed right to receive money, illustrates that this matter of the timing of charitable gifts, for deductibility purposes, ties in with the doctrine of anticipatory assignment of income (see § 3.1(g)) and the step transaction doctrine (see § 4.8). The facts in another court opinion amount to a case study as to how not to go about structuring a charitable contribution of stock, with lessons abounding for donors, lawyers, accountants, and appraisers (*Bergquist v. Commissioner*, 131 T.C. 8 (2008)).

[38] *Kingsrow Enters., Inc. v. Metromedia, Inc.*, 397 F. Supp. 879 (S.D.N.Y. 1975).

[39] 17 U.S.C. § 28 (1976).

[40] The copyright "is not transferred by mere physical delivery, or other acquisition, of the certificate." *Kingsrow Enters, Inc. v. Metromedia, Inc.*, 397 F. Supp. 879, 881 (S.D.N.Y. 1975).

In one instance, an individual physically presented a copyright certificate, for a book that was generating royalties, to a charitable organization, in an attempt to make a charitable gift. There was no executed written transfer instrument and no formal action was taken by the recipient organization to formally transfer the copyright to itself. A court held that, "[t]herefore, standing alone, ... [the individual's] physical presentation of the copyright certificate to . . . . [the charitable organization], although accomplished with much ceremony, was insufficient to transfer a legal interest in the copyright" to the charity; "[t]his invalid transfer," the court continued, "does not begin to qualify as a deductible charitable contribution."[41]

§ 6.7 GIFTS BY MEANS OF NOTES

The making of a note promising to pay money and/or transfer property to a charitable organization, and delivery of the note to the charity, does not create a charitable contribution deduction. This is because a mere promise to pay does not effect transfer of title to the property.[42] Of course, when the money and/or property is actually transferred to the charitable donee, in satisfaction of the requirements of the note, an income tax charitable contribution deduction results.[43] (A promissory note is an item of intangible personal property.)

These distinctions are based on the rule that a charitable deduction is available only for the year the contribution is actually paid.[44] Delivery of a note is not payment of the amount it represents.[45]

A note in these circumstances may bear interest, or purport to bear interest. The tax consequences of payment of the interest depend on the enforceability of the note. If the note is enforceable, the payment of interest on the note is not likely to be deductible as an interest expense; if the note is not enforceable, the additional amounts paid are not interest for tax purposes, but are deductible as charitable contributions.[46]

§ 6.8 GIFTS BY LETTERS OF CREDIT

A charitable contribution made by means of an irrevocable banker's letter of credit is the basis of a charitable deduction as of the date the letter of credit was established. This is because an irrevocable letter of credit from a bank is the equivalent of money.[47]

---

[41] *Smith v. Commissioner*, 42 T.C.M. (CCH) 431, 437-38 (1981).

[42] Rev. Rul. 78-38, 1978-1 C.B. 67. This rule assumes that the notes represent bona fide debt. E.g., *Lippmann v. Commissioner*, 52 T.C. 130 (1969).

[43] Rev. Rul. 68-174, 1968-1 C.B. 81. See also *O'Neil v. United States*, 82-1 U.S.T.C. ¶ 9209 (E.D. Cal. 1982), *aff'd without opinion* (9th Cir. 1982); *Guren v. Commissioner*, 66 T.C. 118 (1976); *Petty v. Commissioner*, 40 T.C. 521 (1963).

[44] See text accompanying *supra* note 1. See also *Story III v. Commissioner*, 38 T.C. 936 (1962); *Andrus v. Burnet*, 50 F.2d 332 (D.C. Ct. App. 1931).

[45] See § 4.1(d).

[46] Rev. Rul. 68-174, 1968-1 C.B. 81.

[47] *Watson v. Commissioner*, 69 T.C. 544 (1978), *aff'd*, 613 F.2d 594 (5th Cir. 1980).

In one instance, an individual established an irrevocable banker's letter of credit in favor of a charitable organization. The letter of credit was for an aggregate amount of $150,000, payable by drafts drawn by the charity. The entire $150,000 was distributed to the charitable organization in four amounts, one in the year the letter of credit was established and the other three in the subsequent year. The IRS ruled that the entire $150,000 was deductible by this individual for the year in which the letter of credit was established, because the full amount was made available without restriction to the charitable organization. The fact that the charity only withdrew a portion of the amount available during the first year was held to be immaterial, because the charitable organization could have withdrawn the entire amount.[48]

§ 6.9 GIFTS OF PROPERTY SUBJECT TO OPTION

A person may own an item of property and create an option by which another person may purchase the property at a certain price at or during a certain time. An option may be created for or transferred to a charitable organization. There is no federal income tax charitable contribution deduction, however, for the transfer of property subject to an option to a charitable organization. Rather, the general rule is that the charitable deduction arises at the time the option is exercised by the charitable donee.[49]

Thus, the transfer to a charitable organization of property subject to an option by the option writer is similar to the transfer of a note or pledge by the maker (see above). In the note situation, there is a promise to pay money at a future date; in the pledge situation, there is a promise to pay money or transfer some other property, or to do both, at a future date. In the option situation, there is a promise to sell property at a future date.

These rules were interrelated by the IRS with the private foundation restrictions,[50] in an instance involving a pledge by a corporation of an option on its common stock to a private foundation. The option document permitted the foundation to transfer the option to one or more charitable organizations, but the foundation decided not to exercise the option. The corporation was a disqualified person with respect to the foundation,[51] and the transaction would have been an act of self-dealing.[52] Thus, the foundation was to sell the option, at its fair market value, to an unrelated charitable organization. The IRS ruled that the corporation will be entitled to a charitable contribution deduction in the year the charitable organization exercises the option and that the amount of the contribution will be the excess of the fair market value of the stock at the time the option is exercised over the exercise price.[53]

A charitable deduction can also arise when the option expires. In one instance, an S corporation executed a deed, contributing a tract of land to a charitable organization; the corporation retained an option to repurchase the land for a

---

[48] Priv. Ltr. Rul. 8420002.
[49] Rev. Rul. 82-197, 1982-2 C.B. 72; Rev. Rul. 78-181, 1978-1 C.B. 261.
[50] See § 3.3.
[51] See § 3.3, note 405.
[52] See *Private Foundations*, ch. 5.
[53] Priv. Ltr. Rul. 9335057.

nominal amount. The IRS concluded that there was more than a remote possibility that the option would be exercised. The gift was made in 1993; the option was set to expire in 1995. For 1993, each of the shareholders of the corporation claimed a charitable contribution deduction for their share of the fair market value of the property. The IRS, however, determined that, because of the option, there could not be charitable deductions for 1993, but that the deductions could be taken with respect to 1995.[54]

§ 6.10 GIFTS OF STOCK OPTIONS

For-profit corporations may pledge stock options to charitable organizations. These transactions can generate tax law issues, particularly if the donee is a disqualified person with respect to the donor, such as by being a substantial contributor.[55] These issues of law include the timing of the resulting charitable contribution deduction. This aspect of the law is reflected in an IRS private letter ruling.[56]

In this instance, a for-profit publicly traded corporation established a private foundation as its charitable giving vehicle. This corporation, being a substantial contributor to the foundation, was a disqualified person with respect to it. The corporation proposed to pledge to the foundation stock options for the purchase of shares of common stock of the corporation; the corporation did not receive any consideration for this pledge. The business purpose underlying the pledge was to further the charitable purpose of the foundation and other charitable organizations.

The options will be exercisable at a price specified in a stock option pledge agreement. This private foundation will not exercise the options directly because payment of the purchase price to the corporation would be an act of self-dealing.[57] Rather, the foundation will either transfer the options to one or more unrelated public charitable organizations or engage in a cashless "net exercise" transaction with the corporation. Pursuant to this net exercise procedure, the holder of options would elect to receive shares of the corporation's stock in an amount equal to the net value of the options being exercised on the date of exercise. This net value of the options is calculated by subtracting the exercise price for the number of the options being exercised from the value of the shares that the holder would have received as the result of a direct exercise. If the holder were to elect the net exercise procedure, the holder would notify the corporation of the number of options being exercised, along with written notice of its election to use the procedure, and the corporation would issue to the holder the number of shares of the corporation's stock computed using a formula specified in the option pledge agreement.

The foundation may sell the stock options to an unrelated charity for a fair market value price, with the value of the option affected by the terms in the option pledge agreement. Alternatively, the foundation may grant options to an

---

[54] Tech. Adv. Mem. 9828001.

[55] See *Private Foundations*, ch. 4.

[56] Priv. Ltr. Rul. 200530007, *superseding* Priv. Ltr. Rul. 200312003.

[57] See *Private Foundations*, ch. 5.

unrelated charity, with the grantee expected to exercise the options prior to their expiration.

The IRS ruled that the pledge of the stock options by the corporation to the foundation did not constitute self-dealing because of the absence of consideration and the charitable purposes to be served. The pledges are not extensions of credit.[58] The net exercise procedure does not entail a sale or exchange, the IRS concluded, so there would not be self-dealing for that reason. The sale of an option by the foundation to an unrelated charity would not be self-dealing inasmuch as the cancellation of the enforceable pledge would be for consideration paid by a nondisqualified person or an entity not controlled by a disqualified person. The exercise of a stock option by an unrelated charity also would not constitute self-dealing.

Stock options are not assets susceptible of use to produce interest, dividends, rents, or royalties. Thus, the proceeds received by the foundation from the sale of stock options to an unrelated charity would be excluded from the computation of the foundation's net investment income for tax purposes.[59] The IRS ruled that the gain on the sale of stock options would be excluded from the computation of the foundation's unrelated business income.[60]

The IRS ruled that, if the foundation transfers the options to an unrelated charitable organization and that charity engages in a cash exercise of the options, the corporation will be entitled to a federal income tax charitable deduction only on the exercise of the options by the unrelated charity. Moreover, the agency held that this deduction will be for an amount equal to the difference between the exercise price and the fair market value of the corporation's stock transferred on the exercise. The IRS also ruled that, if the foundation engages in a net exercise of the options, the corporation will be entitled to a charitable contribution deduction only at the time of the exercise. This deduction will be for an amount equal to the fair market value of the corporation's stock transferred to the foundation on the exercise. The IRS further ruled that, if the foundation transfers the options to an unrelated charity and that charity engages in a net exercise of the options, the corporation will be entitled to a charitable deduction only at the time of the net exercise. This deduction will be for an amount equal to the fair market value of the corporation's stock transferred to the charitable organization on the net exercise.

§ 6.11 GIFTS OF CREDIT CARD REBATES

A deductible charitable contribution can arise when the user of a credit card causes a percentage of the price of an item purchased with the card at a participating retailer to be transferred, by the company sponsoring the card, to a charitable organization selected by the cardholder.[61]

A cardholder may claim the deduction for the tax year in which the company made payments to one or more charitable organizations on the cardholder's

---

[58] Reg. § 53.4941(d)-2(c)(3).

[59] See *Private Foundations*, ch. 10.

[60] IRC § 512(b)(5). See § 3.5.

[61] Priv. Ltr. Rul. 9623035. The facts pertaining to this credit card rebate plan are summarized in § 3.1(h).

behalf. The company is not functioning as an agent for the donee charities. Instead, the company serves as agent for the cardholders with respect to the rebate amounts it holds. Thus, although the rebates are held by the company, the cardholders retain control over them.

For a charitable gift to be deductible, there must be the requisite delivery. It is not enough for there to be delivery to a party for subsequent delivery to a charitable organization. Accordingly, there is no delivery of a charitable contribution when the company receives the rebate amounts, nor when cardholders fail to claim rebates for their personal use. Rather, delivery occurs when the company transfers the rebate funds to the designated charities. (If the company served as the agent of the charities, the charitable deduction would arise at the time the company received the rebate amounts.) This program is designed to allow individuals to have the charitable deduction in the year of the rebate by enabling the company to transfer the rebates to charity before the close of the tax year.

§ 6.12 GIFTS OF TANGIBLE PERSONAL PROPERTY

A person may make deductible gifts of tangible personal property to a charitable organization. Items of tangible personal property include works of art, furniture, automobiles, and clothing.

Usually, there is no formal system in law for the recording and transfer of an item of tangible personal property. (The obvious exception, of course, is the title requirements involving motor vehicles.) In appropriate circumstances, however, title transfer of tangible personal property to a charitable organization can be evidenced by the making of a deed of gift.

§ 6.13 GIFTS OF REAL PROPERTY

A person may make a contribution of real property to a charitable organization and receive an income tax charitable deduction. There is, of course, a formal system in law for the recording and transfer of title to parcels of real estate; transfers of real property are generally effected by means of deeds.

As to the timing of the deduction, the contribution for a gift of real property generally occurs on the date the donor delivers a deed to the property to the charitable donee.[62] Recording of the deed is not necessary to make the transfer complete.[63]

A court denied a charitable contribution deduction for a transfer of real property ostensibly occurring in 1999 because the bill of sale executed on the last day of that year did not result in an irrevocable transfer to the charitable organization involved of legal title to the property because the sale document was not executed in accordance with state law.[64] A properly executed bill of sale was delivered

[62] E.g., *Dyer v. Commissioner*, 58 T.C.M. (CCH) 1321 (1990); *Brotzler v. Commissioner*, 44 T.C.M. (CCH) 1478 (1982); *Guest v. Commissioner*, 77 T.C. 9 (1981); *Alioto v. Commissioner*, 40 T.C.M. (CCH) 1147 (1980); *Dodge, Jr. v. Commissioner*, 27 T.C.M. (CCH) 1170 (1968); *Johnson v. United States*, 280 F. Supp. 412 (S.D.N.Y. 1967).

[63] *Douglas v. Commissioner*, 58 T.C.M. (CCH) 563 (1989).

[64] *Kaplan v. Commissioner*, 91 T.C.M. (CCH) 695 (2006).

to the charity in the subsequent year; that was the year in which the deduction was allowed.

A charitable contribution deduction for a transfer of mortgaged land to a charitable organization by a partnership was denied by a court because the property was subject to a special warranty deed. Under state law, the donor partnership remained liable on the outstanding mortgage. The deed imposed an obligation on the grantor to protect the grantee against adverse claims that might impair the grantee's title to the land. Thus, the court held that the warranty was merely a promise to make payments in the future, with a charitable deduction available when the payments were actually made.[65]

§ 6.14 GIFTS BY C CORPORATIONS

The foregoing rules apply with respect to gifts by both individual and corporate donors. Thus, the general rule that a federal income tax charitable contribution deduction arises at the time of, and for the year in which, the contribution is made is equally applicable to individual and corporate donors.

A C corporation[66] that reports its taxable income using the accrual method of accounting may, however, at its election, deduct charitable contributions paid within 2-1/2 months after the close of its tax year, as long as: (1) the board of directors of the corporation authorized the making of a charitable contribution during the tax year, and (2) the charitable contribution is made after the close of the tax year of the corporation and within the 2-1/2 month period.[67] This election must be made at the time the return for the tax year is filed, by reporting the contribution on the return. There must be, attached to the return, a written declaration that the resolution authorizing the contribution was adopted by the board of directors during the tax year involved, and the declaration must be verified by a statement signed by an officer authorized to sign the return that it is made under penalties of perjury. A copy of the resolution of the board of directors authorizing the contribution must also be attached to the return.[68]

To satisfy this rule, contributions of property need not be segregated by year and there is no requirement that the donees be identified at the time the resolution is adopted.[69]

---

[65] *Tidler v. Commissioner*, 53 T.C.M. (CCH) 934 (1987). In general, Krause & Solendert, "Setting the Ground Rules for Contributions of Real Estate," 9 *J. Tax. Exempt Orgs*. (no. 3) 121 (Nov./Dec. 1997).

[66] See IRC § 1361(a)(2).

[67] IRC § 170(a)(2); Reg. § 1.170A-11(b). An illustration of this rule appears in Priv. Ltr. Rul. 7802001. This rule was created because corporations intending to make the maximum charitable contribution allowable as a deduction experienced difficulty in determining, before the end of the tax year, what their net income would be. S. Rep. 851, 81st Cong., 1st Sess. (vol. 3) 3-4 (1949).

[68] Reg. § 1.170A-11(b)(2). In *Chase v. Commissioner*, 19 T.C.M. (CCH) 234 (1960), and *Wood-Mosaic Co. v. United States*, 160 F. Supp. 63 (W.D. Ky. 1958), charitable deductions were denied because there was no evidence that the corporations authorized the contributions during the tax years involved.

[69] Priv. Ltr. Rul. 7802001. This rule was created because corporations intending to make the maximum charitable contribution allowable as a deduction experienced difficulty in determining, before the end of the tax year, what would be their net income (S. Rep. No. 831, 81st Cong., 1st Sess. (Vol. 3) 3–4 (1949)).

§ 6.15 GIFTS BY S CORPORATIONS

Deductions pursuant to the rules pertaining to C corporations[70] are not available to S corporations,[71] which are treated the same as partnerships for tax purposes.[72] (Each shareholder of an S corporation takes into account the shareholder's pro rata share of the corporation's items of income, loss, deduction, or credit.[73]) Rather, an S corporation must report the charitable contribution on its tax return for the year in which the contribution was actually made.[74] This is because an S corporation generally computes its taxable income in the same manner as an individual.[75] Certain deductions are not allowable to an S corporation; this includes the charitable contribution deduction.[76]

Under the law prior to its amendment in 2006, if an S corporation contributed money or other property to a charitable organization, each shareholder took into account the shareholder's pro rata share of the contribution in determining the shareholder's income tax liability.[77] A shareholder of an S corporation reduced the basis in the stock of the S corporation by the amount of the charitable contribution that flows through to the shareholder.[78]

Pursuant to the amended law, the amount of a shareholder's basis reduction in the stock of an S corporation, by reason of a charitable contribution made by the corporation, is equal to the shareholder's pro rata share of the adjusted basis of the contributed property.[79] This rule is applicable to contributions made in tax years beginning after December 31, 2005, and tax years beginning before January 1, 2010.[80]

EXAMPLE 6.1

An S corporation with one shareholder, an individual, makes a charitable contribution of stock with a basis of $200 and a fair market value of $500. The shareholder is treated as having made a $500 charitable contribution (or a lesser amount if the deduction reduction rules[a] apply). The basis of the S corporation stock is reduced by $200.

[a] See §§ 4.4(b), 4.5, 4.6.

[70] See § 6.14.
[71] See IRC § 1361(a)(1).
[72] See § 6.16.
[73] IRC § 1366(a)(1)(A).
[74] Rev. Rul. 2000-43, 2000-2 C.B. 333.
[75] IRC § 1363(b). The election provided by IRC § 170(a)(2) is not available to an individual.
[76] IRC § 703(a)(2)(C).
[77] IRC § 1366(a)(1)(A).
[78] IRC § 1367(a)(2)(B).
[79] IRC § 1367(a)(2). This rule is comparable to the basis adjustment rule in the case of charitable contributions made by a partnership (see § 6.16).
[80] This rule was originally enacted as part of the Pension Protection Act of 2006 (§ 1203(a)) (Pub. L. No. 109–280) and made available through 2007. The provision was extended by enactment of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (§ 307), which is Division C of the financial markets stabilization legislation (Pub. L. No. 110-343).

The IRS ruled that, if an S corporation made a charitable contribution of appreciated property during a tax year beginning after December 31, 2005, and before January 1, 2008, the amount of the charitable contribution deduction a shareholder of the corporation may claim may not exceed the sum of (1) the shareholder's pro rata share of the fair market value of the contributed property over the property's adjusted tax basis and (2) the loss limitation amount (IRC § 1366(d)) that is allocable to the contributed property's adjusted basis (Reg. § 1.1366-2(a)(4)). Rev. Rul. 2008-16, 2008-1 C.B. 585.

§ 6.16 GIFTS BY PARTNERSHIPS

The taxable income of a partnership generally is computed in the same manner as for individuals; however, the charitable contribution deduction is not allowed to the partnership.[81] Rather, each partner takes into account separately the partner's distributive share of the partnership's charitable contributions.[82]

A partner's distributive share of charitable contributions made by a partnership during a tax year of the partnership is allowed as a charitable deduction on the partner's tax return for the partner's tax year within which the tax year of the partnership ends.[83] The aggregate of the partner's share of partnership contributions and the partner's own (directly made) contributions are subject to the various percentage limitations on annual deductibility.[84]

Moreover, when a partnership makes a charitable contribution of property, the basis of each partner's interest in the partnership is decreased (but not below zero) by the amount of the partner's share of the partnership's basis in the property contributed.[85]

The adjusted basis of a partner's interest in a partnership must be increased by the sum of the partner's distributive share for the tax year and prior tax years of the taxable income of the partnership, the income of the partnership that is exempt from tax, and the excess of the deductions for depletion over the basis of the property subject to depletion.[86] The adjusted basis of a partner's interest in a partnership must be decreased (but not below zero) by distributions by the partnership, as well as by the sum of the partner's distributive share for the tax year and prior tax years of the losses of the partnership and expenditures of the partnership that are not deductible in computing taxable income and not properly chargeable to a capital account.[87]

The adjustments to the basis of a partner's interest in a partnership are necessary to prevent inappropriate or unintended benefits or detriments to the partners. Generally, the basis of a partner's interest in a partnership is adjusted to reflect the tax allocations of the partnership to that partner. This adjustment ensures that the income and loss of the partnership are taken into account by its partners only once. Also, adjustments must be made to reflect certain nontaxable events in the partnership.[88] For example, a partner's share of nontaxable income (such as exempt income) is added to the basis of the partner's interest because, absent a basis adjustment, the partner could recognize gain with respect to the tax-exempt income (such as on a sale or redemption of the partner's interest) and the benefit of the tax-exempt income would be lost to the partner. Likewise, a partner's share of nondeductible expenditures must be deducted from the

[81] IRC § 703(a)(2)(C).
[82] IRC § 702(a)(4); Reg. §§ 1.702-1(a)(4), 1.703-1(a)(2)(iv).
[83] Reg. § 1.170A-1(h)(7).
[84] See ch. 7.
[85] Rev. Rul. 96-11, 1996-1 C.B. 140.
[86] IRC § 705(a)(1).
[87] IRC § 705(a)(2).
[88] IRC § 705(a)(1)(B), (a)(2)(B).

partner's basis to prevent that amount from giving rise to a loss to the partner on a sale or redemption of the partner's interest in the partnership.

In determining whether a transaction results in exempt income[89] or a nondeductible noncapital expenditure,[90] the inquiry must be whether the transaction has a permanent effect on the partnership's basis in its assets, without a corresponding current or future effect on its taxable income.

EXAMPLE 6.2

A and B each contribute an equal amount of money to form a general partnership. Pursuant to the partnership agreement, each item of income, gain, loss, and deduction of the partnership is allocated 50 percent to A and 50 percent to B. This partnership has unencumbered property, with a basis of $60,000 and a fair market value of $100,000. The partnership contributes this property to a charitable organization. (This property is not of the type that requires reduction of the charitable deduction by elements of ordinary income or capital gain.[a])

[a] See §§ 4.4(b), 4.5, 4.6.

As discussed, the contribution of this property by this partnership is not taken into account in computing the partnership's taxable income. Consequently, the contribution results in a permanent decrease in the aggregate basis of the assets of the partnership that is not taken into account by the partnership in determining its taxable income and is not taken into account for federal income tax purposes in any other manner. Therefore, the contribution of the property, and the resulting permanent decrease in partnership basis, is an expenditure of the partnership that is not deductible in computing its taxable income and is not properly chargeable to a capital account.

Reducing the partners' bases in their partnership interests by their respective shares of the permanent decrease in the partnership's basis in its assets preserves the intended benefit of providing a deduction for the fair market value of appreciated property without recognition of the appreciation. By contrast, reducing the partners' bases in their partnership interests by the fair market value of the contributed property would subsequently cause the partners to recognize gain (or a reduced loss), such as on a disposition of their partnership interests, attributable to the unrecognized appreciation in this contributed property at the time of the contribution.

EXAMPLE 6.2 (CONT.)

As noted, under this partnership agreement, partnership items are allocated equally between A and B. Accordingly, the basis of A's and B's interests in this partnership is reduced by $30,000 each.[a]

[a] Another illustration of these rules is available in Priv. Ltr. Rul. 200208019, concerning the federal tax consequences of the making of a qualified conservation contribution (see § 9.7) by a partnership.

[89] IRC § 705(a)(1)(B).
[90] IRC § 705(a)(2)(B).

§ 6.17 GIFTS BY MEANS OF INTERNET

One of the many issues that has arisen out of the utilization of the Internet as a medium to obtain charitable contributions is the tax consequences of the use of for-profit entities by charitable organizations to collect the payments. These entities may deduct a donation service fee and remit the balance to the charity involved.

If the gift is considered made to the for-profit organization, the charitable contribution deduction may be defeated.[91] Otherwise, the matter turns on principles of the law as to principal and agent. If the for-profit intermediary is functioning as an agent for the charitable organization, the full amount of the contribution is deductible (not just the amount contributed net of the service fee). If, however, the for-profit intermediary is serving as the agent of the donor, the charitable contribution deduction will not come into being until the gift money (or perhaps other property) is delivered by the intermediary to the charitable organization.[92]

Because of delays in processing the gift, a donor may be placed in the position of initiating the transaction late in a year, then find that the charitable deduction is not available until the subsequent year.[93]

[91] See § 3.6, second bulleted item.
[92] Similar issues arise in the context of contributions of vehicles. See § 9.23.
[93] In general, see § 10.7. Also see *IRS Exempt Organization Continuing Professional Organization Text for Fiscal Year 2000*, Topic I, Part 1, § 4.B (concerning "third-party sites").

CHAPTER SEVEN

Percentage Limitations

§7.1	**Introduction**	**198**
	(a) Nature of Gift	198
	(b) Tax Law Classification of Donee	198
	(c) Other Limitation Rules	200
§7.2	**Individual's Contribution Base**	**200**
§7.3	**Corporation's Taxable Income**	**201**
§7.4	**Percentage Limitations: An Overview**	**201**
	(a) General Rules	201
	(b) Carryover Rules	202
§7.5	**Fifty Percent Limitation**	**203**
	(a) General Rules	203
	(b) Carryover Rules	204
§7.6	**Thirty Percent Limitation for Gifts of Certain Property**	**208**
	(a) General Rules	209
	(b) Carryover Rules	210
§7.7	**Electable 50 Percent Limitation**	**211**
	(a) General Rules	212
	(b) Timing of Election	216
§7.8	**General 30 Percent Limitation**	**216**
	(a) General Rules	217
	(b) Carryover Rules	217
§7.9	**Interplay of 50 Percent/Special 30 Percent Limitations**	**218**
§7.10	**Interplay of 50 Percent/General 30 Percent Limitations**	**219**
§7.11	**Interplay of Special 30 Percent/General 30 Percent Limitations**	**220**
§7.12	**Twenty Percent Limitation**	**220**
	(a) General Rules	221
	(b) Carryover Rules	221
§7.13	**Gifts for the Use of Charity**	**221**
§7.14	**Blending Percentage Limitations**	**222**
§7.15	**Individuals' Net Operating Loss Carryovers and Carrybacks**	**223**
	(a) Carryover Rules	223
	(b) Carryback Rules	225
§7.16	**Rules for Spouses**	**226**
§7.17	**Information Requirements**	**228**
§7.18	**Percentage Limitation for Corporations**	**229**
	(a) General Rules	229
	(b) Carryover Rules	230
	(c) Conversion Contribution Rules	231
§7.19	**Corporations' Net Operating Loss Carryovers and Carrybacks**	**231**
	(a) Carryover Rules	231
	(b) Carryback Rules	232
	(c) Year Contribution Is Made	233

The deductibility, pursuant to federal income tax law, of a contribution to a charitable organization can depend on several factors.[1] Two of these factors are:

1. The nature of the item (money[2] or property) that is the subject of the gift
2. The federal tax law classification of the charitable organization that is the recipient of the gift

These two elements are manifested in various limitations, expressed as percentages, imposed on both individual and corporate donors.[3]

§ 7.1 INTRODUCTION

One of the elements in determining the extent of deductibility of a charitable gift is the nature of the item contributed.

(a) Nature of Gift

This subject is treated more fully elsewhere,[4] but for these purposes, it is sufficient to note that the federal income tax law basically distinguishes between gifts of money and gifts of property. As to the latter, the law differentiates between the following categories of property:

- Long-term capital gain property
- Ordinary income property
- Short-term capital gain property

These terms describe categories of property on the basis of the tax categorization of the revenue that would result upon a sale of the property. For example, *long-term capital gain property* is property that, if sold, would generate long-term capital gain. Because these terms use the word *gain*, it is usually understood that these properties have appreciated in value (*appreciated property*) and thus would produce a gain upon sale. Long-term capital gain property is often referred to as *capital gain property*, and this text uses that wording throughout.[5]

For these purposes, contributions of ordinary income property and short-term capital gain property are generally treated, for charitable deduction purposes, the same as gifts of money. Thus, the tax rules that reference the deductibility of gifts of money are generally also applicable to gifts of property that, if sold, would give rise to ordinary income or to short-term capital gain.

(b) Tax Law Classification of Donee

The other of these two elements is the federal tax law classification of the charitable donee. (This factor is applicable only in the case of giving by individuals.)

---

[1] See § 3.6.

[2] The term *money* (synonymous with *cash*) is used throughout to refer to United States currency. If the gift is of currency of another country, it may be treated as property.

[3] These limitations may operate to prevent a donor from deducting, in any one year, the entirety of the value of a charitable gift.

[4] See chs. 2, 4.

[5] The federal income tax regulations use the term *30-percent capital gain property*. Reg. § 1.170A-8(d)(3).

That is, the law in this context basically differentiates between gifts to public charitable organizations and gifts to private foundations and certain other tax-exempt organizations. Although this subject is discussed elsewhere,[6] it is appropriate to note that the term *public charitable organization* is used to refer to a charitable organization[7] that is not a private foundation. The principal types of public charitable organizations are churches, schools, colleges, universities, hospitals, a variety of publicly supported charitable organizations, and supporting organizations.

The deductibility of gifts by individuals involves several sets, and sometimes combinations, of percentage limitations. The percentages that are applicable to individuals are applied to an individual donor's contribution base.[8]

The essence of this chapter is the following:

- An individual's contribution base essentially is the same as his or her adjusted gross income.[9]
- An individual's federal income tax charitable contribution deduction for a tax year is subject to limitations of 50, 30, and/or 20 percent of the individual's contribution base.
- The maximum federal income tax charitable contribution deduction for a tax year for an individual is 50 percent of his or her contribution base.
- An individual's federal income tax charitable contribution deduction for a tax year cannot exceed an amount equal to 50 percent of his or her contribution base when the gift (or gifts) is of money (and/or ordinary income property and/or short-term capital gain property) and the charitable recipient is a public charitable organization.
- In general, an individual's federal income tax charitable contribution deduction for a tax year cannot exceed an amount equal to 30 percent of his or her contribution base when the gift is of capital gain property that has appreciated in value and the charitable recipient is a public charitable organization.
- An individual donor can elect to have a 50 percent limitation apply, when the gift is of capital gain property that has appreciated in value and the charitable recipient is a public charitable organization, by reducing the deduction by the amount of the appreciation element.
- An individual's federal income tax charitable contribution deduction for a tax year cannot exceed an amount equal to 30 percent of his or her contribution base when the gift (or gifts) is of money and the charitable recipient is an entity other than a public charitable organization.
- An individual's federal income tax charitable contribution deduction for a tax year cannot exceed an amount equal to 20 percent of his or her contribution base when the gift is of capital gain property that has appreciated in

[6] See § 3.4.
[7] That is, an organization that is tax-exempt under IRC § 501(a) by reason of being described in IRC § 501(c)(3).
[8] See § 7.2.
[9] The concept of adjusted gross income is discussed in § 2.4.

value and the charitable recipient is an entity other than a public charitable organization.

- These limitations are blended when the individual donor contributes more than one type of item (money or property) in a tax year and/or gives to more than one type of charitable organization in a tax year.
- Each of these percentage limitation rules allows for contributions in excess of the limitation to be carried forward and deducted over the subsequent five years, in order of time.
- If a husband and wife file a joint return, the deduction for charitable contributions is the aggregate of the contributions made by the spouses and the percentage limitations are based on the aggregate contribution base of the spouses.
- The charitable contribution deduction for a corporation for a tax year is subject to a limitation of 10 percent of the corporation's pretax net income.
- No percentage limitations apply in the estate tax or gift tax charitable contribution deduction context.[10]

(c) Other Limitation Rules

There are two other limitation rules that are discussed elsewhere[11] but warrant mention at this point so that they can be correlated with the information in this chapter.

- If an individual contributes an item of tangible personal property that has appreciated in value to a public charitable organization, but the public charity does not use the property for a purpose that is related to its tax-exempt purposes, the donor must reduce the deduction by the entirety of the capital gain element.
- When an individual makes a contribution of an item of appreciated property to a charitable organization that is not a public charitable organization, the donor must reduce the deduction by all of the capital gain element.

§ 7.2 INDIVIDUAL'S CONTRIBUTION BASE

The percentage limitations used in ascertaining the deductibility of charitable gifts are applied, in the case of individuals, to an amount equal to the donor's contribution base.[12] The term *contribution base* means the individual's adjusted gross income,[13] computed without regard to any net operating loss carryback[14] to the tax year.[15] For most individuals, the amounts constituting the contribution base and adjusted gross income are the same.

---

[10] See ch. 8.
[11] See §§ 4.5–4.7.
[12] IRC § 170(b)(1)(F).
[13] IRC § 62.
[14] IRC § 172.
[15] Reg. § 1.170A-8(e).

§ 7.3 CORPORATION'S TAXABLE INCOME

The concept of a contribution base is not applicable to contributions by corporations. Rather, the percentage limitation is applicable to a corporation's taxable income.[16] *Taxable income* is gross income less certain deductions,[17] determined without regard to the charitable contribution deduction rules, rules providing special deductions for corporations,[18] any net operating loss carryback to the tax year,[19] the deduction with respect to income attributed to domestic production activities,[20] and any capital loss carryback to the tax year.[21]

§ 7.4 PERCENTAGE LIMITATIONS: AN OVERVIEW

Because of the intricacies of these percentage limitation rules, an overview of them is appropriate. Each of these rules is discussed fully in subsequent sections of this chapter.

The percentage limitations are applied in connection with the contribution year or years involved. In the context of the tax rules concerning charitable giving, a tax year in which a gift is made is termed a *contribution year*.[22]

(a) General Rules

An individual's federal income tax charitable contribution deduction for a tax year is subject to limitations of 50, 30, and/or 20 percent of the individual's contribution base.[23] The limitation or limitations that are applicable depend on the tax classification of the charitable organization that is the donee and the nature of the item (money or property) that is contributed. Irrespective of the combination of charities and gifts, however, an individual's income tax charitable deduction for a tax year cannot exceed an amount equal to 50 percent of his or her contribution base. If a husband and wife file a joint return, the deduction for charitable contributions is the aggregate of the contributions made by the spouses and the percentage limitations are based on the aggregate contribution of the spouses.[24]

The percentage limitation (or limitations) that is applicable depends, in part, on whether the charitable recipient is public or private.[25]

Contributions of money to public charitable organizations, in a tax year, are deductible in an amount not in excess of 50 percent of the individual donor's contribution base for that year.[26] The 50 percent limitation also applies with respect to gifts of tangible personal property that have been reduced by the capital gain

[16] IRC § 170(b)(2)(C).
[17] IRC § 63.
[18] IRC §§ 241–247, 249–250.
[19] IRC § 172.
[20] IRC § 199.
[21] IRC § 1212(a)(1).
[22] E.g., Reg. § 1.170A-8(d)(2)(ii).
[23] Reg. § 1.170A-8(a)(1).
[24] Reg. § 1.170A-8(a)(1). See § 7.16.
[25] See § 3.4.
[26] IRC § 170(b)(1)(A); Reg. § 1.170A-8(b). See § 7.5.

element because the property was put to an unrelated use by the donee charitable organization.[27]

There is a 30 percent limitation, which is applicable when the contribution (or contributions) is to one or more public charitable organizations and the gift or gifts are of capital gain property.[28] This rule applies with respect to gifts that do not have to be reduced by the amount of the appreciation element inherent in the property.[29] When a special election is made, contributions of capital gain property may be subject to the 50 percent limitation rather than the 30 percent limitation.[30]

In general, contributions of money to private foundations (and/or certain other donees, such as veterans' organizations and fraternal organizations), in a tax year, are deductible in an amount not in excess of 30 percent of the individual donor's contribution base for that year.[31] If the contributions are less, however, the limitation is an amount equal to the excess of 50 percent of the donor's contribution base for the year over the amount of charitable contributions allowable under the 50 percent limitation.[32]

Contributions of capital gain property to private foundations and certain other donee organizations are usually subject to a 20 percent limitation.[33]

Contributions by a corporation are deductible for a tax year in an amount not to exceed 10 percent of the corporation's taxable income, computed with certain adjustments.[34]

(b) Carryover Rules

Donors of gifts that exceed the applicable percentage limitation are entitled to carry the excess amounts forward, for purposes of deduction over the succeeding five years, in order of time. The carryover rules apply to:

- Individuals, in relation to the 50 percent limitation[35]
- Individuals, in relation to the 30 percent limitation, concerning gifts of capital gain property[36]
- Individuals, in relation to the general 30 percent limitation[37]
- Individuals, in relation to the 20 percent limitation[38]
- Corporations[39]

---

[27] IRC § 170(b)(1)(C)(i).
[28] *Id*. See § 7.6.
[29] See §§ 4.5–4.7.
[30] IRC § 170(b)(1)(C)(iii). See § 7.7.
[31] IRC § 170(b)(1)(B)(i). See § 7.7.
[32] IRC § 170(b)(1)(B)(ii).
[33] IRC § 170(b)(1)(D)(i). See § 7.11.
[34] IRC 170(b)(2)(A).
[35] IRC § 170(d)(1).
[36] IRC § 170(b)(1)(C)(ii).
[37] IRC § 170(b)(1)(B), last sentence.
[38] IRC § 170(b)(1)(D)(ii).
[39] IRC § 170(d)(2).

The carryover rules apply with respect to contributions made during a tax year in excess of the applicable percentage limitation, even when the donor elects to use the standard deduction[40] for that year instead of itemizing the deductions allowable in computing taxable income for that year.[41]

The carryover provisions do not apply to contributions made out of an estate. The provisions do not apply to a trust unless the trust is a private foundation which is allowed[42] a charitable deduction subject to the provisions applicable to individuals.[43]

§ 7.5 FIFTY PERCENT LIMITATION

The maximum federal income tax charitable contribution deduction for a tax year for an individual is 50 percent of the individual's contribution base.

(a) General Rules

An individual's charitable contributions made during a tax year to one or more public charitable organizations, when the gifts are of money, are deductible to the extent that the contributions in the aggregate do not exceed 50 percent of the individual's contribution base for the tax year.[44]

This limitation applies with respect to gifts to public and publicly supported charitable organizations, private operating foundations, governmental units, and certain types of foundations.[45]

A contribution to a charitable organization that is not a public charitable organization does not qualify for the 50 percent limitation, notwithstanding the fact that the organization makes the contribution available to a public charitable organization.[46]

These rules are illustrated by the following two examples (in these, and in all other examples concerning individuals in this chapter, the individual donor (or donors) reports his or her income to the IRS on a calendar year basis).

EXAMPLE 7.1

A had, for 2009, a contribution base of $100,000. During 2009, she made charitable contributions of money to a church, a university, and a hospital (each of which is a public charitable organization), totaling $45,000, and made no other charitable gifts in that year. A was allowed a federal income tax charitable contribution deduction for 2009 for the $45,000. (Her maximum allowable deductible giving for 2009 was $50,000, that is, 50% of $100,000.)

[40] See ch. 2.
[41] Reg. § 1.170A-10(a)(2).
[42] Reg. § 1.642(c)-4.
[43] Reg. § 1.170A-10(a)(3).
[44] IRC § 170(b)(1)(A); Reg. § 1.170A-8(b).
[45] IRC § 170(c)(1), (2). See § 3.4.
[46] Reg. § 1.170A-8(b).

EXAMPLE 7.2

H and W (husband and wife) had, for 2009, a contribution base of $150,000. During that year, H made charitable contributions of money to a hospital, totaling $30,000; during that contribution year, W made charitable contributions of money to a school, totaling $40,000. Neither H nor W made any other charitable gifts in 2009. Filing jointly, H and W were able to properly claim a charitable contribution deduction of $70,000 for 2009. (Their maximum allowable deductible charitable giving for 2009 was $75,000, that is, 50% of $150,000.)

As discussed elsewhere,[47] when an individual makes a contribution of an item of tangible personal property, that has appreciated in value, to a public charitable organization, but the public charity does not use the property for a purpose that is related to its tax-exempt purposes, the donor must reduce the deduction by all of the capital gain element.[48] (The *capital gain element* is the portion of the proceeds that would have been long-term capital gain had the property been sold.) Once the (potentially) deductible amount is determined under this rule, the amount is then subjected, for purposes of determining the actual charitable contribution deduction, to the 50 percent limitation.[49]

Also, as discussed below,[50] there is a special rule by which the charitable contribution deduction for a gift of capital gain property can become subject to the 50 percent limitation rather than a 30 percent limitation (to which the deduction for gifts of that type of property are generally subject).

There are, then, five instances in which a charitable contribution deduction may be limited by the 50 percent limitation:

1. Gifts of money
2. Gifts of ordinary income property (property the sale of which would produce ordinary income)
3. Gifts of short-term capital gain property (property the sale of which would produce short-term capital gain)
4. Gifts of capital gain property for which the charitable deduction was reduced by the amount of the capital gain element because the charitable donee put the property to an unrelated use[51]
5. Gifts of capital gain property as to which a special election is made

(b) Carryover Rules

In general, the excess of:

> The amount of the charitable contribution or contributions of money made by an individual in a contribution year to one or more public charitable organizations

---

[47] See § 4.6.
[48] IRC § 170(e)(1)(B)(i).
[49] IRC § 170(b)(1)(C)(i).
[50] See § 7.7.
[51] See § 3.5.

divided by:

50 percent of the individual's contribution base for the contribution year

is treated as a charitable contribution paid by the individual to a public charitable organization, subject to the 50 percent limitation, in each of the five tax years immediately succeeding the contribution year, in order of time.[52] Thus, for federal income tax purposes, an amount paid to a charitable organization in one year is, when the carryover rules are applied, treated as paid to a charitable organization in a subsequent year.

These rules may be illustrated by the following two examples:

EXAMPLE 7.3

The facts are the same as in Example 7.1, except that A made charitable contributions of money to public charitable organizations totaling $55,000. She was allowed a charitable contribution deduction for 2009 of $50,000 (50% of $100,000) and the balance of $5,000 was carried forward, to be used in the subsequent five years, beginning in 2010.

EXAMPLE 7.4

H and W had a contribution base for 2008 of $50,000 and for 2009 of $40,000, and filed a joint tax return for both years. In 2008, H and W made a charitable contribution of money in the amount of $27,000 to PC (a public charitable organization). In 2009, they made a charitable contribution in money of $15,000 to PC. They were able to properly claim a charitable contribution deduction of $25,000 in 2008 (50% of $50,000) and the excess of $2,000 ($27,000 − $25,000) constituted a charitable contribution carryover, which was subsequently treated by them as a charitable contribution paid by them to a public charitable organization in each of the five succeeding tax years in order of time. Because 50 percent of their contribution base for 2009 ($20,000) exceeded the charitable contribution of $15,000 made by them in 2009 to PC (computed without regard to the carryover rules), the 2008 carryover amount of $2,000 was treated as paid to a public charitable organization in 2009. Thus, H and W had a $17,000 federal income tax charitable contribution deduction for 2009.

In applying these rules, the amount of the excess contributions that are to be treated as paid to a public charitable organization in any one of the five tax years immediately succeeding the contribution year may not exceed the lesser of the following three amounts:

1. The amount by which 50 percent of the donor's contribution base for the succeeding tax year involved exceeds the sum of:
   - The charitable contributions actually made (computed without regard to the carryover rules) by the donor in the year to public charitable organizations, and
   - The charitable contributions, other than contributions of capital gain property to which the 30 percent limitation applies,[53] made to public

[52] IRC § 170(d)(1); Reg. § 1.170A-10(b)(1).
[53] See § 7.6.

charitable organizations in years preceding the contribution year which, pursuant to the carryover rules, are treated as having been paid to a public charitable organization in the succeeding tax year involved.

2. In the case of the first tax year succeeding the contribution year, the amount of the excess charitable contribution in the contribution year.
3. For the second, third, fourth, and fifth tax years succeeding the contribution year, the portion of the excess charitable contribution in the contribution year that has not been treated as paid to a public charitable organization in a year intervening between the contribution year and the succeeding year involved.

If a donor, in any one of the five tax years succeeding a contribution year, elects to utilize the standard deduction instead of itemizing deductions allowable in computing taxable income, the lesser of these three amounts must be treated as paid (but not allowable as a deduction) for the year of the election.[54] This rule applies because the standard deduction is deemed to include the charitable contribution deduction (for the taxpayer who does not itemize his or her tax deductions); absent this rule, a taxpayer would, in effect, receive a double deduction for a charitable contribution.

These rules may be illustrated by the following three examples, which show, on a more technical basis, how these rules operate.

Example 7.5

B had a contribution base for 2008 of $20,000 and for 2009 of $30,000. In 2008, B contributed $12,000 in money to PC, a public charitable organization; in 2009, B contributed $13,500 in money to PC. B was able to properly claim a charitable contribution deduction of $10,000 (50% of $20,000) for 2005. The excess of $2,000 ($12,000 − $10,000) constituted a charitable contribution carryover which was treated as a charitable contribution paid by B to a public charitable organization in the five tax years immediately succeeding 2008 in order of time. B was able to claim a charitable contribution deduction of $15,000 (50% of $30,000) in 2009. This $15,000 consisted of the $13,500 contribution to PC in 2009 and $1,500 of the $2,000 carried over from 2008. The $1,500 contribution treated as paid in 2006 was computed as follows:

2008 excess contributions		$2,000
50% of B's contribution base for 2009		$15,000
Less:		
Contributions actually made in 2009 to a public charitable organization	13,500	
Contributions made to public charitable organizations in years prior to 2005 treated as having been paid in 2006	0	
Balance	$13,500	$1,500

Amount of 2008 excess charitable gift treated as paid in 2006 is $1,500: the lesser of $2,000 (2005 excess contributions) or $1,500 (excess of 50% of contribution base for 2005 ($15,000) over the sum of the contributions to a public charitable organization

[54] Reg. § 1.170A-10(b)(2).

actually made in 2009 ($13,500) and the contributions to public charitable organizations made in years prior to 2008 treated as having been paid in 2009 ($0). Thus, $1,500 of the contribution made by B in 2008 is treated, for tax purposes, as having been paid in 2009. The remaining $500 is carried forward for possible use in 2010, depending on B's other tax circumstances.

If the excess contributions made by B in 2008 had been $1,000 instead of $2,000, the amount of the 2008 excess contributions treated as paid in 2009 would have been $1,000 rather than $1,500. In this situation, there would not be any carryover for 2010.[a]

[a] Reg. § 1.170A-10(b)(2), Example (1).

EXAMPLE 7.6

This example is based on the facts of Example 7.5. Also, B had a contribution base for 2007 of $10,000 and for 2008 of $20,000. With respect to 2007, B elected not to itemize his deductions and to utilize the standard deduction in computing his taxable income. B's contributions to public charitable organizations in 2007 were $300 in money. With respect to 2008, B itemized his deductions, which included a $5,000 contribution of money to PC. B's deductions for 2007 were not increased by reason of the $500 available as a charitable contribution carryover from 2005 (excess contributions made in 2005 of $2,000, less the amount of the excess treated as paid in 2006 of $1,500), inasmuch as B elected to use the standard deduction in 2007. For purposes of determining the amount of the excess charitable contributions made in 2005 that was available as a carryover to 2008, however, B was required to treat the $500 as a charitable contribution paid in 2007—the lesser of $500 or $4,700 (50% of contribution base of $5,000 over contributions actually made in 2007 to public charitable organizations of $300). Therefore, even though the $5,000 contribution by B in 2008 to PC did not amount to 50 percent of B's contribution base for 2008 (50% of $20,000), B was able to claim a charitable contribution deduction of only the $5,000 actually paid in 2008, because the entire excess charitable contribution made in 2005 ($2,000) was treated as paid in 2006 ($1,500) and in 2007 ($500).[a]

[a] Reg. § 1.170A-10(b)(2), Example (2).

EXAMPLE 7.7

The following facts apply with respect to D, who itemized her deductions in computing taxable income for each of the following years:

	2005	2006	2007	2008	2009
Contribution base	$10,000	$7,000	$15,000	$10,000	$9,000
Contributions of cash to public charitable organizations (no other contributions)	6,000	4,400	8,000	3,000	1,500
Allowable charitable contribution deductions (computed without regard to carryover of contributions)	5,000	3,500	7,500	5,000	4,500
Excess contributions for tax year to be treated as paid in five succeeding tax years	1,000	900	500	0	0

Because D's contributions in 2008 and 2009 to public charitable organizations were less than 50 percent of her contribution base for those years, the excess contributions for 2005, 2006, and 2007 were treated as having been paid to public charitable organizations in 2008 and 2009 as follows:

(*continues*)

EXAMPLE 7.7 (*CONTINUED*)

2008

Contribution year	Total excess	Less: Amount treated as paid in year prior to 2002	Available charitable contributions carryovers
2005	$1,000	0	$1,000
2006	900	0	900
2007	500	0	500
	Total		$2,400

50 percent of D's contribution base for 2008	$5,000
Less: Charitable contributions made in 2008 to public charitable organizations	3,000
	$2,000

Amount of excess contributions treated as paid in 2008—lesser of $2,400 (available carryovers to 2008) or $2,000 (excess of 50% of contribution base ($5,000) over contributions actually made in 2002 to public charitable organizations ($3,000)) = $2,000

2009

Contribution year	Total excess	Less: Amount treated as paid in year prior to 2003	Available charitable contributions carryovers
2005	$1,000	$1,000	0
2006	900	900	0
2007	500	100	$400
2008			0
	Total		$ 400

50 percent of D's contribution base for 2009	$4,500
Less: Charitable contributions made in 2009 to public charitable organizations	1,500
	$3,000

Amount of excess contributions treated as paid in 2009—lesser of $400 (available carryovers to 2009) or $3,000 (excess of 50% of contribution base ($5,500) over contributions actually made in 2009 to public charitable organizations ($1,500)[a]

[a] Reg. § 1.170A-10(b)(2), Example (3).

§ 7.6 THIRTY PERCENT LIMITATION FOR GIFTS OF CERTAIN PROPERTY

A 30 percent limitation applies with respect to charitable contributions of certain property that has appreciated in value since the donor acquired the property, when the recipient is a public charitable organization.[55] Thus, even though the donee is a public charitable organization, the percentage limitation in this context is 30 percent, not 50 percent.

[55] IRC § 170(b)(1)(C)(i); Reg. § 1.170A-8(d)(1).

(a) General Rules

To be subject to treatment under this 30 percent limitation, an item of property must satisfy three requirements:

1. The property must be a capital asset[56]
2. If the property were sold by the donor at its fair market value at the time of the contribution, the sale would result in the recognition of gain, all or any portion of which would be long-term capital gain
3. The circumstances are not such that the amount of the contribution need be reduced by the appreciation element inherent in the capital gain property[57]

Property that qualifies for this 30 percent limitation is, as noted, referred to throughout as *capital gain property*.[58]

The fair market value of an item of capital gain property is used in calculating the value of the deduction, although the actual deduction for a contribution year may be less as the result of this (or other) limitation.

In general, then, an individual may deduct charitable contributions of capital gain property made during a tax year to any public charitable organization to the extent that the contributions in the aggregate do not exceed 30 percent of the donor's contribution base.[59]

EXAMPLE 7.8

This example may be compared to Example 7.1. A had, for 2009, a contribution base of $100,000. During 2009, she made charitable contributions using securities that had appreciated to $45,000 in value, since she acquired them (and were capital gain property). She made the contributions to a church, a university, and a hospital (each of which is a public charitable organization). A was allowed a federal income tax charitable contribution deduction for 2009 of $30,000 (30% of $100,000), rather than $45,000 (A's deduction in Example 7.1).

The full 30 percent limitation may not always apply, however, which is to say that the allowable amount for a contribution year may be less. This is because contributions of money to public charitable organizations, and the applicable percentage limitations, have to be taken into account first.[60] In this process, the value of the capital gain property contributed to public charitable organizations that must be used is the full fair market value, not the amount limited by the 30 percent rule.[61]

The federal income tax law thus establishes an order of priority for categories of gifts to public charitable organizations, which can determine the deductibility of charitable gifts. The federal income tax law favors the giving of money, rather

[56] See ch. 2. A property that is used in a trade or business (IRC § 1231(b)) is treated as a capital asset.
[57] See §§ 4.5, 4.6.
[58] IRC § 170(b)(1)(C)(iv); Reg. § 1.170A-8(d)(3).
[59] IRC § 170(b)(1)(C)(i); Reg. § 1.170A-8(d)(1).
[60] IRC § 170(b)(1)(C)(i); Reg. § 1.170A-8(d)(1). One category of gifts that is not considered in this regard is contributions of capital gain property to charitable organizations that are not public charitable organizations. See § 7.12.
[61] IRC § 170(b)(1)(B)(ii); Reg. § 1.170A-8(c)(2)(ii).

than property, to public charitable organizations. Therefore, when computing current or carried-forward charitable deductions, contributions of money to public charitable organizations are, as noted, considered first.

This rule is illustrated by the following example:

EXAMPLE 7.9

C, an individual, had a contribution base for 2009 of $100,000. During that year, C made a gift of capital gain property to PC, a public charitable organization, in the amount of $10,000. During that year, C also contributed $45,000 in money to PC. C's federal income tax charitable contribution deduction for 2009 was $50,000 (50% of $100,000), consisting of the $45,000 of money and $5,000 of the gift of property. Thus, even though the value of the capital gain property, taken alone, was less than 30 percent of C's contribution base, only a portion of it ($5,000) was deductible for 2009 income tax purposes.

When a donor makes a gift of an undivided fractional interest in an item of property[62] that is qualified capital gain property, the donee is a public charity, and the electable 50 percent limitation[63] is not elected, the amount of the gift is determined under this 30 percent limitation. The amount of the gift will equal the product of (1) the fraction times (2) the fair market value of the entire item of property at the time of the gift of the fractional interest.[64]

(b) Carryover Rules

Subject to certain conditions and limitations, the excess of:

> The amount of the charitable contributions of capital gain property subject to the 30 percent limitation made by an individual in a contribution year to public charitable organizations

divided by:

> 30 percent of the individual's contribution base for the contribution year

is treated as a charitable contribution of capital gain property, subject to this 30 percent limitation, paid by the individual to a public charitable organization in each of the five tax years immediately succeeding the contribution year, in order of time.[65] Also, any charitable contribution of capital gain property subject to the 30 percent limitation that is carried over to these years under the general carryover rules[66] is treated as though it were a carryover of capital gain property under the special carryover rules[67] concerning this type of property.[68]

In applying these rules, the amount of the excess contributions that are to be treated as paid to a public charitable organization in any one of the five tax years immediately succeeding the contribution year may not exceed the lesser of the following four amounts:

---

[62] See § 15.3.
[63] See § 7.7.
[64] E.g., Priv. Ltr. Rul. 9303007.
[65] IRC § 170(b)(1)(C)(ii); Reg. § 1.170A-8(c)(1).
[66] See § 7.8, text accompanied by *infra* note 103.
[67] IRC § 170(b)(1)(C)(ii).
[68] Reg. § 1.170A-10(c)(1).

1. The amount by which 30 percent of the donor's contribution base for the succeeding tax year involved exceeds the sum of
   - The charitable contributions of capital gain property made (computed without regard to the carryover rules) by the donor in the year to public charitable organizations, and
   - The charitable contributions of capital gain property made to public charitable organizations in years preceding the contribution year which, pursuant to the contribution rules, are treated as having been paid to a public charitable organization in the succeeding tax year involved.
2. The amount by which 50 percent of the donor's contribution base for the succeeding tax year involved exceeds the sum of
   - The charitable contributions made (computed without regard to the carryover rules) to public charitable organizations by the donor in the year,
   - The charitable contributions of capital gain property, made to public charitable organizations in years preceding the contribution year, that, pursuant to the carryover rules, are treated as having been paid to a public charitable organization in the succeeding year involved, and
   - The charitable contributions made to public charitable organizations, other than contributions of capital gain property, that, pursuant to the general carryover rules, are treated as having been paid to a public charitable organization in the succeeding year.
3. In the case of the first tax year succeeding the contribution year, the amount of the excess charitable contribution of capital gain property in the contribution year.
4. In the case of the second, third, fourth, and fifth tax years succeeding the contribution year, the portion of the excess charitable contribution of capital gain property in the contribution year that has not been treated as paid to a public charitable organization in a year intervening between the contribution year and the succeeding tax year involved.

For purposes of applying the first and second of these amounts, the amount of charitable contributions of capital gain property actually made in a year succeeding the contribution year is determined by first applying the 30 percent limitation.

If a donor, in any one of the four tax years succeeding a contribution year, elects to utilize the standard deduction instead of itemizing the deductions allowable in computing taxable income, the return in such a year must be treated as paid (but not allowable as a deduction), in the year the standard deduction is used, the lesser of the above four amounts.[69]

§ 7.7 ELECTABLE 50 PERCENT LIMITATION

The federal tax law provides an opportunity for an individual donor to elect application of the 50 percent limitation where the 30 percent limitation would otherwise apply.

[69] Reg. § 1.170A-10(c)(2). The rationale for this rule is discussed *supra*, text following reference to note 54.

(a) General Rules

An individual donor may elect, for any tax year, to reduce his or her potential federal income tax charitable contribution deduction, occasioned by the gift or gifts of capital gain property to charity made during the tax year, by the amount of what would have been long-term capital gain had the property been sold, in exchange for use of the 50 percent limitation.[70] This election may be made with respect to contributions of capital gain property carried over to the tax year involved even though the donor has not made any contribution of capital gain property in the year. If this election is made, the 30 percent limitation[71] and the carryover rules with respect to it[72] are inapplicable to the contributions made during the year.[73] This means that the 50 percent limitation applies.

In deciding whether to make this election, an individual must determine whether the 50 percent limitation or the 30 percent limitation is most suitable for him or her (or them) under the circumstances. A principal factor is usually the extent to which the property has appreciated in value; this election can be preferable when the property has not appreciated much in value. Another factor is whether the donor is seeking the maximum charitable contribution deduction for a contribution year. Because capital gain property generally is deductible using the fair market value of the property, the 30 percent limitation can operate to reduce what would otherwise be a larger charitable contribution deduction if the 50 percent limitation applied. This election enables a donor to calculate the deduction by using the fair market value of the property rather than simply the basis in the property.[74] This rule may be illustrated by the following example:

EXAMPLE 7.10

M had a contribution base for 2009 of $100,000. During that year, M made a gift of capital gain property having a fair market value of $45,000 to PC, a public charitable organization. M's basis in this property was $38,000. She made no other charitable gifts during 2009. M was advised that if she did not make the election, her charitable contribution deduction for 2009 would be $30,000 (30% of $100,000), with a carryover of $15,000 ($45,000 − $30,000). She was also advised, however, that if she made the election, her charitable contribution deduction for 2009 would be $38,000 ($45,000 less the capital gain element of $7,000). Being particularly concerned with her tax liability for 2009, M made the election so that she could have a $38,000 (rather than a $30,000) charitable deduction for that year. She thus knowingly abandoned the $15,000 carryover that would have been potentially used in computing her tax liability for 2010.

If there are carryovers to a tax year of charitable contributions of capital gain property made in preceding, qualifying tax years (subject to the 30 percent limitation), the amount of the contributions in each preceding year must be revised as if

[70] IRC § 170(b)(1)(C)(iii); Reg. § 1.170A-8(d)(2).
[71] IRC § 170(b)(1)(C)(i).
[72] IRC § 170(b)(1)(C)(ii).
[73] Reg. § 1.170A-8(d)(2)(i)(a).
[74] This method of reducing the charitable deduction is the same as that required with respect to gifts of capital gain property to charitable organizations that are not public charitable organizations (see § 4.5) and for gifts of tangible personal property that are not used for related exempt purposes by the charitable donee (see § 4.6).

this deduction reduction rule had applied to them in the preceding year,[75] and must be carried over to the tax year and succeeding years as contributions of property other than capital gain property. The percentage limitations for the preceding tax year and for any tax years intervening between that year and the year of the election are not redetermined, and the amount of any charitable deduction allowed for the years with respect to the charitable contributions of capital gain property in the preceding year is not redetermined. The amount of the charitable deduction so allowed in the preceding tax year must, however, be subtracted from the reduced amount of the charitable contributions made in that year (that is, the capital gain element must be subtracted) to determine the excess amount carried over from that year. If the amount of the deduction so allowed in the preceding tax year equals or exceeds the reduced amount of the charitable contributions, there may not be any carryover from that year to the year of the election.[76]

This election may be made for each tax year in which a charitable contribution of capital gain property is made or to which the charitable deduction is carried over under the rules of the 30 percent limitation.[77] If there are also carryovers, under the general rules concerning carryovers of excess contributions,[78] to the year of the election by reason of this election for a previous tax year, these carryovers may not be redetermined by reason of the subsequent election.[79] When the election is made, however, it must apply with respect to all contributions of capital gain property made to public charitable organizations during the contribution year.[80]

These rules may be illustrated by the following two examples:

EXAMPLE 7.11

H had a contribution base for 2008 of $100,000 and for 2009 of $120,000. In 2008, H made a contribution of capital gain property to a public charitable organization, PC, having a fair market value of $40,000 and a basis of $25,000. In 2009, H made a contribution of capital gain property to PC having a fair market value of $50,000 and a basis of $45,000. H did not make any other charitable gifts during those years. H did not make the election for 2008. Therefore, H properly claimed a charitable contribution deduction for that year in the amount of $30,000 (30% of $100,000) and carried forward the amount of $10,000 ($40,000 − $30,000).

H elected to have the 50 percent limitation apply to his contribution of $50,000 in 2009. Accordingly, H was required to recompute his carryover from 2008 as if the deduction reduction rule had applied to his contribution of capital gain property in that year.

If the deduction reduction rule had applied in 2008 to H's contribution of capital gain property, the amount of H's contribution for these purposes would have been reduced from $40,000 to $25,000, the reduction of the $15,000 being all of the gain ($40,000 − $25,000) that would have been long-term capital gain had H sold the property at its fair market value at the time of its contribution in 2008. Accordingly, by taking this election

(continues)

[75] Reg. § 1.170A-8(d)(2)(i)(b).
[76] *Id*.
[77] See text accompanied by *supra* note 68.
[78] See text accompanied by *supra* note 52.
[79] Reg. § 1.170A-8(d)(2)(i)(c).
[80] IRC § 170(b)(1)(C)(iii); Reg. § 1.170A-8(d)(2).

EXAMPLE 7.11 (*CONTINUED*)

into account, H did not have a recomputed carryover to 2009, because the $25,000 was fully deductible in 2005 (H's maximum charitable deduction in that year was $30,000 (30% of $100,000)). H's charitable contribution deduction of $30,000 allowed for 2005, however, did not have to be recomputed by reason of this election.

Pursuant to the election for 2009, the contribution of capital gain property for that year was reduced from $50,000 to $45,000, the reduction of $5,000 being all of the gain of $5,000 ($50,000 − $45,000) that would have been long-term capital gain had H sold the property at its fair market value at the time of its contribution in 2005. Accordingly, H was allowed a charitable contribution deduction for 2006 of $45,000, rather than of $36,000 (30% of $120,000) had the election not been made.

EXAMPLE 7.12

In 2008, A made a charitable contribution to a church of capital gain property having a fair market value of $60,000 and an adjusted basis of $10,000. A's contribution base for 2008 was $50,000 and A did not make any other charitable contributions in that year. A did not elect for 2008 to have the deduction reduction rule apply to the contribution. A was allowed, under the 30 percent limitation, a charitable contribution deduction for 2008 of $15,000 (30% of $50,000). Under the carryover rules for capital gain property,[a] A was allowed a carryover to 2006 of $45,000 ($60,000 − $15,000) for his contribution of this capital gain property.

In 2009, A made a charitable contribution to a church of capital gain property having a fair market value of $11,000 and an adjusted basis of $10,000. A's contribution base for 2009 was $60,000 and he did not make any other charitable contributions in that year. He elected for 2009 to have the election apply to his contribution of $11,000 in that year and to his carryover of $45,000 from 2008. Accordingly, A was required to recompute his carryover from 2008 as if the deduction reduction rule had applied to his contribution of capital gain property in that year.

If the deduction reduction rule had applied in 2008 to A's contribution of capital gain property, the amount of A's contribution for these purposes would have been reduced from $60,000 to $10,000, the reduction of the $50,000 being all of the gain ($60,000 − $10,000) that would have been long-term capital gain had A sold the property at its fair market value at the time of its contribution in 2008. Accordingly, by taking this election into account, A did not have a recomputed carryover to 2009 in connection with his contribution of capital gain property in 2008, because the $10,000 was fully deducted in 2008 (A's maximum charitable deduction in that year was $15,000 (30% of $50,000)). A's charitable contribution deduction of $15,000 allowed for 2008 did not, however, have to be recomputed by reason of this election.

Pursuant to the election for 2009, the contribution of capital gain property for that year was reduced from $11,000 to $10,000, the reduction of $1,000 being all of the $1,000 gain ($11,000 − $10,000) that would have been long-term capital gain had A sold the property at its fair market value at the time of its contribution in 2009.

Accordingly, A was allowed a charitable contribution deduction for 2009 of $11,000.[b]

[a] See text accompanied by *supra* note 68.
[b] Reg. § 1.170A-8(f), Example (9).

This example also illustrates a circumstance in which the election is inappropriate. In the example, A did not need to make the election in 2009 to cause all of the $11,000 gift to be deductible in that year, because the maximum amount of allowable giving was $18,000 (30% of $60,000). Worse, by making the election, A lost the economic effect of the $45,000 carryforward to 2008.

If a husband and wife file a joint federal income tax return for a year in which a charitable contribution is made, and one of the spouses makes this election in a later year when he or she files a separate return, or if a spouse dies after a contribution

year for which a joint return is filed, any excess contribution of capital gain property that is carried over to the election year from the contribution year must be allocated between the husband and wife, as provided under the rules concerning carryovers of excess contributions.[81] If a husband and wife file separate returns in a contribution year, any election in a later year when a joint return is filed applies to any excess contributions of capital gain property of either individual carried over from the contribution year to the election year. This is also the case when two individuals marry and file a joint return. A remarried individual who filed a joint return with his or her former spouse for a contribution year and thereafter filed a joint return with his or her present spouse must treat the carryover to the election year as provided under the rules[82] concerning carryovers of excess contributions.[83]

When this election is made, the charitable contribution deduction must be reduced by application of the deduction reduction rule.[84] If the property that is the subject of the gift is tangible personal property, the charitable deduction that would otherwise be determined must be reduced as provided for in the deduction reduction rule applicable to gifts of this type of property that are put to an unrelated use.[85] This second rule applies (1) even though the gift property is in fact clearly put to a related use[86] and (2) irrespective of whether the gift is an outright gift or conveys an undivided fractional interest in the property.[87]

Moreover, when this election is made (and the deduction reduction rule is triggered), and the charitable contribution is of less than the donor's entire interest in the property contributed, the donor's adjusted basis in the property must be allocated between the interest contributed and any interest not contributed.[88] An example of this situation is presented in an IRS private letter ruling for a donor who contributed undivided fractional interests in works of art to a museum; the IRS pointed out that if the 50 percent limitation was elected, the deduction reduction rule and the basis allocation rule would apply.[89] The IRS ruled that, in this instance, the amount of the income tax charitable contribution attributable to any gift would equal the

> product of (a) such fraction times (b) another fraction, the numerator of which is the [d]onor's adjusted basis in her interest in the work immediately preceding the gift of the fractional interest, and the denominator of which is the fraction representing the portion of the [d]onor's ownership in the entire work immediately preceding the gift of the fractional interest.[90]

This election is made by attaching to the federal income tax return for the year of the election a statement indicating that the election is being made. Preferably, the statement will refer to the appropriate sections of the Internal Revenue Code[91] and, ideally, of the regulations.[92] If there is a carryover to the tax year of

[81] Reg. § 170A-10(d)(4)(i), (iii).
[82] Reg. § 1.170A-10(d)(4)(ii).
[83] Reg. § 1.170A-8(d)(ii).
[84] See § 4.4.
[85] See § 4.6.
[86] E.g., Priv. Ltr. Rul. 9303007.
[87] *Id*. The rules concerning gifts of undivided interests are the subject of § 15.3.
[88] IRC § 170(e)(2).
[89] Priv. Ltr. Rul. 9303007.
[90] *Id*. This rule is formulated in Reg. § 1.170A-4(c)(1)(ii).
[91] IRC § 170(b)(1)(C)(iii).
[92] Reg. § 1.170A-8(d)(2)(i).

any charitable contributions of capital gain property from a previous tax year or years, the statement must show the recomputation[93] of the carryover, setting forth sufficient information with respect to the previous tax year or any intervening year to show the basis of the recomputation. The statement must indicate the district director of the IRS, or the director of the Internal Revenue Service center, with whom the return for the previous tax year or years was filed, the name or names in which the return or returns were filed, and whether each of the returns was a joint return or a separate return.[94]

(b) Timing of Election

This election cannot be made retroactively. In the principal case on the point, the donors calculated their charitable deduction for a significant gift of property (which was highly appreciated in value) by making this election. This act produced a charitable deduction for the year of the gift and for two subsequent years. Two years later, the donors recalculated their charitable deduction stemming from the gift and filed amended returns using the 30 percent limitation. This approach gave them a smaller deduction in the year of the gift and the two following years, but it produced a charitable contribution deduction in each of the next three tax years. Litigation was launched when the IRS disallowed the deductions for the most recent three years.

One of the arguments advanced by the donors was that they had never made a valid election to use the 50 percent limitation, so they were not bound by that initial decision. The court held, however, that the election was valid, noting that no particular words are required and that adequate notice as to the election had been provided to the IRS.[95]

The other argument was that the election is revocable. Persuaded by the government's argument that irrevocability is required to avoid burdensome uncertainties in administration of the revenue laws, the court held that the donors were bound by their election in the year of the gift. The court observed that "where . . . the taxpayer's initial election later becomes, through hindsight, less financially advantageous than some other option, the improvident election does not enable the taxpayers to revoke that election."[96]

This election may not be made by means of an amended return.[97]

§ 7.8 GENERAL 30 PERCENT LIMITATION

A 30 percent limitation generally applies in instances of contributions of money to charitable organizations other than public charities.

---

[93] Reg. §§ 1.170A-8(d)(2), 1.170A-4.

[94] Reg. § 1.170A-8(d)(2)(iii).

[95] *Woodbury v. Commissioner*, 900 F.2d 1457 (10th Cir. 1990).

[96] *Id*. at 1461. See also *Grynberg v. Commissioner*, 83 T.C. 255 (1984), in which the court relied on the *doctrine of election*, precluding the donor from revoking the election because the donor had a free choice between the two alternatives and engaged in the overt act (by filing a tax return) of communicating that choice to the IRS.

[97] Rev. Rul. 77-217, 1977-1 C.B. 64. In general, Auster, "Deducting Charitable Contributions of Capital Gain Property After 1993 Tax Legislation: When to Make the 50 Percent Election," 9 *Exempt Org. Tax Rev.* (no. 2) 291 (Feb. 1994).

(a) General Rules

Normally, an individual's charitable contributions made during a tax year, to one or more charitable organizations other than public charitable organizations, when the subject of the gift is money, are deductible to the extent that these contributions in the aggregate do not exceed 30 percent of the individual's contribution base for the tax year.[98] Separate rules apply when the property is long-term capital gain property and is contributed to charitable organizations other than public charitable organizations.[99]

This limitation applies to donees such as private foundations, veterans' organizations, fraternal organizations, and certain cemetery companies.[100]

EXAMPLE 7.13

> This example may be compared with Example 7.1. A had, for 2009, a contribution base of $100,000. During 2009, she made charitable contributions of money, in the amount of $45,000, to a private foundation. A was allowed a charitable contribution deduction for 2005 of $30,000 (30% of $100,000).

In some instances, however, the actual annual limitation on deductible gifts of this nature is less than the 30 percent limitation. This occurs when gifts of money and/or capital gain property to public charitable organizations are also made in the same contribution year. Thus, if the amount is less, the limitation will be an amount equal to the excess of 50 percent of the donor's contribution base for the year over the amount of deductible charitable contributions that are allowable under the 50 percent limitation.[101] This rule is discussed more fully below.[102]

As noted previously, these rules as applicable to money also apply to certain types of property. Thus, this general 30 percent limitation applies to gifts of money, ordinary income property, and short-term capital gain property.

(b) Carryover Rules

In general, the excess of:

> the amount of the charitable contribution or contributions of capital gain property made by an individual in a contribution year to one or more public charitable organizations

divided by:

> 30 percent of the individual's contribution base for the contribution year

is treated as a charitable contribution paid by the individual to a public charitable organization, subject to the 30 percent limitation, in each of the five tax years

---

[98] IRC § 170(b)(1)(B)(i).
[99] See § 7.12.
[100] IRC §§ 170(c)(2)–(5).
[101] IRC § 170(b)(1)(B).
[102] See §§ 7.9, 7.10.

immediately succeeding the contribution year, in order of time.[103] As noted, for federal income tax purposes, when the carryover rules are applied, an amount paid to a charitable organization in one year is treated as paid to the charitable organization in a subsequent year.

EXAMPLE 7.14

This example is based on the facts of Example 7.13. A was allowed a charitable contribution deduction for 2009 of $30,000 (30% of $100,000) and a carryforward of $15,000 ($45,000 − $30,000).

§ 7.9 INTERPLAY OF 50 PERCENT/SPECIAL 30 PERCENT LIMITATIONS

In computing the charitable contribution deduction, contributions of money to public charitable organizations are taken into account before contributions of capital gain property to public charitable organizations.

This rule is illustrated by the following two examples:

EXAMPLE 7.15

H and W (husband and wife) had a contribution base for 2008 of $50,000 and for 2009 of $40,000, and filed a joint return for both years. In 2008, H and W contributed $20,000 in money and $13,000 of capital gain property to PC, a public charitable organization. In 2009, they contributed $5,000 in cash and $10,000 of capital gain property to PC. They were able to properly claim a charitable contribution deduction of $25,000 for 2008. The excess of $33,000 (contributed to PC) over the $25,000 (50% of contribution base), or $8,000, constituted a charitable contribution carryover, which was treated as a charitable contribution of capital gain property (subject to the 30 percent limitation) paid by them to a public charitable organization in each of the five succeeding tax years in order of time. Because 30 percent of the contribution base for H and W for 2009 ($12,000) exceeded the charitable contribution of capital gain property ($10,000) made by them in 2009 to a public charitable organization (computed without regard to the carryover rules), the portion of the 2008 carryover equal to the excess of $2,000 ($12,000 − $10,000) was treated as paid to a public charitable organization in 2009. The remaining $6,000 constituted an unused charitable contribution carryover in respect of capital gain property subject to the 30 percent limitation from 2008.[a]

[a] Reg. § 1.170A-10(c)(1), Example (1).

EXAMPLE 7.16

This example is based on the facts of Example 7.15, except that the $33,000 of charitable contributions in 2008 was all of capital gain property. Because the charitable contributions of H and W in 2008 exceeded 30 percent of their contribution base ($15,000) by $18,000 ($33,000 − $15,000), they were able to claim a charitable contribution deduction of $15,000 in 2008; the excess of $33,000 over $15,000 ($18,000) constituted a charitable contribution carryover, which was treated as a charitable contribution of capital gain property (subject to the 30 percent limitation) paid by them to a public charitable organization in each of the five succeeding tax years in order of time. Because they were allowed to treat only $2,000 of their 2008 contributions as paid in 2009, H and W had a remaining

[103] IRC § 170(b)(1)(B), last sentence.

unused charitable contribution carryover of $16,000 in respect of capital gain property subject to the 30 percent limitation from 2008.[a]

[a] Reg. § 1.170A-10(c)(1), Example (2).

§ 7.10 INTERPLAY OF 50 PERCENT/GENERAL 30 PERCENT LIMITATIONS

When an individual donor makes, in the same year, gifts of money and/or capital gain property to one or more public charitable organizations and gifts of money in circumstances involving the general 30 percent limitation, the charitable contribution deduction is computed by first taking into consideration the gift or gifts to one or more public charitable organizations.[104] The contributions subject to the 30 percent limitation are deductible, in whole or in part, only to the extent that: (1) these gifts do not exceed the 30 percent limitation; or (2) the gift or gifts to one or more public charitable organizations do not, in the aggregate, exceed the amount allowable by the 50 percent limitation.

The actual deductible amount is the lesser of these two items. That is, the maximum amount deductible in any one year for gifts subject to the 30 percent limitation in these circumstances is the lesser of the amount capped by the 30 percent limitation or the amount (if any) represented by the "gap" between the amount contributed to one or more public charitable organizations during the year and the maximum amount allowable under the 50 percent limitation for the year.

These rules concerning gifts of money are illustrated in the following two examples:

EXAMPLE 7.17

B had, for 2009, a contribution base of $100,000. During 2009, B made charitable contributions of $70,000 in money, $40,000 of which was given to public charitable organizations and $30,000 of which was given to charitable organizations that were not public charitable organizations. B was allowed, for 2009, a charitable contribution deduction of $50,000 (50% of $100,000), which consisted of the $40,000 contributed to the public charities and $10,000 of the $30,000 contributed to the other organizations. Only $10,000 of the $30,000 contributed to the other charitable organizations was allowed as a deduction, because the contribution of $30,000 was allowed to the extent of the lesser of $30,000 (30% of $100,000) or $10,000 ([50% of $100,000] − $40,000, being the contributions allowed under the 50 percent limitation).[a]

[a] Reg. § 1.170A-8(f), Example (1).

EXAMPLE 7.18

H and W (husband and wife) had a contribution base for 2008 of $50,000 and for 2009 of $40,000, and filed a joint return for both years. In 2008, H and W made a charitable contribution in money of $26,500 to PC, a public charitable organization, and $1,000 to PF, a charitable organization that is not a public charitable organization. In 2009, they made a charitable contribution in money of $19,000 to PC and $600 to PF. They were able to properly claim a charitable contribution deduction of $25,000 in 2008 (50 percent of $50,000). This deduction was of $25,000 of the gift to PC; none of the gift to PF was deductible in 2008.

(continues)

[104] IRC § 170(b)(1)(B).

EXAMPLE 7.18 (*CONTINUED*)

The excess of $2,500 ($27,500 − $25,000) constituted a charitable contribution carryover that was subsequently treated as a charitable contribution paid by them to a public charitable organization ($1,500) and a nonpublic charitable organization ($1,000) in each of the five succeeding tax years in order of time. Their contribution of $19,000 to PC in 2009 was fully deductible in that year, because 50 percent of their contribution base was $20,000. Also, $1,000 of the $1,500 carryover (actually contributed to PC in 2008) was considered paid to PC in 2009 and was deductible in that year. Thus, H and W had a 2009 charitable contribution deduction of $20,000. Once again, none of the gift to PF was deductible in 2009. The remaining $500 contributed to PC in 2008 was treated as a carryover of gifts of money to public charitable organizations; the gifts to PF of $1,000 in 2008 and $600 in 2009 were treated as a carryover of gifts of money to charitable organizations that are not public charitable organizations.[a]

[a] Reg. § 1.170A-10(b)(1), Example 1.

§7.11 INTERPLAY OF SPECIAL 30 PERCENT/GENERAL 30 PERCENT LIMITATIONS

The federal income tax law favors gifts of capital gain property to public charitable organizations over gifts of money to charitable organizations that are not public charitable organizations. Thus, a gift of money to, for example, a private foundation may not be fully deductible under the general 30 percent limitation because of a gift of capital gain property in the same year to a public charitable organization.

This rule is illustrated by the following example:

EXAMPLE 7.19

X had a contribution base for 2009 of $100,000. During that year X contributed an item of capital gain property, having a fair market value of $60,000, to PC, a public charitable organization, and contributed money in the amount of $5,000 to PF, a private foundation. The gift of money was not deductible in computing X's tax liability for 2009. This is because the fair market value of the property contributed was in excess of 50 percent of X's contribution base. (The actual charitable contribution deduction for this gift of property was limited to the amount equal to 30 percent of X's contribution base, or $30,000.) X thus had two carryovers to 2010. One was a carryover of $30,000 for the gift to PC (subject to the 30 percent limitation applicable to gifts of capital gain property) and the other was a carryover of the $5,000 (subject to the general 30 percent limitation).

§7.12 TWENTY PERCENT LIMITATION

In general, contributions of capital gain property by individuals to charitable organizations that are not public charitable organizations are subject to a 20 percent limitation.[105] This limitation is a percentage of the donor's contribution base for the contribution year.

EXAMPLE 7.20

A had, for 2009, a contribution base of $100,000. During that year, she contributed an item of capital gain property to PF, a private foundation. The fair market value of the property was $25,000. A made no other charitable gifts in 2009. A was allowed a federal income tax charitable contribution deduction for 2009 of $20,000 (20% of $100,000).

[105] IRC § 170(b)(1)(D)(i).

(a) General Rules

In some instances, however, the actual annual limitation on deductible gifts of this nature is less than the 20 percent limitation. This occurs when gifts of capital gain property to public charitable organizations are also made in the same contribution year. Thus, the charitable deduction for this type of gift is confined to the lesser of:

- The amount allowable under the 20 percent limitation, or
- An amount equal to the excess of 30 percent of the donor's contribution base for the year over the amount of charitable contributions of capital gain property to public charitable organizations that are allowable under the 30 percent limitation.[106]

This 20 percent limitation applies to contributions of property when the amount of the gift, for deduction purposes, was reduced under the deduction reduction rules.[107]

(b) Carryover Rules

In general, the excess of:

> The amount of the charitable contribution or contributions of capital gain property made by an individual in a contribution year to one or more charitable organizations that are not public charitable organizations

divided by:

> 20 percent of the individual's contribution base for the contribution year

is treated as a charitable contribution paid by the individual to a nonpublic charitable organization, subject to the 20 percent limitation, in each of the five tax years immediately succeeding the contribution year, in order of time.[108]

EXAMPLE 7.21

The facts of this example are the same as in Example 7.20. A had a carryforward of $5,000 to be treated as a gift of capital gain property to charitable organizations that are not public charitable organizations for years subsequent to 2009.

§ 7.13 GIFTS FOR THE USE OF CHARITY

The federal income tax law provides for a charitable contribution deduction for gifts to or for the use of one or more qualified charitable donees.[109] Charitable contributions discussed in other sections of this chapter are gifts *to* a charitable organization. Contributions *for the use* of a charitable organization are discussed elsewhere.[110]

[106] *Id*.
[107] *Id*. The deduction reduction rules are the subject of §§ 4.5–4.7.
[108] IRC § 170(b)(1)(D)(ii).
[109] IRC § 170(c).
[110] See § 10.3.

Contributions for the use of a charitable organization are subject to the general 30 percent limitation.[111]

§ 7.14 BLENDING PERCENTAGE LIMITATIONS

A donor who is an individual may make gifts of various types to charitable organizations of various tax classifications in a single year. These gifts may be partly of money and partly of property. The property may or may not be capital gain property. The charitable donees may be public charities, private foundations, veterans' organizations, or other charitable recipients. The law provides for application of the various percentage limitations in situations in which differing types of gifts are made and/or differing categories of charitable organizations are recipients of the gifts.

When an individual contributes cash to public and private charities in the same year, there is an interplay between the 50 percent limitation and the 30 percent limitation.[112] When an individual contributes money and capital gain property to one or more public charities in the same year, there is an interplay between the 50 percent limitation and the special 30 percent limitation. Also, there can be an interplay between percentage limitations when capital gain property is contributed in the same year to both one or more public charities and one or more charitable organizations that are not public ones. In some instances, all of the percentage limitations are applicable.

No matter what the mix of gift subjects and gift recipients may be, the maximum amount that may be deducted by an individual in any one year, as the result of one or more charitable gifts, is an amount equal to 50 percent of the donor's contribution base. Contributions of money to public charitable organizations are considered before contributions of money to charitable organizations that are not public charitable organizations. Contributions of money are taken into account before contributions of capital gain property. Contributions of capital gain property to public charitable organizations are taken into account before contributions of such property to nonpublic charitable organizations.

When the documentation is not precise, the charitable contribution deduction is likely to default to the 20 percent limitation. For example, in one instance, the IRS, having ruled that two trusts qualified as charitable remainder unitrusts,[113] pointed out that the power of certain individuals to name charitable beneficiaries was not confined to the naming of public charities. Therefore, because of the possibility that a private foundation might be designated as a beneficiary, the IRS ruled that charitable contributions to the trust were limited, for deduction purposes, to the 20 percent limitation.[114]

Charitable gift amounts that exceed these various limitations can be, as discussed in the preceding sections of this chapter, carried forward and be

---

[111] IRC § 170(b)(1)(B).
[112] See § 7.9.
[113] See ch. 12.
[114] Priv. Ltr. Rul. 9252023.

potentially deductible in subsequent years. Just as there can be an interplay of gifts and money in the same year, however, there can be an interplay of two or more years in conjunction with a single gift (because of one or more carryovers). In computing allowable deductions for that year, a charitable contribution in a current year is considered before taking into account contribution deductions based on carryovers.[115]

§ 7.15 INDIVIDUALS' NET OPERATING LOSS CARRYOVERS AND CARRYBACKS

An individual having a net operating loss carryover[116] from a prior tax year, which is available as a deduction in a contribution year, must apply a special rule for net operating loss carryovers[117] in computing the excess charitable contributions for the contribution year.

(a) Carryover Rules

In determining the amount of excess charitable contributions that must be treated as paid in each of the five years succeeding the contribution year, the excess charitable contributions described above must be reduced by the amount by which the excess reduces taxable income (for purposes of determining the portion of a net operating loss that must be carried to tax years succeeding the contribution year under the general rule concerning net operating loss carryovers).[118] This increases the net operating loss carried to a succeeding tax year. In reducing taxable income under these rules, an individual who has made charitable contributions in the contribution year to public organizations and to other charitable organizations must first deduct the contributions made to public charitable organizations from his or her adjusted gross income, computed without regard to his or her net operating loss deduction, before any of the contributions made to other charitable organizations may be deducted from adjusted gross income. Thus, if the excess of the contributions made in the contribution year to public charitable organizations over the amount deductible in the contribution year is utilized to reduce taxable income (under the general rules concerning net operating loss carryovers)[119] for the year, thereby serving to increase the amount of the net operating loss carryover to a succeeding year or years, no part of the excess charitable contributions made in the contribution year may be treated as paid in any of the five immediately succeeding tax years. If only a portion of the excess charitable contributions is so used, the excess charitable contributions need be reduced only to that extent.[120]

---

[115] IRC § 170(d)(1); Reg. §§ 1.170A-8, 1.170A-10.
[116] IRC § 172.
[117] IRC § 170(d)(1)(B).
[118] IRC § 170(b)(2), second sentence.
[119] *Id*.
[120] Reg. § 1.170A-10(d)(1).

These rules may be illustrated by the following three examples:

EXAMPLE 7.22

B, for 2005, had adjusted gross income (computed without regard to any net operating loss deduction) of $50,000. During that year, B made charitable contributions of money in the amount of $30,000, all of which were to public charitable organizations; B also had a net operating loss carryover from 2004 of $50,000. In the absence of the net operating loss deduction, B would have been allowed a deduction for charitable contributions of $25,000 (50% of $50,000). After application of the net operating loss deduction, B was not allowed any deduction for charitable contributions, and there was (before applying the special rule for net operating loss carryovers) a tentative excess charitable contribution of $30,000. For purposes of determining the net operating loss that remained to be carried over to 2006, B computed his taxable income for 2005 under the general rule concerning net operating loss carryovers by deducting the $25,000 charitable contribution. After the $50,000 net operating loss carryover was applied against the $25,000 of taxable income for 2005 (computed in accordance with this general rule, assuming no deductions other than the charitable contribution deduction were applicable in making the computation), there remained a $25,000 net operating loss carryover to 2006. Because application of the net operating loss carryover of $50,000 from 2004 reduced the 2005 adjusted gross income (for purposes of determining 2005 tax liability) to zero, no part of the $25,000 of charitable contributions in 2005 was deductible, under the percentage limitation rules for individuals. In determining the amount of the excess charitable contributions to be treated as paid in tax years 2006, 2007, 2008, 2009, and 2010, however, the $30,000 must be reduced to $5,000 by the portion of the excess charitable contributions ($25,000) that was used to reduce taxable income for 2005 (as computed for purposes of the general rule concerning net operating loss carryovers) and that thereby increased the net operating loss carryover to 2006 from zero to $25,000.[a]

[a] Reg. § 1.170A-10(d)(1), Example (1).

EXAMPLE 7.23

The facts of this example are the same as those in Example 7.22, except that B's total charitable contributions of $30,000 in money made during 2005 consisted of $25,000 to public charitable organizations and $5,000 to other charitable organizations. There was a tentative excess charitable contribution of $25,000, rather than $30,000 as in Example 7.22. For purposes of determining the net operation loss that remained to be carried over to 2006, B computed his taxable income for 2005 under the general rule concerning net operating loss carryovers by deducting the $25,000 of charitable contributions to public charitable organizations. Because the excess charitable contribution of $25,000 was used to reduce taxable income for 2005 (as computed for purposes of this general rule) and thereby increased the net operating loss carryover to 2006 from zero to $25,000, no part of the excess charitable contributions made in the contribution year could be treated as paid in any of the five immediately succeeding tax years. A carryover was not allowed with respect to the $5,000 of charitable contributions made in 2005 to the other charitable organizations.[a]

[a] Reg. § 1.170A-10(d)(1), Example (2).

EXAMPLE 7.24

This example is based on the facts in Example 7.23, except that B's total charitable contributions of $30,000 made during 2005 were of capital gain property subject to the 30 percent limitation. There was a tentative excess charitable contribution of $30,000. For purposes of determining the net operating loss that remained to be carried over to 2006, B computed his taxable income for 2005 under the general rule concerning net operating loss carryovers by deducting the $15,000 (30% of $30,000) contribution of capital gain property that would have been deductible in 2005 absent the net operating loss deduction.

Because $15,000 of the excess charitable contribution of $30,000 was used to reduce taxable income for 2005 (as computed for purposes of this general rule) and thereby increased the net operating loss carryover to 2006 from zero to $15,000, only $15,000 ($30,000 − $15,000) of the excess could be treated as paid in tax years 2006, 2007, 2008, 2009, and 2010.[a]

[a] Reg. § 1.170A-10(d)(1), Example (3).

(b) Carryback Rules

The amount of the excess charitable contribution for a contribution year may not be increased because a net operating loss carryback is available as a deduction in the contribution year.

Example 7.25

In 2006, D had an excess charitable contribution of $50,000, which was to be carried to the five succeeding tax years. In 2009, D had a net operating loss, which she was able to carry back to 2006. The excess contribution of $50,000 for 2006 could not have been increased by reason of the fact that D's adjusted gross income for 2006 (on which the excess contribution was based) was subsequently decreased by the carryback of the net operating loss from 2009. In addition, in determining under the general rule concerning net operating loss carryovers the amount of the net operating loss for any year subsequent to the contribution year that is a carryback or carryover to tax years succeeding the contribution year, the amount of contributions made to public charitable organizations is limited to the amount of the contributions that did not exceed 50 percent of the donor's contribution base, computed without regard to any of the net operating loss deduction modifications rules,[a] for the contribution year. Thus, D had a net operating loss in 2009 that was carried back to 2006 and in turn to 2007—but D had made charitable contributions in 2006 to public charitable organizations. In determining the maximum amount of the charitable contributions that was deductible in 2006, for purposes of determining the taxable income for 2006 deductible under the general rule from the 2009 loss to ascertain the amount of that loss (which was carried back to 2007), the 50 percent limitation was based on D's adjusted gross income for 2006 computed without taking into account the net operating loss carryback from 2009 and without making any of the modifications.[b]

[a] IRC § 172(d).
[b] Reg. § 1.170A-10(d)(2).

The amount of the charitable contribution from a preceding tax year that is treated as paid in a current tax year (the *deduction year*) may not be reduced because a net operating loss carryback is available as a deduction in the deduction year. Additionally, in determining[121] the amount of the net operating loss, for any tax year subsequent to the deduction year, that is a carryback or carryover to tax years succeeding the deduction year, the amount of contributions made to public charitable organizations in the deduction year must be limited to the amount of the contributions that were actually made in the deduction year and those that were treated as paid in that year.[122] Moreover, these contributions may not exceed the 50 percent limitation or, in the case of capital gain property, the 30 percent limitation, computed without regard to any of the net operating loss deduction modifications[123] for the deduction year.[124]

[121] IRC § 172(b)(2).
[122] Reg. § 1.170A-10(d)(3).
[123] IRC § 172(d).
[124] Reg. § 1.170A-10(d)(3).

§ 7.16 RULES FOR SPOUSES

If a husband and wife:

1. File a joint return for a contribution year,
2. Compute an excess charitable contribution for that year, and
3. File separate returns for one or more of the five tax years immediately succeeding the contribution year,

any excess charitable contribution for the contribution year that is unused at the beginning of the first of these five tax years for which separate returns are filed must be allocated between the husband and the wife. For purposes of this allocation, a computation must be made of the amount of any excess charitable contribution that each spouse would have computed if separate returns had been filed for the contribution year.

The portion of the total unused excess charitable contribution for the contribution year allocated to each spouse must be an amount that bears the same ratio to the unused excess charitable contribution as the spouse's excess contribution, based on the separate return computation, bears to the total excess contributions of both spouses, based on the separate return computation. To the extent that a portion of the amount allocated to either spouse is not treated as a charitable contribution to a public charitable organization in the tax year in which separate returns are filed, each spouse must treat his or her respective unused portion as the available charitable contribution carryover to the next succeeding tax year in which the joint excess charitable contribution may be treated as paid. If a husband and wife file a joint return for one of the five tax years immediately succeeding the contribution year with respect to which a joint excess charitable contribution is computed, and following the first tax year for which the husband and wife filed separate returns, the amounts allocated to each spouse for this first tax year must be aggregated for purposes of determining the amount of the available charitable contribution carryover to the succeeding tax year. The amounts allocated must be reduced by the portion of the amounts treated as paid to a public charitable organization in this first tax year and in any tax year intervening between this first tax year and the succeeding tax year in which the joint return is filed.[125]

These rules are illustrated by the following example:

EXAMPLE 7.26

H and W filed joint returns for 2006, 2007, and 2008. In 2009 they filed separate returns. In each of these years, H and W itemized their deductions in computing taxable income. The following facts apply with respect to H and W for 2006:

	H	W	Joint return
Contribution base	$50,000	$40,000	$90,000
Contributions of cash to public charitable organizations (no other contributions)	37,000	28,000	65,000

[125] Reg. § 1.170A-10(d)(4)(i).

Allowable charitable contribution deductions	25,000	20,000	45,000
Excess contributions to be treated as paid in five succeeding tax years	12,000	8,000	20,000

The joint excess charitable contribution of $20,000 had to be treated as having been paid to a public charitable organization in the five succeeding tax years. In 2007, the portion of the excess treated as paid by H and W was $3,000 and in 2008 the portion of the excess treated as paid was $7,000. Thus, the unused portion of the excess charitable contribution made in the contribution year was $10,000 ($20,000 − $3,000 [amount treated as paid in 2007] + $7,000 [amount treated as paid in 2008]). Because H and W filed separate returns in 2009, $6,000 of the $10,000 was allocable to H and the remaining $4,000 was allocable to W. This was determined as follows:

$$\frac{\$12,000 \text{ (excess charitable contributions made by H (based on separate return computation) in 2006}}{\$20,000 \text{(total excess charitable contributions made by H and W (based on separate return computation) in 2006}} \times \$10,000 = \$6,000$$

$$\frac{\$8,000 \text{ (excess charitable contributions made by W (based on separate return computation) in 2006}}{\$20,000 \text{ (total excess charitable contributions made by H and W (based on separate return computation) in 2006}} \times \$10,000 = \$4,000$$

In 2009, H had a contribution base of $70,000 and he contributed $14,000 in cash to a public charitable organization. In that year, W had a contribution base of $50,000 and she contributed $10,000 in cash to a public charitable organization. Accordingly, H was able to properly claim a charitable contribution deduction of $20,000 in 2009 and W was able to properly claim a charitable contribution deduction of $14,000 in 2009. H's $20,000 deduction consisted of the $14,000 contribution in 2009 and the $6,000 carried over from 2006 and treated as a charitable contribution paid by him to a public charitable organization in 2006. W's $14,000 deduction consisted of the $10,000 contribution in 2009 and the $4,000 carried over from 2006 and treated as a charitable contribution paid by her to a public charitable organization in 2009.

	H	W
Available charitable contribution carryover	$6,000	$4,000
50% of contribution base	35,000	25,000
Contributions of cash made in 2008 to public charitable organizations (no other contributions)	14,000	10,000
	$21,000	$21,000

Amount of excess contributions treated as paid in 2009: The lesser of $6,000 (available carryover of H to 2009) or $21,000 (excess of 50% of contribution base ($35,000) over contributions actually made in 2009 to a public charitable organization ($14,000)	$6,000
The lesser of $4,000 (available carryover of W to 2009) or $15,000 (excess of 50% of contribution base ($25,000)) over contributions actually made in 2008 to a public charitable organization ($10,000)	$4,000

For purposes of this example, it was assumed that H and W did not make any contributions of capital gain property during the years involved. Had they done so, however, there would have been similar adjustments based on the 30 percent limitation.[a]

[a] *Id.*

In the case of a husband and wife, when:

- either or both of the spouses filed a separate income tax return for a contribution year,
- they computed an excess charitable contribution for the year under these rules, and
- they filed a joint income tax return for one or more of the tax years succeeding the contribution year,

their excess charitable contribution for the contribution year that was unused at the beginning of the first tax year for which a tax return was filed must be aggregated for purposes of determining the portion of the unused charitable contribution that must be treated (in determining the amount considered as paid in years succeeding a contribution year) as a charitable contribution paid to a public charitable organization. This rule also applies in the case of two single individuals who are subsequently married and file a joint return. A remarried individual who filed a joint return with a former spouse in a contribution year with respect to which an excess charitable contribution was computed, and who in any one of the five tax years succeeding the contribution year filed a joint return with his or her present spouse, must treat the unused portion of the excess charitable contribution allocated to him or her in the same manner as the unused portion of an excess charitable contribution computed in a contribution year in which he or she filed a separate return, for purposes of determining the amount considered as paid in years succeeding a contribution year to a public charitable organization in the succeeding year.[126]

When one spouse dies, any unused portion of an excess charitable contribution allowable to that spouse is not treated as paid in the tax year in which the death occurs, or in any subsequent tax year, except on a separate return made for the deceased spouse by a fiduciary for the tax year that ends with the date of death, or on a joint return for the tax year in which the death occurs.[127]

The application of this rule may be illustrated as follows:

EXAMPLE 7.27

The facts are the same as in Example 7.26, except that H died in 2008 and W filed a separate return for 2009. W filed a joint return for H and W for 2008. In Example 7.26, the unused excess charitable contribution as of January 1, 2008, was $10,000, of which $6,000 was allocable to H and $4,000 to W. No portion of the $6,000 allocable to H may be treated as paid by W or by any other person in 2008 or in any subsequent tax year.[a]

[a] *Id.*

§ 7.17 INFORMATION REQUIREMENTS

If, in a tax year, a deduction is claimed in respect of an excess charitable contribution which, in accordance with the rules for determining an amount considered

[126] Reg. § 1.170A-10(d)(4)(ii).
[127] Reg. § 1.170A-10(d)(4)(iii).

as paid in years succeeding a contribution year, is treated (in whole or in part) as paid in the year, the donor must attach to his or her return a statement showing the following:

- The contribution year (or years) in which the excess charitable contributions were made
- The excess charitable contributions made in each contribution year, and the amount of the excess charitable contributions consisting of capital gain property
- The portion of the excess, or of each excess, treated as paid in any tax year intervening between the contribution year and the tax year for which the return is filed, and the portion of the excess that consists of capital gain property
- Whether or not an election has been made under the rules allowing the 50 percent limitation with respect to contributions of capital gain property,[128] so as to affect any of the excess contributions of capital gain property
- Whatever other information the tax returns or the instructions accompanying them may reasonably require[129]

§7.18 PERCENTAGE LIMITATION FOR CORPORATIONS

(a) General Rules

The deduction in a tax year for charitable contributions by a corporation subject to income taxation is limited to 10 percent of the corporation's taxable income for the year, computed with certain adjustments.[130]

In the case of an entity that has elected to be taxed as a regulated investment company,[131] the deduction for dividends paid[132] must be taken into account in determining its taxable income for charitable contribution deduction purposes.[133] In the case of a corporation that holds a residual interest in a real estate mortgage investment conduit (REMIC),[134] taxable income for purposes of calculating the charitable deduction percentage limitations means taxable income under the general rules[135] as adjusted for excess inclusion income.[136] A holder of a residual

---

[128] See § 7.7.

[129] Reg. § 1.170A-10(e).

[130] IRC § 170(b)(2)(A); Reg. § 1.170A-11(a). See § 7.3. These rules do not apply in the case of S corporations. See § 6.13. Charitable contributions by S corporations pass through to the shareholders and are subject to the limitations on deductibility applicable to individuals. IRC § 1366.

[131] IRC § 851(b)(1).

[132] IRC § 561.

[133] E.g., Priv. Ltr. Rul. 200845007. The IRS noted that investment company taxable income is generally the taxable income of the regulated investment company, adjusted for the dividends-paid deduction (IRC § 852 (b)(2)). Nonetheless, the IRS stated that IRC § 170(b)(2)(C) provides an "exclusive list" of adjustments that must be made to a corporation's taxable income (defined in IRC § 63) in order to calculate the charitable deduction, so that, contrary to the investment company's position, the IRC § 852(b)(2) adjustments are not relevant in this context. Priv. Ltr. Rul. 8626065, which supported the company's position, was held to be "incorrect."

[134] IRC § 860D.

[135] IRC § 63.

[136] IRC § 860E.

interest in a REMIC may not offset excess inclusion income by an otherwise allowable charitable contribution deduction.[137]

Much of the federal tax law as to the characterization of property is equally applicable to contributions by corporations. For example, the general rule is that a deduction for a charitable gift of a capital asset by a corporation is determined using the fair market value of the property at the time of the gift. A corporation may, however, donate to charity what is known as a *corporate archive*. In one of these instances, the gift was of a newspaper clipping library by a newspaper publisher.[138] In another instance, a broadcasting company contributed a film library, consisting of footage documenting local news stories.[139] These archives were compiled and maintained by employees of the company. The IRS held in these cases that the items were property similar to a letter or memorandum prepared or produced for the donor, and therefore were excluded from the definition of *capital asset*.[140] Thus, the amount of the gift had to be confined to the donor's basis in the property (if any).[141]

(b) Carryover Rules

Any charitable contributions made by a corporation in a tax year (a *contribution year*) in excess of the amount deductible in the contribution year under the 10 percent limitation are deductible in each of the five immediately succeeding tax years, in order of time, but only to the extent of the lesser of the following amounts:

- The excess of the maximum amount deductible for the succeeding tax year, under the 10 percent limitation, over the sum of the charitable contributions made in that year, plus the aggregate of the excess contributions made in tax years before the contribution year that are deductible under these rules in the succeeding tax year
- In the first tax year succeeding the contribution year, the amount of the excess charitable contributions
- In the second, third, fourth, and fifth tax years succeeding the contribution year, the portion of the excess charitable contributions not deductible under these rules for any tax year intervening between the contribution year and the succeeding tax year[142]

These rules apply to excess charitable contributions by a corporation, whether or not the contributions are made to or for the use of[143] the recipient

[137] Chief Couns. Adv. Mem. 200850027. The general rule is that the taxable income of a holder of a residual interest in a REMIC for a tax year is not less than the holder's excess inclusion for the year (IRC § 860E(a)(1)). The IRS observed that IRC § 170(b)(2)(C) does not provide an adjustment for excess exclusion income (see *supra* note 133). Therefore, the IRS held, this general rule is applicable in the computation of the holder's charitable deduction.

[138] *Chronicle Publ'g Co. v. Commissioner*; 97 T.C. 445 (1991), *reconsideration denied*, 63 T.C.M. (CCH) 1899 (1992).

[139] Tech. Adv. Mem. 200119005.

[140] IRC § 1221(3)(B). See § 2.16(a), fifth bulleted item.

[141] IRC § 170(e)(1)(A). See § 4.4(b).

[142] IRC § 170(d)(2)(A).

[143] See § 10.3.

charitable organization and whether or not the donee is a public charitable organization. These rules may be illustrated by the following example:

EXAMPLE 7.28

Corporation X, which reports its income on the calendar year basis, made a charitable contribution of $20,000 in 2005. X's taxable income (determined without regard to any deduction for charitable contributions) for that year was $100,000. Accordingly, the charitable contribution deduction for 2005 was $10,000 (10% of $100,000). The excess charitable contribution deduction not deductible in 2005 ($10,000) was a carryover to 2006.

X had taxable income (determined without regard to any deduction for charitable contributions) of $150 in 2006 and made a charitable contribution of $10,000 in 2006. For 2006, X properly deducted as a charitable contribution the amount of $15,000 (10% of $150,000). This amount consisted of the $10,000 contribution made in 2006 and $5,000 of the amount carried over from 2005. The remaining $5,000 carried over from 2005 and not allowable as a deduction for 2006 because of the 10 percent limitation was carried over to 2007.

X had taxable income (determined without regard to any deduction for charitable contributions) of $200,000 in 2007 and made a charitable contribution of $18,000 that year. For 2007, X was able to deduct $20,000 (10% of $200,000). This amount consisted of the $18,000 contribution made in 2007 and of $2,000 of the amount ($5,000) carried over from 2005 to 2007. The remaining $3,000 of the carryover from 2005 was available as a charitable contribution carryover from 2005 to 2008, 2009, and 2010.[a]

[a] Reg. § 1.170A-11(c)(1).

(c) Conservation Contribution Rules

Different rules apply as respects the annual percentage limitation and carryover rule where corporations, that are qualified farmers and ranchers, make qualified conservation contributions.[144] This type of contribution is allowable, for deduction purposes, up to 100 percent of the excess of the corporation's taxable income over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100 percent limitation.

§ 7.19 CORPORATIONS' NET OPERATING LOSS CARRYOVERS AND CARRYBACKS

A corporation having a net operating loss carryover from any tax year must apply a special rule concerning these carryovers[145] before computing the excess charitable contribution carryover from any tax year.

(a) Carryover Rules

This special rule is as follows: In determining the amount of excess charitable contributions that may be deducted in tax years succeeding the contribution year, the excess of the charitable contributions made by a corporation in the contribution year over the amount deductible in that year must be reduced by the amount by which the excess (1) reduces taxable income for purposes of

[144] See § 9.7(j).
[145] IRC § 170(d)(2)(B).

determining the net operating loss carryover under the net operating loss deduction rules[146] and (2) increases a net operating loss carryover to a succeeding tax year. Thus, if the excess of the contributions made in a tax year over the amount deductible in a tax year is utilized to reduce taxable income (under the rules for determining net operating loss carryover[147]) for the year, thereby increasing the amount of the net operating loss carryover to a succeeding tax year or years, a charitable contribution carryover is not available. If only a portion of the excess charitable contribution is so used, the charitable contribution carryover must be reduced only to that extent.

These rules may be illustrated by the following example:

EXAMPLE 7.29

Corporation Y, which reports its income on the calendar year basis, made a charitable contribution of $20,000 during 2005. Y's taxable income for that year was $80,000 (computed without regard to any net operating loss deduction and without regard to any deduction for charitable contributions). Y had a net operating loss carryover from 2004 of $80,000. In the absence of the net operating loss deduction, Y would have been allowed a charitable contribution deduction for 2005 of $8,000 (10% of $80,000). After application of the net operating loss deduction, Y was not allowed a deduction for charitable contributions, and there was a tentative charitable contribution carryover from 2005 of $20,000. For purposes of determining the net operating loss carryover to 2006, Y computed its taxable income for 2005 by deducting the $8,000 charitable contribution. Thus, after the $80,000 net operating loss carryover was applied against the $72,000 of taxable income for 2005, there remained an $8,000 net operating loss carryover to 2006. Because application of the net operating loss carryover of $80,000 from 2004 reduced the taxable income of Y for 2005 to zero, no part of the $20,000 of charitable contributions in that year was deductible. In determining the amount of the allowable charitable contribution carryover from 2005 to 2006, 2007, 2008, 2009, and 2010, however, the $20,000 had to be reduced by the portion of it ($8,000) that was used to reduce taxable income for 2005 and which thereby increased the net operating loss carryover from 2004 to 2006 from zero to $8,000.[a]

[a] Reg. § 1.170A-11(c)(2).

(b) Carryback Rules

The amount of the excess contribution for a contribution year is not increased because a net operating loss carryback is available as a deduction in the contribution year. In addition, in determining the amount of the net operating loss for any year subsequent to the contribution year, which is a carryback or carryover to tax years succeeding the contribution year, the amount of any charitable contributions must be limited to the amount of the contributions that did not exceed 10 percent of the donor's taxable income for the contribution year.[148]

The amount of the charitable contribution from a preceding tax year that is deductible in a current tax year (the *deduction year*) cannot be reduced because a net operating loss carryback is available as a deduction in the deduction year. In addition, in determining the amount of the net operating loss for any tax year subsequent to the deduction year, which is a carryback or carryover to tax years

[146] IRC § 172(b)(2), second sentence.
[147] IRC § 172(b)(2).
[148] Reg. § 1.170A-11(c)(3).

succeeding the deduction year, the amount of contributions made in the deduction year must be limited to the amount of these contributions, actually made in that year,[149] that did not exceed 10 percent of the donor's taxable income for the deduction year.[150]

(c) Year Contribution Is Made

Contributions made by a corporation in a contribution year include contributions that are considered as paid during the contribution year.[151]

[149] IRC § 170(d)(2).
[150] Reg. § 1.170A-11(c)(4).
[151] Reg. § 1.170A-11(c)(5).

CHAPTER EIGHT

Estate and Gift Tax Considerations

§ 8.1 Introduction **236**

§ 8.2 Federal Gift Tax **237**

(a) Definition of Gift 237
(b) Imposition of Gift Tax in General 238
(c) Scope of Covered Transfers and Property 238
(d) Powers of Appointment 239
(e) Transfers Deemed Not to Be Gifts 239
(f) Taxable Gifts 240
(g) Exclusions from Taxable Gift 240
(h) Annual Exclusion 240
(i) Valuation of Gift Transfers 241
(j) Basis of Gifted Property 242
(k) Gift Tax Deductions 243
(l) Liability for Gift Tax 246
(m) Split Gifts Between Spouses 246
(n) Disclaimers 246

§ 8.3 Federal Estate Tax **247**

(a) Gross Estate 247
(b) Taxable Estate 250
(c) Time of Valuation of Gross Estate 257
(d) Basis of Transferred Property 257

§ 8.4 Unification of Taxes **258**

§ 8.5 Generation-Skipping Transfer Tax **259**

§ 8.6 Estate Planning Principles **261**

(a) Estate Reduction 262
(b) Estate Freezes and Special Valuation Rules 262
(c) Deferral 263
(d) Generation-Skipping Transfers 264
(e) Credit-Maximizing Trusts and Transactions 264
(f) Estate Equalization 264
(g) Revocable Living Trusts 265
(h) Disclaimers 265
(i) Last Will 266
(j) Durable Power of Attorney 267
(k) Living Will 267

§ 8.7 Remainder Interests **267**

(a) In General 268
(b) Will Contests 269
(c) Reformations 271

§ 8.8 Ascertainability **276**

§ 8.1 INTRODUCTION

Federal estate and gift tax law came into existence in 1916, and has been a continuous and growing (and controversial) component of the federal tax scheme ever since. Unlike federal income tax law, federal estate and gift taxes are an excise tax on the transfer of property of individuals, either during their lives or upon their deaths.

The federal estate and gift tax is a unified transfer tax system comprising two elements: the first element is the *gift tax*; the second element is the *estate tax*. The tax is *unified* in that both gift and estate transfers are taxed as an integrated whole. They constitute a unified transfer tax system.

The federal estate tax is a tax on the value of estate property of an individual passing to others on his or her death. This is not the same as state law inheritance taxes, which tax the beneficiary or recipient of property from a decedent. Thus, the estate tax is a tax on the transmission of wealth at death; it is a tax on the right to dispose of property. The federal gift tax is a tax on the value of property that a living individual passes, to one or more other persons, during his or her life when property of lesser value (if any) is received in return—that is, a transfer of property for less than adequate consideration.

Another transfer tax is the tax on *generation-skipping transfers*. The generation-skipping transfer tax is not integrated with the gift and estate transfer tax system, but is a separate tax on transfers. This tax, however, is complementary to, and works in conjunction with, the unified gift and estate tax system. It reaches transfers of wealth that are otherwise missed by the unified transfer tax. As its name implies, it endeavors to tax transferred wealth that skips a generation.

Separate and apart from its function as a revenue device, the federal transfer taxes serve an important social function. These taxes tend to lessen the concentration of wealth, particularly family wealth, in society. Nevertheless, because of the increasing complexity of the estate and gift tax regime, its growing applicability to greater numbers of individuals, and the relatively small amount of tax revenue generated by these taxes, serious consideration is being given to permanent repeal of this component of federal taxation.[1]

Although the federal estate and gift tax applies to any transfer, the traditional focus of concern has been on transfers within the family context. More precisely, the focus is upon generational transfers of family wealth to successive generations.

The income tax, as a progressive tax, sets rates that increase as income levels rise.[2] As a tax on income, however, it has little effect on previously accumulated wealth. It may lessen individuals' ability to accumulate wealth, but it has no effect on previously accumulated wealth—typically family wealth—that is passed from generation to generation.

Unlike the federal income tax, the federal estate tax is, fundamentally, a tax on wealth. It is a tax on personal wealth, and generally arises whenever that wealth is transferred gratuitously during an individual's life or upon transfer at that individual's death.

The estate tax is designed to lessen concentrations of wealth in families through a progressive tax rate structure. The estate and gift tax rates begin at

---

[1] Detractors of this tax prefer to characterize it as a *death tax*.
[2] See § 2.15.

18 percent on the first $10,000 of taxable transfers and reach 49 percent on taxable transfers up to $2.5 million. For taxable transfers in excess of $2.5 million but not more than $3 million, the estate and gift tax rate is 53 percent. For taxable transfers of more than $3 million, the top estate and gift tax rate is 55 percent. To phase out the benefit of the graduated brackets and the unified credit (see below), the estate and gift tax is increased by 5 percent on cumulative taxable transfers—in excess of $10 million but not in excess of the amount at which the average tax rate is 55 percent.[3]

Families with small concentrations of wealth are given tax relief. Through the availability of a credit known as the *unified credit*, estates of amounts up to certain levels can pass free of federal estate and gift tax (see below).

Additionally, small amounts of wealth can be transferred annually to other individuals free of gift tax. Through what is known as the *annual* (gift tax) *exclusion*, as much as $11,000 per individual may be transferred each year free of the unified estate and gift tax during a person's lifetime (see below).

Given the sizable tax liability associated with large estates, and the natural tendency and desire on the part of individuals to pass as much of their family wealth as possible to the next generation, a great deal of attention has been paid to estate tax planning. Estate planning has developed as a means of minimizing or reducing the amount of transfer taxes incurred in passing on family wealth.

§ 8.2 FEDERAL GIFT TAX

Federal tax law imposes an excise tax on the value of an individual's lifetime transfers of property.[4] Not all transfers, however, are subject to the tax. Only transfers that constitute gifts fall within the ambit of the tax.

A *gift*, in common parlance, is understood to be a present or donation. Frequently one makes a gift as an act or expression of love, affection, friendship, or respect. The gift is generally understood to be gratuitous, and not for any consideration or remuneration. The term *gift* may have a different meaning for federal gift tax purposes, as contrasted with other federal tax contexts.

(a) Definition of Gift

The term *gift* is not defined in the federal statutory tax law, although the IRS has provided guidance by construing the term.[5] A *gift* is defined as any transfer whereby property, or property rights, are gratuitously conferred on another. The essential characteristics of a gift are:

- Transfer of money, property, or property rights sufficient to vest legal or equitable title in the donee
- Relinquishment of dominion and control over the gift property by the donor
- Absence of full and adequate consideration for the transfer

[3] IRC §§ 2001(c), 2502(a).
[4] See § 3.1.
[5] Reg. § 25.2511-1(c).

- No disclaimer or renunciation of the gift by the donee
- Competence of the donor to make the gift

The criteria establishing the essential characteristics of a gift do not take into account the objective or subjective gratuitousness in the transfer. Neither intention nor motivation is a governing factor. If any transfer is made for less than full and adequate consideration, it is deemed a gift if all the other criteria are present.

If, however, as of the date of a gift a transfer for charitable purposes is dependent on the performance of some act or the happening of a precedent event to become effective, a gift tax charitable deduction is not allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.[6] Further, if an interest has passed to, or is vested in, a charitable organization on the date of the gift and the interest would be defeated by the performance of some act or the happening of some event, the possibility of occurrence of which appeared on that date to be so remote as to be negligible, the gift tax charitable deduction is allowable.[7] These rules are the same as those used for determining whether the income tax charitable contribution deduction is allowable under similar circumstances,[8] and whether the estate tax charitable contribution deduction is allowable under similar circumstances.[9]

(b) Imposition of Gift Tax in General

Under federal gift tax law, a tax is imposed ''on the transfer of property by gift during [the] calendar year by any individual.''[10]

The federal gift tax applies generally to all individuals, whether they are residents or nonresidents of the United States.[11] Special rules apply throughout the gift tax area to nonresidents and nonresidents who are not citizens of the United States. Corporations and other artificial entities are not subject to the tax.

A U.S. citizen who resides in a U.S. possession is considered a citizen.[12] If, however, an individual acquired U.S. citizenship solely by being a citizen of the possession, or birth or residence in the possession, he or she is considered a nonresident and not a citizen of the United States.[13]

(c) Scope of Covered Transfers and Property

Generally, all property of every kind is included within the scope of the tax. It applies to real or personal, tangible or intangible property.[14] It applies to property situated inside or outside the United States.[15] Only transfers of property situated

---

[6] Reg. § 25.2522(c)-3(b)(1).
[7] This rule of law was applied by the IRS in Priv. Ltr. Rul. 9303007, in which the IRS found that the conditions were so remote as to be negligible.
[8] See § 10.4(b).
[9] See § 8.3.
[10] IRC § 2501.
[11] IRC § 2501(a)(1).
[12] IRC § 2501(b).
[13] IRC § 2501(c).
[14] IRC § 2511(a).
[15] *Id.*

within the United States, however, are covered in the case of a nonresident who is not a citizen of the United States.

Transfers of intangible property by a nonresident who is not a citizen of the United States are not included,[16] unless the intangible property is stock in a domestic corporation or debt obligations of the United States, its political subdivisions, or its citizens.[17] There is a special exception in cases of lost U.S. citizenship.[18]

Also, the tax applies to all types of transfers, ''whether the transfer is in trust or otherwise, whether the gift is direct or indirect.''[19]

(d) Powers of Appointment

Generally, the exercise, release, or lapse of a general power of appointment is considered to be a transfer subject to the gift tax.[20] A *general power of appointment* over property is the power to appoint property to oneself, one's estate, creditors, or the creditors of that estate.[21]

A power to appoint property to any person or group, other than those included in the definition of a general power of appointment, is not a general power of appointment.[22] For example, a power limited by an ascertainable standard, or in conjunction with some other person, is not a general power. Therefore, powers to ''consume, invade, or appropriate property for the benefit of the possessor,'' when limited by an ascertainable standard concerning health, education, support, or maintenance, are not general powers.[23] Further, powers exercisable only in conjunction with the person creating the power, or a person with an adverse interest, are not considered general.[24]

Certain lapses are not treated as releases of general powers over property. When property can be appointed annually that does not exceed the greater of $5,000 or 5 percent of the value of the asset, the lapse of such power is not considered to be the release of a general power over the property. This type of qualifying lapse is not subjected to imposition of the gift tax.

(e) Transfers Deemed Not to Be Gifts

Gifts are transfers for less than adequate consideration. Under the federal gift tax law, certain transfers are deemed to be for full and adequate consideration, and hence do not fall within the definition of a gift. These transfers are all made pursuant to a written marital property settlement agreement that meets certain other conditions.[25] A divorce must occur within a three-year period that begins one year before the date the agreement was entered into. Further, the transfers must be to the other spouse in settlement of marital or property rights, or to provide for child support during the minority of children born to the marriage.

---

[16] IRC § 2501(2).
[17] IRC § 2511(b).
[18] IRC § 2501(3).
[19] IRC § 2511(a).
[20] IRC § 2514.
[21] IRC § 2514(c).
[22] IRC § 2514.
[23] IRC § 2514(c)(1).
[24] IRC § 2514(c)(3)(A).
[25] IRC § 2516.

(f) Taxable Gifts

Gift and estate taxes are unified and aggregated to take account of all gratuitous transfers, whether during life or taking effect at death. Death is not, however, the taxable event for purposes of the gift tax. Taxable gifts are accounted for and taxed on an annual basis during the life of an individual.[26] A *taxable gift* is defined as the ''total amount of gifts made during the calendar year'' above the annual exclusion (if applicable), less allowable gift tax deductions.[27]

(g) Exclusions from Taxable Gift

Certain transfers are excluded from the definition of a taxable gift.

Tuition for Education. The federal gift tax law excludes from tax transfers of property (typically, cash payments) made directly to a qualified educational organization for tuition, on behalf of some individual (typically, but not limited to, descendants).[28] The tax law encourages the private funding of education free of potential transfer tax.

Medical Care Costs. The federal gift tax law excludes from tax transfers of property (again, typically cash payments) made directly to a medical care provider for medical care services on behalf of some individual (typically, but not limited to, a family member).[29] Recognizing that health care is expensive and can be a significant financial burden, the federal tax law does not impose an additional financial burden on those who come to the aid of others in the payment of medical services.

Waiver of Pension Rights. The third exclusion from the definition of a taxable gift is for waivers of certain pension survivor benefits or rights to them.[30]

Loans of Art Works. The fourth exclusion from the definition of a taxable gift involves a loan of any work of art that is archaeological, historic, or creative tangible personal property. The federal tax law excludes from the gift tax loans of art works made to a tax-exempt charitable organization (other than a private foundation) and used for the organization's tax-exempt purposes.[31]

Transfers to Political Organizations. The fifth exclusion from the definition of a taxable gift is for transfers to certain political organizations.[32]

(h) Annual Exclusion

As noted above, taxable gifts are all gifts made during a calendar year after taking into account the annual exclusion, less allowable deductions. The annual

[26] IRC § 2501(a)(1).
[27] IRC § 2503.
[28] IRC § 2503(e).
[29] *Id*.
[30] IRC § 2503(f).
[31] IRC § 2503(g). See, e.g., Priv. Ltr. Rul. 9303007. See § 9.1(b).
[32] IRC § 2501(a)(4). See *Tax-Exempt Organizations*, ch. 17.

exclusion is a fixed dollar amount that is allowed as an exclusion from gift tax. Currently, the amount of the exclusion is $11,000.[33]

There are a number of restrictions on the availability or applicability of the annual exclusion.

First, the exclusion is available annually. It may not be carried over to another year if it is unused or underused.

Second, currently the exclusion is available for the first $11,000 of a gift to each recipient thereof, termed a *donee*. There is no limit on the number of donees that may be gifted property covered by the annual exclusion.[34]

Third, only gifts of present interests are considered for purposes of the annual exclusion. Gifts of future interests in property,[35] including reversions and remainder interests,[36] are denied the exclusion.

Certain transfers made for the benefit of minors are not considered to be future interests under the annual exclusion. A transfer for the benefit of a minor qualifies for the annual exclusion when:

- the property, and income therefrom, may be used only by or for the benefit of the minor before he or she reaches 21, and
- any remaining property and income is distributed to the minor when he or she reaches 21, or, if the minor dies before reaching 21, to his or her estate, or as he or she appoints pursuant to a general power of appointment.[37]

(i) Valuation of Gift Transfers

The federal gift transfer tax applies to the value of the property transferred as of the date of transfer.[38] However, when the gift is also a direct skip within the meaning of the generation-skipping transfer tax (see below), the value of the gift is increased by the amount of the generation-skipping transfer tax imposed.[39] The value of money gifts is the amount given. A gift of property other than money is valued at its fair market value.[40]

In the case of transfers of property for less than full and adequate consideration, the value of the property transferred for gift tax purposes is the fair market value of the property less the consideration received.[41] For example, a parent purchased real estate that has since greatly appreciated in value. It was purchased years ago for $50,000. Today, it has a fair market value of $250,000. The parent decides to give the realty to an only child, and transfers the property to the child

---

[33] IRC § 2503. This amount is indexed for inflation (IRC § 2503(b)(2)); the amount for 2010 is $13,000. Rev. Proc. 2009-50, 2009-2 C.B. 1107, § 3.30(1).

[34] The annual exclusion may be utilized in conjunction with contributions made to a noncharitable tax-exempt organization. See, e.g., Priv. Ltr. Rul. 9818042, concerning gifts made to a tax-exempt social club. See also § 1.5, note 140.

[35] IRC § 2503(b).

[36] Reg. § 25.2503-3.

[37] IRC § 2503(c); Reg. § 25.2503-4(a).

[38] IRC § 2512(a).

[39] IRC § 2515.

[40] Reg. § 25.2512-1.

[41] IRC § 2512(b); Reg. § 25.2512-1.

for an amount equal to its cost ($50,000). Because the value of the property at the time of the transfer exceeded the consideration received, part of the transfer constitutes a taxable gift. The value of the taxable gift would be $200,000—namely, the amount of the fair market value of the property ($250,000) less the amount of consideration received ($50,000).

(j) Basis of Gifted Property

The basis of gift property in the hands of the recipient is generally the transferor's basis plus the gift tax paid as a result of the transfer.[42] To account for the transferor's investment in property, the federal income tax law provides that the basis in gifted property to a transferee (or donee) is the transferor's basis. This is known as a *transferred* or *carryover basis*. The basis of the property in the hands of the gift giver, the transferor, is transferred with the gift, and becomes the basis of the gift/property in the hands of the recipient, the transferee. As noted, the amount of the transferred basis in gifted property is increased by the amount of gift tax paid by the transferor as a result of the gift.

There is an important limitation on carryover of the transferor's basis. The transferee's basis in gifted property is the same as the basis in the hands of the transferor, except that the basis cannot exceed the fair market value of the property at the time of the gift. What this means is that tax wealth can be transferred, but not tax losses. Should loss property (property in which the basis exceeds the fair market value of the asset) be transferred by gift, the transferee will not be able to recognize the transferor's loss on the property.

An example of the basis rule is a *bargain sale* of property, which is a sale for less than fair market value (insufficient consideration). It is also known as a *part gift/part sale transaction*, as the intention of the transferor is to make a gift of a part of the property.[43]

Using the previous example, suppose the transferor wishes to sell his $250,000 investment property, which he purchased years ago for $50,000, for less than its value. The intent is to make a gift of part of the appreciation.

If the transferor sold the property for $40,000, less than the basis in the property, no loss would be allowed on the sale. The amount of the taxable gift would be $210,000, the difference between the fair market value of the gift ($250,000) and the amount of consideration received ($40,000).

If the transferor sold the property for $60,000, there would be a gain of $10,000 on the transaction. The amount of the taxable gift would be $190,000, the difference between the fair market value of the gift ($250,000) and the amount of consideration received ($60,000).

On the $40,000 sale, the transferee's basis would be the gift tax plus the greater of the amount paid by the transferee ($40,000) or the transferor's basis ($50,000). In this case, the transferee assumes the transferor's basis of $50,000.

On the $60,000 sale, the transferee's basis would be the gift tax plus the greater of the amount paid by the transferee ($60,000) or the transferor's basis ($50,000). In this case, the transferee takes his or her own cost basis of $60,000.

---

[42] IRC § 1015(d).
[43] See § 9.19.

(k) Gift Tax Deductions

The federal gift tax law provides two deductions from taxable gifts: the marital deduction and the charitable contribution deduction.

Marital Deduction. The federal gift tax law provides an unlimited gift tax deduction for transfers between spouses.[44] Spouses generally can make any number of transfers between themselves, in any amount, free of gift tax. The unlimited marital deduction is, however, subject to a number of conditions and limitations.

Generally, life estates and other terminable interests may not qualify for the marital deduction. *Terminable interests* are interests in property that may be terminated. If one spouse makes a transfer to a transferee spouse of an interest that may terminate, the transfer does not qualify for the marital deduction. Thus, the marital deduction is not available if:

- the transferor spouse retains or gifts to someone other than the other spouse an interest in the property, and such person may enjoy use or possession of the property upon a termination, or
- the transferor spouse retains a power of appointment over use or possession of the property upon a termination.

There is an exception to the terminable interest rule. *Qualified terminable interest property* (QTIP) will qualify for the marital deduction if certain conditions are met. The spouse must receive income for life and no other person may have a power of appointment over the property except to appoint to the other spouse during the other spouse's life.[45] An election must be made to take advantage of the QTIP provisions.

A qualified charitable remainder trust will not be disqualified from a marital deduction if the other spouse is the only noncharitable beneficiary of the trust.[46]

The deduction is disallowed in its entirety if the other spouse is not a citizen of the United States. In its place is substituted the annual exclusion with a limit of $100,000, subject to adjustment for inflation.[47] Other special rules apply in this context.

Charitable Deduction. Like federal income tax law, the federal gift tax law also provides a deduction for gifts to charitable organizations.[48]

Citizens and residents of the United States are allowed to deduct all gift transfers to or for the use of:

- The United States, any state (including the District of Columbia), and political subdivisions thereof for exclusively public purposes
- Organizations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes; to foster amateur sports competition (but not athletic facilities or equipment); to encourage art; or for

[44] IRC § 2523.
[45] IRC § 2523(f).
[46] IRC § 2523(g). See ch. 12.
[47] IRC § 2523(i).
[48] IRC § 2522.

the prevention of cruelty to children or animals (no net earnings to private shareholders or individuals, and not a disqualified organization for attempted legislative influence, and no participation in political campaigns)

- Fraternal societies for use exclusively for religious, charitable, scientific, literary, or educational purposes, including encouragement of art or the prevention of cruelty to children or animals
- Veterans' organizations organized in the United States or a possession (no net earnings to private shareholder or individual)

The IRS, from time to time, issues rulings as to whether a transfer of money or property qualifies for the federal gift tax charitable deduction.[49]

Nonresidents who are not citizens of the United States are allowed to deduct all gift transfers to or for the use of:

- The United States, any state (including the District of Columbia), and political subdivisions thereof for exclusively public purposes
- Domestic corporations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to encourage art, or for the prevention of cruelty to children or animals (no net earnings to private shareholders or individuals, and not a disqualified organization for attempted legislative influence, and no participation in political campaigns)
- Trusts, funds, community chests, or foundations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to encourage art, or for the prevention of cruelty to children or animals (no substantial part of activities for propaganda or to influence legislation, and no participation in political campaigns), when the gifts are used exclusively within the United States for such purposes
- Fraternal societies for use exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art or the prevention of cruelty to children or animals
- Veterans' organizations organized in the United States or a possession (no net earnings to private shareholder or individual)

The charitable deduction is subject to disallowance in certain cases. Transfers to certain charitable organizations subject to the termination tax applicable with respect to private foundations[50] or to charitable organizations that are no longer tax-exempt[51] do not qualify for the charitable contribution deduction. Generally, a transfer of a remainder interest in property to a charity is not entitled to a charitable gift tax deduction when the transferor retains an interest, or transfers his or her retained interest to a donee, for a use other than the charitable uses described above.[52]

[49] E.g., Priv. Ltr. Rul. 200324023.
[50] IRC § 508(d).
[51] IRC § 4948(c)(4).
[52] IRC § 2522(c).

A charitable deduction is allowed for remainder transfers (remainder interests) to charities by the following methods:

- A charitable remainder annuity trust[53]
- A charitable remainder unitrust[54]
- A pooled income fund[55]
- A guaranteed annuity[56]
- An annual fixed percentage distribution of fair market value of property.[57]

Three other exceptions to this general rule are: (1) contributions of a remainder interest in a personal residence or farm,[58] (2) contributions of an undivided portion of a donor's entire interest in a property,[59] and (3) qualified conservation contributions.[60]

As to the second of these three exceptions, an income tax charitable contribution deduction is allowable for a gift of property to a charitable organization when the donee organization is given the right, as a tenant in common with the donor, to possession, dominion, and control of the property for a portion of each year appropriate to its interest in the property.[61] This rule regarding possession for only a portion of the year is not in the gift tax regulations;[62] nonetheless, it is the position of the IRS that this rule applies for gift tax purposes.[63]

A gift tax charitable contribution deduction is available in respect of any transfer of a qualified real property interest,[64] as long as the interest meets certain requirements.[65] Essentially, this deduction is available for irrevocable transfers of easements in real property.[66]

The IRS ruled that a donor is entitled to a gift tax charitable deduction for a contribution of money or other property to a charitable organization where the donor, or the donor's investment manager, retains the power, under certain conditions, to manage the gift property in a designated account.[67] In this instance, the investment or brokerage account was established solely in the name of the charity, the charity had the right in its sole discretion to terminate the arrangement, and the authority to manage the investments terminated 10 years from the date of the gift. The IRS ruled that the power retained to manage the investment of the

[53] See ch. 12.
[54] *Id.*
[55] *Id.*
[56] IRC § 2522(c)(2)(B).
[57] *Id.* When a beneficiary of a life interest in a charitable remainder trust transfers that interest to the remainder interest beneficiary charitable organization, it is a charitable gift for gift tax purposes. Rev. Rul. 86-60, 1986-1 C.B. 302.
[58] IRC §§ 2522(c)(2), 170(f)(3)(B)(i). See § 15.2.
[59] IRC §§ 2522(c)(2), 170(f)(3)(B)(ii). See § 15.3.
[60] IRC §§ 2522(c)(2), 170(f)(3)(B)(iii). See § 9.7.
[61] Reg. § 1.170A-7(b)(1). See § 15.3, text accompanied by note 50. These rules apply with respect to transfers of art works. *Winokur v. Commissioner*, 90 T.C. 733 (1988); Priv. Ltr. Rul. 9303007.
[62] See Reg. § 25.2522(c)-3(c)(2)(i).
[63] Priv. Ltr. Rul. 9303007.
[64] This term is defined in IRC § 170(h)(2)(C). See § 9.7(a).
[65] These are the requirements of IRC § 170(h) (see § 9.6) without regard to IRC § 170(h)(4)(A) (see § 9.6(c)).
[66] IRC § 2522(d).
[67] Priv. Ltr. Rul. 200445023.

assets did not constitute the retention of an interest in the property[68] and did not cause the charitable gifts to be subject to a condition or power.[69]

In instances of gifts to charitable organizations of fractional interests in items of tangible personal property after August 17, 2006, special rules apply in connection with the gift tax charitable contribution deduction.[70]

The IRS ruled that when an individual makes a contribution of an income interest in a marital trust to a charitable organization, the individual is deemed[71] to have made a transfer of all interests in the trust property other than the income interest, resulting in a gift tax charitable deduction for the amount deemed transferred to the charity.[72]

(l) Liability for Gift Tax

Gift tax is computed on the value of taxable gift transfers. Liability to pay the tax imposed is upon the donor—the transferor of the gift property.[73]

(m) Split Gifts Between Spouses

The federal gift tax law allows a nontransferor spouse to agree to share equally in gifts made by the transferor spouse.[74] This permits use of the nontransferor spouse's annual exclusion and unified credit. If the annual exclusion is split, a $22,000 gift-tax-free transfer can be made in lieu of the regular $11,000 exclusion per donee.

When both spouses consent[75] to a split gift, each becomes jointly and severally liable for the entire gift tax liability.[76]

Gift splitting is not permitted on transfers wherein one spouse gives the other spouse a general power of appointment over the property.[77]

(n) Disclaimers

A person who holds an interest in property, including powers with respect to property, may refuse his or her interest without the refusal being treated as a taxable transfer to that person.[78] This refusal is termed a *qualified disclaimer*. To qualify, the disclaimer must be an irrevocable and unqualified refusal to accept a property interest.[79] Furthermore, to be effective, the disclaimer must meet certain other prescribed form and notice requirements.

---

[68] IRC § 2522(c)(2); Reg. § 25.2522(c)-3(c)(1).
[69] Reg. § 25.2522(c)-3(b).
[70] IRC § 2522(e). See § 15.3(b).
[71] IRC § 2519.
[72] Priv. Ltr. Rul. 200122025.
[73] IRC § 2502(c).
[74] IRC § 2513.
[75] Required by IRC § 2513(a)(2).
[76] IRC § 2513(d).
[77] IRC § 2513.
[78] IRC § 2518.
[79] IRC § 2518(b).

When property, or an interest therein, passes to another as a result of a qualified disclaimer, the person disclaiming is not treated as having made a taxable transfer.[80]

§ 8.3 FEDERAL ESTATE TAX

The second part of the unified federal transfer tax system is the estate tax. This aspect of the system concerns transfers of property that take place upon the death of an individual.[81]

(a) Gross Estate

The first step in determining estate tax liability is determination of the value of the decedent's *gross estate*. The value of the gross estate is defined as including the date-of-death value of "all property, real or personal, tangible or intangible, wherever situated."[82] The value of the gross estate also includes the "value of all property to the extent of the interest therein of the decedent at the time of his [or her] death."[83]

If the federal estate tax or any state inheritance (or succession, legacy, or estate) tax is payable out of charitable bequests, legacies, or devises, the estate tax charitable contribution deduction is confined to the amount of the bequests, legacies, or devises reduced by the amount of the taxes.[84] When this rule applies, an interrelated calculation is required to determine the amount of the allowable deduction.[85] Generally, the manner in which death taxes are apportioned to the assets that constitute a decedent's gross estate is governed by state law.[86] The law may provide that if a will specifies an estate-tax apportionment method different from the method provided by statute, the method specified in the will controls. In a case involving such a law, the death taxes and other bequests, debts, and expenses of the decedent that were paid by the residuary estate exhausted the residuary estate. Thus, no probate assets were available for allocation to the charitable bequest, so the deduction was significantly reduced.[87]

The gross estate encompasses a broad spectrum of property. The gross estate includes within its reach the probate estate, contractual payments (such as insurance), and jointly titled property. In addition to the broad sweep of the gross estate given by its statutory definition, the federal estate tax law provides for other specific inclusions in the gross estate. Included within the gross estate are:

- Dower or curtesy interests
- Certain transfers within three years of death
- Retained life estates

[80] Reg. § 25.2518-1(b).
[81] IRC § 2001.
[82] IRC § 2031.
[83] IRC § 2033.
[84] IRC § 2055(c).
[85] Reg. § 20.2055-3(a)(2).
[86] E.g., *Riggs v. Del Drago*, 317 U.S. 95 (1942).
[87] *Estate of Bradford v. Commissioner*, 84 T.C.M. (CCH) 337 (2002).

- Transfers taking effect at death
- Revocable transfers
- Annuities
- Joint interests
- Powers of appointment
- Life insurance
- Transfers for insufficient consideration

There are basic policy reasons for inclusion of these property interests in the decedent's estate. The decedent retains (as a matter of law) significant beneficial interests in property of this type. Therefore, the decedent should be treated as the owner for purposes of imposing the estate transfer tax. When the retained powers and control over property are such that the decedent has the ability to affect the beneficial use and enjoyment of property during life, or upon death, particularly with respect to transferring such interests, the decedent can in all fairness be treated as though he or she were the owner of such property. As a deemed owner, the decedent is taxed on such property as though it were a part of his or her transferable estate on death.

Dower or Curtesy Interests. The full value of all property subject to dower, curtesy, or other similar marital estate interests of the surviving spouse in the decedent's estate are specifically included in the gross estate.[88]

Transfers within Three Years of Death. At one time, the federal estate tax law required that transfers in contemplation of death be included in the estate of the decedent. The policy reason was obvious. A person, nearing death, with knowledge that he or she would soon die, could bypass the estate tax burden through deathbed lifetime gifts of most or all of his or her property.[89]

To rectify this matter, transfers in contemplation of death were recaptured and added back to the taxable estate. This provision, however, also generated a great deal of litigation over whether certain transfers were in contemplation of death.

To forestall deathbed-type transfers, and to avoid litigation over whether certain transfers were in contemplation of death, a bright-line rule was adopted. All transfers within three years of the decedent's death were added back to the estate.

Except for certain kinds of transfers, the three-year rule does not apply.[90] The transfers made within three years of death that are included in the estate are:

- Transfers with retained life interests
- Transfers taking effect at death
- Revocable transfers
- Life insurance proceeds

[88] IRC § 2034.
[89] IRC § 2035.
[90] IRC § 2035(d).

Certain other gifts made within three years of death are also included in the gross estate, but only for special purposes and calculations.[91]

Retained Life Estates. The gross estate includes property in which the decedent retained for life (or a period ascertainable by reference to the decedent's life) the right to (or the right to appoint) the possession, enjoyment, or income from the property.[92]

Transfers Taking Effect at Death. The gross estate includes the value of all property in which the decedent transferred an interest that can be enjoyed only by surviving the decedent, when the decedent retained a reversionary interest that exceeds 5 percent of the value of the property.[93] A *retained interest* includes any interest to the decedent, his or her estate, or subject to a power of appointment in the decedent.[94]

When the value of a retained reversion is 5 percent or less, this type of a reversion may be included back in the estate.[95]

Revocable Transfers. Property ownership is more than mere legal title. Ownership, in its broader sense, includes a bundle of rights tied up in the property. Legal title is but one of these rights. The other rights include beneficial rights, such as the power to control use and enjoyment of property. One may sever legal title to property and yet retain so many other powers and rights that control of the property (through its use and enjoyment) has been retained. In these cases, the person controlling the property is in effect the de facto owner of the property.

The gross estate includes the value of all property over which the decedent had a power to alter, amend, revoke, or terminate an interest in property. Any form of a revocable transfer is includable.[96]

Annuities. An *annuity* is a contractual arrangement whereby a stream of income is paid in exchange for a premium payment. An annuity (periodic income payments) is paid to a beneficiary for a stated period of time. The payments are usually of a specified amount (fixed dollar amount), payable at certain intervals (weekly, monthly, yearly), over a certain period of time (number of years or for life).

The gross estate includes the value of any annuity or other payment receivable by any beneficiary by reason of surviving the decedent, under any form of contract or agreement (other than insurance), if any payment was payable to the decedent, or the decedent had a right to receive a payment, alone or with another, for life or a period not ascertainable without reference to the decedent's life.[97] The amount of payments includable in the gross estate are the amounts proportionate to the purchase price paid by the decedent.

---

[91] IRC § 2035(d)(3).
[92] IRC § 2036.
[93] IRC § 2037(a).
[94] IRC § 2037(b).
[95] Reg. § 20.2037-1(c).
[96] IRC § 2038.
[97] IRC § 2039.

Joint Interests. Except for spouses, the gross estate includes the value of all property held as joint tenants with rights of survivorship, unless it can be shown that the interest held originally belonged to some other person. Spouses include only one-half of property owned as joint tenants or as tenants by the entireties. Jointly held property acquired by gift, bequest, devise, or inheritance includes only the decedent's fractional share of the property.[98]

Powers of Appointment. The gross estate includes the value of property over which the decedent had a general power of appointment at the time of death.[99]

Certain lapses are not treated as releases of general powers over property. When property can be appointed annually but does not exceed the greater of $5,000 or 5 percent of the value of the asset, the lapse of such power is not considered to be the release of a general power over the property. This type of qualifying lapse is subjected to imposition of the estate tax.

Life Insurance. The gross estate includes the value of life insurance receivable by the executor on the life of the decedent, and insurance receivable by other beneficiaries when the decedent retained any incidents of ownership at the time of death, exercisable alone or in conjunction with another.[100] A reversionary interest of more than 5 percent of the value of the policy immediately before death is considered an incident of ownership.

Other incidents of ownership include the power to change beneficiaries, revoke an assignment of the policy, pledge the policy for a loan, or cancel, surrender, or transfer the policy.[101]

The amount or value of the insurance policy includable in the owner's estate is the face amount of the policy, as opposed to its cash surrender value.

Transfers for Insufficient Consideration. The gross estate includes the following property transferred for less than full and adequate consideration:

- Certain transfers within three years of death
- Retained life estate
- Transfers taking effect at death
- Revocable transfers
- Powers of appointment

(b) Taxable Estate

The *taxable estate* is defined in the federal estate tax law as the value of the gross estate less allowable deductions.[102]

The following items are deductions allowable from the gross estate to arrive at the taxable estate:

---

[98] IRC § 2040.
[99] IRC § 2041. See § 8.2(d).
[100] IRC § 2042.
[101] Reg. § 20.2042-1(c)(2).
[102] IRC § 2051.

- Funeral expenses
- Administration expenses
- Claims against the estate
- Unpaid indebtedness included in the gross estate
- Losses and other casualties
- Charitable deduction
- Marital deduction

The two most significant deductions are the charitable and marital estate tax deductions.

Charitable Estate Tax Deduction. A charitable estate tax deduction[103] generally is allowed for the value of all estate transfers of the decedent to or for the use of the following organizations:

- The United States, any state (including the District of Columbia), and political subdivisions thereof for exclusively public purposes
- Organizations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes; to foster amateur sports competition (but not athletic facilities or equipment); to encourage art; or for the prevention of cruelty to children or animals (no net earnings to private shareholders or individuals, and not a disqualified organization for attempted legislative influence, and no participation in political campaigns)
- Fraternal societies for use exclusively for religious, charitable, scientific, literary, or educational purposes, including encouragement of art or the prevention of cruelty to children or animals (not a disqualified organization for attempted legislative influence and no participation in political campaigns)
- Veterans' organizations organized by act of Congress, or their departments or local chapters or posts (no net earnings to private shareholder or individual)

From time to time, the IRS issues rulings as to whether a transfer of money or property qualifies for the federal estate tax charitable deduction.[104]

The charitable deduction is disallowed in certain cases. Transfers to certain charitable organizations subject to the termination tax applicable with respect to

---

[103] IRC § 2055(a). In computing the amount of property passing to a charitable organization as the result of a residual bequest, for estate tax charitable contribution deduction purposes, the gift taxes paid by the decedent are not treated as passing to charity; lawyers' and accountants' fees incurred during administration of the estate are deducted from the value of the trust principal. Tech. Adv. Mem. 9351001.

The IRS ruled that the transfer of land from an estate to a charitable organization gave rise to an estate tax charitable deduction, even though the land could not yet be used for its intended charitable purposes (museum and gardens open to the public) because the organization was having political difficulties securing the requisite local use permit. The charitable organization would, in the interim, be conducting another type of charitable activity—namely, the preservation and maintenance of an historically significant property. Priv. Ltr. Rul. 200116007. See § 3.3(b)(i), (ii).

[104] E.g., Priv. Ltr. Rul. 200418002.

private foundations,[105] or to charitable organizations that are no longer tax-exempt,[106] do not enjoy the charitable contribution deduction. Generally, a transfer of a split interest in property to a charity is not entitled to a charitable estate tax deduction when an interest in the same property is transferred to a person, or for a use, other than the charitable uses described above.[107]

Another context in which the estate tax charitable deduction may be disallowed is in connection with amounts paid to a charitable organization pursuant to the settlement of a will. Deductibility of the payments is not determined on the basis of a good faith adversary proceeding. Rather, the appropriate inquiry is whether the ''interest in issue'' reaches the charity pursuant to correctly interpreted and applied state law.[108] The charity must have recognizable, enforceable rights, under state law, to at least some portion of the estate.[109] For example, when a charity was named as a beneficiary in a decedent's will, but not in any of six subsequent wills and a codicil, the IRS concluded that there was little likelihood that the first will would be admitted to probate. Thus, the estate was not entitled to any charitable deduction for the payment.[110]

Still another of these contexts involves the concept of the *qualified disclaimer*.[111] In one case, an individual inherited the entirety of an estate, with the anticipation that she would disclaim a portion of the inheritance so that the disclaimed property would be transferred to a charitable trust and a charitable foundation. A court held that the estate was not entitled to a charitable deduction for the gift to the trust because the partial disclaimer did not constitute a qualified disclaimer.[112] By contrast, the amount that passed to the foundation was held to be deductible because the disclaimer was a qualified one.

A charitable deduction is allowed for these types of split interests in property when the interest (remainder interest) transferred is:

- A charitable remainder annuity trust
- A charitable remainder unitrust
- A pooled income fund
- A guaranteed annuity
- An annual fixed percentage distribution of fair market value of property[113]

---

[105] IRC § 508(d).

[106] IRC § 4948(c)(4).

[107] IRC § 2055(e). The estate tax charitable deduction may also be disallowed when the donee fails to qualify as a charitable entity. See § 8.7(a).

[108] E.g., *Terre Haute First Nat'l Bank v. United States*, 91-1 U.S.T.C. ¶ 60,070 (S.D. Ind. 1991).

[109] Reg. § 20.2056(c)-2(d)(2).

[110] Tech. Adv. Mem. 200306002.

[111] IRC § 2518(b)(4).

[112] *Estate of Christiansen v. Commissioner*, 130 T.C. No. 1 (2008).

[113] IRC § 2055(e)(2). E.g., *Galloway v. United States*, 492 F.3 d 219 (3rd Cir. 2007); *Estate of Johnson v. United States*, 941 F.2d 1318 (5th Cir. 1991); *Zabel v. United States*, 1998 WL 84385 (D. Neb. 1998) (split-interest trusts that were created partially to benefit charities were ruled not to be one of the qualifying types).

The IRS amended the estate tax regulations in 2003 to eliminate the requirement that the charitable interest commence no later than a noncharitable interest that is in the form of a guaranteed annuity or unitrust interest would commence. T.D. 9068. This change followed the Tax Court's decision in *Estate of Boeshore v. Commissioner*, 78 T.C. 523 (1982).

Contributions of split interests in copyrighted tangible works of art are not denied a charitable contribution deduction when the art work is conveyed separately from the copyright in such work.[114] The split interests of the art work and its copyright are treated as separate properties. The contribution must be made to a qualified organization that will use the property in a manner related to the organization's function. A qualified organization is a charitable organization other than a private foundation.

An estate tax charitable contribution deduction is available in respect of any transfer of a qualified real property interest,[115] as long as the interest meets certain requirements.[116] Essentially, this deduction is available for irrevocable transfers of easements in real property.[117]

In instances of gifts to charitable organizations of fractional interests in items of tangible personal property after August 17, 2006, special rules apply in connection with the estate tax charitable contribution deduction.[118]

Marital Estate Tax Deduction. An unlimited marital deduction is allowed to a decedent for the value of any property transferred to his or her surviving spouse.[119] Transfers of terminable interests in property generally do not qualify for the marital deduction.[120] *Terminable interests* are interests that fail after a certain period of time, the occurrence of a contingency, or failure of some event.[121]

An interest that is conditional on the continued survival of the surviving spouse will not be considered a terminable interest when the condition does not exceed six months.[122]

The portion of a terminable life estate interest in property given to the surviving spouse is entitled to the marital deduction when the spouse is entitled to receive all the income from the portion of the interest at least annually, with power of appointment in the surviving spouse (or the spouse's estate) over that portion of all the property.[123]

Similarly, in the case of proceeds from a life insurance policy, or an annuity, if the proceeds are payable in installments (or held to pay interest thereon) and the installments are payable at least annually (beginning at least 13 months after the decedent's death), such payments qualify for the marital deduction.[124] The payments must be payable only to the surviving spouse. Further, the surviving spouse (or the surviving spouse's estate) must have a power of appointment over the property.

---

[114] IRC § 2055(e)(4).

[115] This term is defined in IRC § 170(h)(2)(C). See § 9.7(a).

[116] These are the requirements of IRC § 170(h) (see § 9.7) without regard to IRC § 170(h)(4)(A) (see 9.7(c)).

[117] IRC § 2055(f). A court denied an estate an *income tax* charitable deduction (IRC § 642(c)) for the value of stock it transferred to a charitable organization in satisfaction of a bequest and for which the estate successfully claimed an estate tax charitable deduction. *Crestar Bank v. IRS*, 99-1 U.S.T.C. ¶ 50, 545 (E.D. Va. 1999). In general, see Raby & Raby, "Calculating Estate Tax Charitable Deductions," 39 *Exempt Orgs. Tax Rev*. (no. 1) 47 (Jan. 2003).

[118] IRC § 2055(g). See § 15.3(b).

[119] IRC § 2056(a).

[120] IRC § 2056(b).

[121] Reg. § 20.2056(b)-1(b).

[122] IRC § 2056(b)(3).

[123] IRC § 2056(b)(5).

[124] IRC § 2056(b)(6).

The marital deduction is available, by election, for *qualified terminable interest property* (QTIP).[125] Under a QTIP election, a *qualified terminable income interest* for the life of the surviving spouse is made subject to the marital deduction. The deduction applies when the surviving spouse has a right, for life, to income as to that portion of property for which an election is made, payable at least annually, or has a life usufruct interest in the property. Further, no person may have a power of appointment over the property during the life of the surviving spouse.

Interests passing to the surviving spouse through a qualified charitable remainder trust qualify for the marital deduction.[126] A trust is qualified if it is a charitable remainder annuity trust or a charitable remainder unitrust. The only noncharitable beneficiary under this type of a trust must be the surviving spouse.

Special rules apply to a surviving spouse who is not a United States citizen. Generally, transfers to such spouses are not entitled to the marital deduction.[127] A transfer through a qualified domestic trust, however, is entitled to a marital deduction.[128]

Interrelationship with Administration Expenses. The Supreme Court resolved a controversy as to the interrelationship between the allocation of estate administration expenses to estate principal and income, and the amount of the estate tax charitable contribution deduction (and the marital deduction).[129] At the core of the dispute was the outcome when these expenses are allocated by the executor of the estate to income. The Court held that the estate tax deduction for charitable bequests does not have to be reduced by the amount of the estate's expenses that were paid from income generated during administration of the estate by assets allocated to the bequests.[130] (This means that, when the representative of the estate is given the power by the will to apportion expenses to income or principal, the estate tax charitable deduction need only be reduced by the portion of estate administration expenses allocated to principal.)

The estate involved was valued at more than $30 million. During the period of administration, the estate generated more than $4.5 million in income and more than $2 million in administration expenses (including substantial litigation costs). The estate paid about $500,000 in expenses from principal and paid the rest of the expenses from this postdeath income. The executors were given the authority to apportion administration expenses; this apportionment provision and other aspects of the will were consistent with state law.

The estate, in calculating its tax liability, did not reduce its charitable (or marital) deductions by the amount of the income used to pay the balance of the administration expenses. The IRS contended, however, that use of income for this purpose requires a dollar-for-dollar reduction of the amounts of the charitable

[125] IRC § 2056(b)(7).
[126] IRC § 2056(b)(8).
[127] IRC § 2056(d)(1).
[128] IRC §§ 2056(d)(2), 2056A.
[129] IRC § 2056.
[130] *Commissioner v. Estate of Hubert*, 520 U.S. 93 (1997), *aff'g* 63 F.3d 1083 (11th Cir. 1995), *aff'g* 101 T.C. 314 (1993).

(and marital) deductions.[131] (The parties to this case agreed that the charitable and marital deductions had to be reduced by the amount of charitable and marital residue principal used to pay administration expenses.)

The Supreme Court noted that, although the language of the estate tax charitable deduction and the marital deduction differs in some respects, the two deduction statutes are to be read to require the same answer in this context. Inasmuch as the marital deduction has more specific terms on this point, the Court in its rendition of the law concentrated on that provision. It started with the observation that the marital deduction is available for qualifying property based on the value of the property value as of the date of death.[132] This valuation is based on the present value of the remainder interest passing to the spouse.[133] The controlling regulation includes a provision that requires material limitations on the right to receive income to be taken into account when valuing the property interest passing to the surviving spouse.[134] The IRS read this regulation as stating that the fact that income from property is used to pay expenses during the administration of an estate is always a material limitation that would have an effect on valuation. The Court, by contrast, read the regulation as meaning that such a fact "may" be material, and went on to find that an executor's discretion to pay administration expenses out of income is not a material limitation on the right to receive income.[135] Though the record was not complete on the point, the Court found that the estate's expenses could have been thought to be immaterial in relation to the amount of income that the estate's corpus could have been expected to generate.[136]

In general, then, the matter comes down to distinguishing between the sources of estate administration expenses. When an administration expense is paid out of principal, the amount received by the beneficiaries is reduced. Thus, when the beneficiaries are a charitable organization and a spouse, the charitable and marital deductions are correspondingly lowered. By contrast, administration expenses allocable to income do not change the amount of the estate principal received by the beneficiaries, so the amount of the deductions should not be altered.

Critics of this view assert that the outcome approved by the Supreme Court leads to a double deduction, in that the larger charitable (and marital) estate tax deduction is preserved and the administration expenses allocable to income are deductible for purposes of income taxation of the estate. This is perceived as a violation of tax law.[137] This argument was dismissed by the Court plurality as

---

[131] The Tax Court previously rejected this position of the IRS in *Street Estate v. Commissioner*, 56 T.C.M. (CCH) 774 (1988), but was reversed on appeal. 974 F.2d 723 (6th Cir. 1992). This position of the Sixth Circuit was thus in conflict with that of the Eleventh Circuit (see *supra* note 110), although another federal court of appeals was in accord with the former. *Burke v. United States*, 994 F.2d 1576 (Fed. Cir.), *cert. denied*, 510 U.S. 990 (1993). See also *Bonner v. City of Pritchard*, 661 F.2d 1206 (11th Cir. 1981); *Alston v. United States*, 349 F.2d 87 (5th Cir. 1965); *Roney Estate v. Commissioner*, 294 F.2d 774 (5th Cir. 1961); *Ballantine v. Tomlinson*, 293 F.2d 311 (5th Cir. 1961).

[132] IRC § 2056(a); Reg. § 20.2056(b)-4(a). The exception to this rule occurs when an estate uses the alternative valuation date. IRC § 2051.

[133] Reg. §§ 25.2523(a)-1(e), 20.2031-7; see also Reg. § 20.2055-2(f)(1).

[134] Reg. § 20.2056(b)-4(a).

[135] A revenue ruling so holds. Rev. Rul. 69-56, 1969-1 C.B. 224.

[136] The Court observed that its analysis is consistent with its prior comparable valuation opinions, principally *United States v. Stapf*, 375 U.S. 118 (1963), and *Ithaca Trust Co. v. United States*, 279 U.S. 151 (1929).

[137] An estate may take an estate tax deduction for administration expenses (IRC § 2053(a)(2)) or, if deductible, in computing taxable income, but it may not do both. IRC § 642(g).

being ''rhetorical'' and of ''no basis,'' in that the charitable and marital deductions are already valued with respect to expected income and material expected administration expense charges to which estate income may be subjected.[138]

The IRS was not satisfied with this opinion and announced that it was in the process of developing regulations concerning situations in which there is a material limitation on a surviving spouse's right to the income from property, when the income is used to pay administrative expenses of the estate. Comments on this matter were sought by the IRS.[139] Thereafter, the IRS abandoned the approach based on material limitations and issued regulations that differentiate between *estate transmission expenses* and *estate management expenses*; the value of the property involved, for purposes of either deduction, would be reduced by the first category of expenses.[140]

Land Subject to Permanent Conservation Easement. A special rule[141] allows an executor to elect to exclude from a decedent's estate 40 percent of the value of any land subject to a qualified conservation easement that meets the following requirements:

- The land has been owned by the decedent or a member of the decedent's family at all times during the three-year period ending on the date of the decedent's death
- A qualified conservation contribution of a qualified real property interest[142] was granted by the transferor or a member of his or her family

Preservation of an historically important land area or a certified historic structure does not qualify as a conservation purpose in this setting. Debt-financed property qualifies for this exclusion to the extent of the net equity in the property.

To the extent that the value of this land is excluded from the estate, the basis of the land acquired at death is a carryover basis (that is, the basis is not stepped up to its fair market value at death).

The exclusion amount is calculated on the basis of the value of the property after the conservation easement has been placed on the property. The exclusion from estate taxes does not extend to the value of any development rights retained by the decedent or donor,[143] although payment for estate taxes on retained development rights may be deferred for up to two years or until the disposition of the property, whichever is earlier.

The 40 percent estate tax exclusion for land subject to a qualified conservation easement may be taken in addition to the maximum exclusion for qualified family-owned business interests. De minimis commercial recreational activity that is consistent with the conservation purpose (such as the granting of hunting and fishing licenses) will not cause the property to fail to qualify under this rule.

[138] *Commissioner v. Estate of Hubert*, 520 U.S. 93 (1997).
[139] Notice 97-63, 1997-2 C.B. 6.
[140] T.D. 8846. See Reg. § 20. 2055-3(b).
[141] IRC § 2031(c).
[142] See § 9.7.
[143] *Retained development rights* are any rights retained to use the land for a commercial purpose that is not subordinate to and directly supportive of farming purposes (for example, tree farming, ranching, viticulture, and the raising of other agricultural or horticultural commodities). IRC § 6420.

If the value of the conservation easement is less than 30 percent of the value of the land without the easement, reduced by the value of any retained development rights, the exclusion percentage is reduced. The reduction in the exclusion percentage is equal to 2 percentage points for each point that the ratio falls below 30 percent. If the value of the easement is 10 percent or less of the value of the land before the easement, less the value of the retained development rights, the exclusion percentage is equal to zero. The maximum exclusion for land subject to a qualified conservation easement is limited to $500,000 in 2002 and thereafter.[144]

(c) Time of Valuation of Gross Estate

The general rule is that the gross estate is valued as of the decedent's date of death.[145] An alternate valuation date, however, can be elected by the executor of the estate. The election generally allows the gross estate to be valued as of six months after death for undistributed property, and as of the date of transfer for distributions within six months of death.[146] The election is allowable, however, only when it will result in a decrease in both the value of the gross estate and the sum of the transfer tax imposed.[147]

Generally, the value of the estate is the fair market value of the property on the date of death.[148] Special valuation rules are provided for farms and other qualified real estate.[149]

Unlisted stocks and securities are valued by taking into consideration the value of similar securities of other corporations in the same or similar line of business.[150]

(d) Basis of Transferred Property

One significant difference between lifetime transfers and transfers that take place at death involves the basis of the property transferred. For lifetime transfers, the basis of property in the hands of the transferor is carried over and becomes the basis in the hands of the transferee.

In contrast, transfers that take place at death receive special preferential treatment. The basis to the recipient is not a carryover basis, but the fair market value of the property as of the date of death (or the alternate valuation date).[151] The recipient of a decedent's estate enjoys a stepped-up basis in the transferred property. Any appreciation in the asset prior to the death of the decedent escapes income tax as a result of the testamentary transfer.

[144] The granting of a qualified conservation easement is not treated as a disposition triggering the recapture provisions of IRC § 2032A. The existence of a qualified conservation easement does not prevent the property from subsequently qualifying for special-use valuation treatment under that provision.
[145] IRC § 2031(a).
[146] IRC § 2032(a).
[147] IRC § 2032(c).
[148] IRC § 2031; Reg. § 20.2031-1(b).
[149] IRC § 2032A.
[150] IRC § 2031(b).
[151] IRC § 1014.

§ 8.4 UNIFICATION OF TAXES

The unified federal transfer tax is a progressive tax. As discussed, it taxes the value of transferred property in brackets ranging from a low of 18 percent to a high of 55 percent for estates of more than $3 million.

A credit is available to offset the taxes imposed under the unified estate and gift transfer tax. Known as the *unified credit*, it is available to offset, dollar for dollar, taxes imposed on both lifetime gift transfers and transfers by reason of death.[152]

This credit is in the form of an *applicable credit amount*, which is based on a series of *applicable exclusion amounts*. Under the unified credit, tax-free transfers up to the applicable exclusion amount in asset value can be made during an individual's life and/or upon that person's death.

Under the unified transfer tax system, other credits are available to offset or reduce tax liability:

- Credit for state death taxes[153]
- Credit for foreign death taxes[154]
- Credit for prior transfer[155]
- Credit for death taxes on remainders[156]

Notwithstanding the foregoing, however, legislation signed into law on June 7, 2001, radically altered this aspect of the law.[157] Generally, the estate and gift taxes are to be reduced between 2002 and 2009, with the estate tax scheduled to be restored in 2010. In 2002, the rates in excess of 50 percent were repealed. Also, in 2002, the unified credit application exclusion amount was increased to $1 million.

The phase-out of the estate tax is to proceed as follows: (1) In 2003, the estate and gift tax rates in excess of 49 percent were repealed. (2) In 2004, the estate and gift tax rates in excess of 48 percent were repealed, and the unified credit exemption amount for estate tax purposes was increased to $1.5 million (leaving the exemption amount for gift tax purposes at $1 million). (3) In 2005, the estate and gift tax rates in excess of 47 percent are to be repealed. (4) In 2006, the estate and gift tax rates in excess of 46 percent are to be repealed, and the unified credit exemption amount for estate tax purposes will increase to $2 million. (5) In 2007, the estate and gift tax rates in excess of 45 percent are to be repealed. (6) In 2009, the unified credit exemption amount will increase to $3.5 million. (7) In 2010, the estate tax is to be repealed. Thereafter, the estate tax is to be reinstated, at the prior levels.

---

[152] IRC §§ 2010, 2505.
[153] IRC § 2011.
[154] IRC § 2014.
[155] IRC § 2013.
[156] IRC § 2015.
[157] Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 106th Cong., 1st Sess. (2001), §§ 501, 511, 521 [EGTRRA].

§ 8.5 GENERATION-SKIPPING TRANSFER TAX

Another transfer tax was added to the federal tax system in 1976.[158] The purpose of this tax is to curb a perceived abuse involving the use of trust vehicles in estate planning. It was subsequently retroactively repealed and replaced with a revised version for property transfers made after 1986.

As will be seen, trusts can be used effectively as a means for passing wealth on to successive generations at minimum tax cost to the decedent's estate. Indeed, one of the guiding principles of estate planning is the passing down of wealth to ''lower'' or successive generations at a minimum tax cost.

Because decedent's estates are taxed on the value of their property, and trusts are taxed only on the income they generate, trusts have become convenient vehicles, or depositories, for generational wealth. A decedent's wealth (denominated *first generation*) can be transferred to a trust. The transfer may or may not incur a transfer tax. Typically, the trust retains the property (known as *trust corpus* or *principal*) and distributes income to the next generational level (denominated *second generation*), typically the sons and daughters of the decedent. Tax is paid on the trust income, but not the trust property. The trust property is not included in the estate of a child of the decedent upon the child's death. Therefore, there is no estate tax at the second generational level. The trust, upon the death of a child of the decedent, typically distributes its property to the grandchildren of the decedent (denominated *third generation*) free of transfer tax. Through the use of a trust vehicle, property ownership skips a generation and that generation's level of estate transfer tax.

To curb generation-skipping transfers of wealth through use of trusts, and preserve the integrity of uniform generation-to-generation transfer taxes, the generation-skipping transfer tax was adopted.

A transfer tax is imposed on every generation-skipping transfer.[159] The tax rate is a flat amount equal to the maximum unified estate and gift tax rate.[160] The generation-skipping transfer (GST) tax rate is 55 percent. The tax itself, although a transfer tax, is not unified with the estate and gift tax. It is a separate tax on transfers of property. The source for payment of the tax is the property subject to the GST tax.[161]

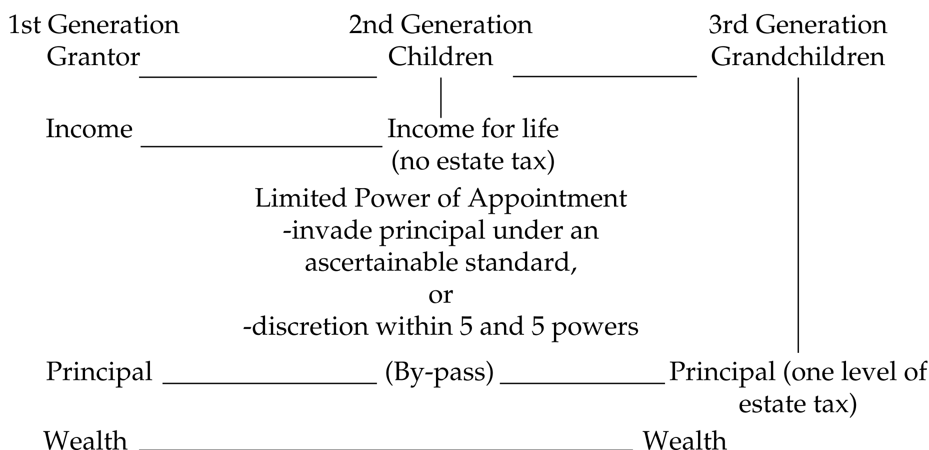
The federal tax code provides rules for determining to which generation a transferor of a generation-skipping transfer belongs.[162] Generally, generational levels are assigned based on lineal descent. Adopted persons, and persons related by half-blood, are treated as lineal descendants. A married individual is assigned to the same generational level as his or her spouse. Nonlineal descendants are assigned to generations based on their age. An individual born within 12½ years of a transferor is assigned to the same generation as the transferor. An individual between 12½ and 37½ years younger than a transferor is assigned to the next lower generational level. New generational levels are created for each additional 25-year difference.

---

[158] IRC § 2601 *et seq.*
[159] IRC § 2601.
[160] IRC § 2602.
[161] IRC § 2603.
[162] IRC § 2651.

A *generation-skipping transfer* is defined as any:

- Taxable distribution[163]
- Taxable termination[164]
- Direct skip[165]



Certain transfers are excluded from the definition.

- *Taxable distribution* is any distribution from a trust to a skip person,[166] that is, a person two or more generations below the transferor of the interest.[167] The amount of a taxable distribution is the value of the property received by the transferee, reduced by expenses of the transferee related to the tax.[168]
- *Taxable termination* is any termination of an interest in property held in trust when the interest is for the benefit of a skip person.[169] The taxable amount in the case of a taxable termination is the value of the property received on the termination, reduced by expenses related to the property.[170]
- *Direct skip* is the transfer of an interest in an item of property to a skip person.[171] The amount of the taxable gift is the value received.

The valuation of the transfer is as of the time of the transfer.[172] The estate tax alternate valuation period may apply to direct skips or taxable terminations at death.[173]

[163] IRC § 2611(a)(1).
[164] IRC § 2611(a)(2).
[165] IRC § 2611(a)(3).
[166] IRC § 2612(b).
[167] IRC § 2613.
[168] IRC § 2621.
[169] IRC § 2612(a).
[170] IRC § 2621.
[171] IRC § 2612(c).
[172] IRC § 2624.
[173] IRC § 2624.

An exemption is allowed to every individual with respect to the value of property transferred, with the base amount of the exemption of $1 million.[174] As with the gift tax annual exclusion, spouses are permitted to split the generation-skipping transfer tax exemption. This allows married couples to transfer up to twice the available exemption amount free of GST tax.

Another exemption is permitted for transfers to certain grandchildren.[175] If a parent of a grandchild, who is a lineal descendant of the transferor, is dead, the grandchild is treated as the child of the transferor. In this case, the generation-skipping gap is closed up so that no GST tax applies to the transaction.

All lifetime gifts entitled to the education or medical exclusion are exempt from the GST tax.[176]

Gifts directly to skip persons are exempt from the GST tax to the extent of the gift tax annual exclusion. Gifts to a trust for the benefit of a skip person are exempt from the GST tax to the extent of this annual exclusion only if: (1) the income and corpus of the trust can be distributed only to that skip person for whom the trust was created; and (2) if that skip person dies before termination of the trust, the trust's assets are includible in the gross estate of that skip person (typically accomplished by granting that skip person a general power of appointment exercisable by that skip person's will).[177]

Notwithstanding the foregoing, legislation signed into law on June 7, 2001, caused the GST taxes to be reduced between 2002 and 2009, and these taxes are slated to be restored in 2010.[178] The GST tax exemption for a given year (prior to repeal) is equal to the unified credit exemption amount for estate tax purposes.[179] Also, as under prior law, the GST tax rate for a given year will be the highest estate and gift tax rate in effect for that year.

§ 8.6 ESTATE PLANNING PRINCIPLES

The term *estate planning* applies to lifetime financial and tax planning for an individual (and his or her family), as well as planning for the transfer of accumulated lifetime wealth. Typically, the estate planner focuses on the lifetime financial resources, needs, and desires of an individual. At the same time, the estate planner looks at that individual's needs and desire to provide for others after the individual's death. The estate planner attempts to meet these needs and desires by utilizing techniques and devices to reduce or eliminate tax consequences to the individual and his or her estate.

There are a number of principles that guide an estate planner in his or her efforts to reduce the federal transfer tax.

---

[174] IRC § 2631.
[175] IRC § 2612(c).
[176] IRC § 2642(c)(3).
[177] IRC § 2642(c)(2).
[178] EGTRRA § 501.
[179] See § 8.4, text accompanied by *supra* note 157.

(a) Estate Reduction

The first principle of estate planning is minimization of the value of the property constituting the decedent's gross estate. The federal transfer tax ultimately reaches only that property remaining in, or by tax law included in, the decedent's estate. To avoid or minimize tax, one can reduce an estate so that by the time death (and taxes) arrives, little or nothing remains to be taxed.

A number of techniques are available to accomplish this result. The annual gift tax exclusion is one method for removing assets from the estate. An individual can give up to $11,000 annually to any number of individuals without application of the transfer tax. If the donor individual is married, he or she can aggregate the spouse's annual exclusion and give away $22,000 per year.

The annual exclusion can be leveraged to convey assets that will (or can be expected to) appreciate greatly over time. An annual exclusion amount tax-free gift of appreciating property today may, over time, shelter several times the value of the transfer.

Likewise, an individual can take advantage of the unified credit to make lifetime transfers of more than the annual exclusion amount to remove large assets that will (or can be expected to) appreciate over time. Assets in amounts up to the applicable exclusion amount (see above) can be transferred without taxation, and with them any appreciation over the life of the donor.

(b) Estate Freezes and Special Valuation Rules

A complementary device for controlling appreciation in the estate is through what is known as an *estate freeze*. Instead of transferring the entire asset that is expected to appreciate over time, the amount of appreciation in the asset can be frozen at its current level and the appreciation potential conveyed away at little or no tax cost.

One technique involves the recapitalization of stock in a corporation. All of the original owners of the stock in the corporation could arrange for the delivery of their stock to the corporation in return for the reissuance of two new classes of stock, often called *common* and *preferred*. Each class of stock is granted different attributes. This is a type of recapitalization.

For example, the preferred stock could have been designed to have a right to receive a fixed specified rate of return prior to any of the corporation's profit being shared with respect to the common stock. Only after the right to income of the preferred stock was met could the balance be allocated among the shares of common stock. But the value of the preferred stock could not increase as the corporation grew, because the return with respect to the preferred stock was fixed. Therefore, the growth of the corporation would be reflected only in the value of the shares of common stock. As a result, at the time of recapitalization, most of the value of the company would be absorbed by the preferred stock and, until the company's value grew over the future, the common shares would be attributed very little value. In this way, the original shareholders could give the common stock to their children and grandchildren at a low value, and therefore a reduced gift tax cost, while retaining preferred rights to the company's profits. Thus, the parents effectively froze the value of the preferred stock to prevent its growth in their estates and diverted appreciation of the company to the common stock that was transferred by gifts to their children.

These estate freeze techniques were viewed as abusive rules, enacted to regulate their use with respect to intrafamily transactions. Rules apply to the taxation of intrafamily transfers of equity interest in corporations and partnerships,[180] the effect of intrafamily agreements restricting transfer of these interests (buy-sell agreements),[181] the taxation of transfers in trust,[182] and the effect of lapsing rights.[183] The overall focus of these rules with respect to intrafamily transfers is on determining whether a gift has been made and, if so, the value of that gift. In effect, the law provides a set of special valuation rules for intrafamily transfers under circumstances in which the transferor retains an interest in property with characteristics that differ from the transferred interest in that property. In general, the framework of the special valuation rules for intrafamily transfers is organized so as to ignore, for transfer tax purposes, attributes of transferred property interests that otherwise would reduce the value of those interests. Thus, the special valuation rules do not prohibit transfers; the rules merely govern the valuation of certain transfers. These same special valuation rules also provide for certain statutory transfers that are allowed to escape application of the special valuation rules.

Some examples of the statutory exceptions to the special valuation rules are:

- Equity interests in business entities that provide for *qualified payments*[184] with respect to the parents' retained preferred equity interest
- Transfers in trust for a family member in which the transferor retains a *qualified annuity*, *unitrust*, or *remainder interest*[185]
- Buy-sell agreements that meet the three-prong test of being recognized as a *bona fide* business arrangement under which transfers are not made for less than adequate consideration to a family member and the terms of which are comparable to similar arrangements entered into by persons in arm's length transactions[186]
- Restrictions that are imposed by federal or state law or that may be exercised or removed only with the consent of a nonfamily member[187]

(c) Deferral

Another fundamental technique of estate planning is deferral of estate tax. The principle concerning the time value of money posits that the deferred or delayed enjoyment of one dollar a year from now is worth less than a dollar today. Therefore, the same amount of money today is worth more than the same amount of money in the future. The greater the deferral, the greater the present value of money.

[180] IRC § 2701.
[181] IRC § 2703.
[182] IRC § 2702.
[183] IRC § 2704.
[184] IRC § 2701(a)(3)(A).
[185] IRC § 2702(b).
[186] IRC § 2703(b).
[187] IRC § 2704(b)(3).

Deferral of transfer taxes can be accomplished in a number of ways. The most significant method is by transfers to a spouse. The marital deduction is unlimited. Except for the exclusion of certain unqualified terminable interests, taxes can be deferred through transfers to a spouse qualifying for the marital deduction.

Another popular deferral device is use of one or more trusts. Assets placed in trust could provide for support of a spouse, with distribution on death to the children. Similarly, a trust could provide for support of children, with a distribution on death to grandchildren. In either event, taxation of the trust assets would be deferred until after they were distributed to the children or grandchildren. The generation-skipping transfer tax must be carefully considered with respect to these types of transactions.

(d) Generation-Skipping Transfers

Like deferral, a traditional estate planning goal has been to pass assets down to as many lower generations as possible with little or no tax. Bypass trusts were used for this purpose. A trust could be set up to provide for a transferor's children, with the remainder to the grandchildren. The next lower generation would be skipped over free of estate tax at that level.

Today, that device is limited to a degree by the generation-skipping transfer tax. By utilizing the GST tax exclusion, however, opportunities to skip generations tax free still exist.

(e) Credit-Maximizing Trusts and Transactions

Another technique is use of available credits to shield assets from tax, and thus maximize tax savings. Spouses can, by reason of the marital deduction,[188] transfer assets to the other free of tax. However, if a spouse transferred assets out of his or her estate to a person other than his or her spouse, when the amount transferred is shielded by the unified credit, the transfer would also be tax free. That "person" can be a trust. Thus, an individual can transfer assets to a trust, shielded by the credit, and assets to a spouse, shielded by the marital deduction, in such a way as to reduce or perhaps eliminate estate taxation.[189]

(f) Estate Equalization

Because of the progressive nature of the estate tax, larger estates may be taxed to a greater extent than smaller ones. If one or the other spouse ends up with a proportionately larger estate than the other, higher estate taxes may be the result. To take advantage of the tax savings of lower rates, the estate planner will seek to balance the estates of spouses so that they are approximately equal. Reliance on the marital deduction alone may mean that the value and benefit of one spouse's unified credit is lost. Estate equalization is accomplished by means of a blend of use of the marital deduction and the unified credit.

---

[188] See § 8.3(b)(ii).

[189] See, e.g., § 8.6(g).

(g) Revocable Living Trusts

Estate planning can entail use of one or more revocable living trusts. This trust is in the nature of a contract that determines how an individual's property is to be managed and distributed during his or her lifetime, and also at death. A trust is a *living trust* when it is established during the lifetime of the individual creating the trust (the *grantor* of the trust[190]) and it is *revocable* when the grantor has reserved the right to amend or revoke the trust during his or her lifetime. Often, the grantor of a revocable living trust is the trustee of the trust.[191]

Once the trust is established, the grantor transfers property to the trust during his or her lifetime. Thus, instead of owning certain assets in the individual's name, or owning assets jointly with another (such as the individual's spouse), the assets are "owned" by the individual in the capacity of trustee of the trust. Because the trust is revocable and because the grantor is the trustee, the individual has complete control over and access to the assets that are owned by the trust while he or she is living. Should the individual become incapacitated, the person named as the successor trustee (such as the spouse) would begin to serve, managing and utilizing the property for the individual's benefit. This approach avoids the need for a court to appoint a conservator of the property.

The individual may name beneficiaries to receive assets from the trust. At death, any property owned by the trust or any assets transferred to the trust by reason of death (such as life insurance proceeds, if the trust was designated as the beneficiary) will be distributed to the beneficiaries in the manner specified in the trust agreement. In this regard, the trust instrument functions in the same fashion as a will.[192]

Another benefit of a revocable trust is that assets owned by the trust at the death of the grantor are not subject to probate. Likewise, assets that are not owned solely in the decedent's name, or that name beneficiaries pursuant to a contract, are not subject to probate at death. These assets include benefits from individual retirement accounts, other retirement plans, life insurance proceeds, and property with a "pay-on-death" or "transfer-on-death" designation under which the death benefits or property are paid or transferred directly to the designated beneficiary on death. In addition, property held in joint tenancy will not be subject to probate on the occasion of the death of the joint tenant who is the first to die. In the event of the simultaneous deaths of the joint tenants, however, or in the event the surviving joint tenant owns property in his or her name at the time of death, the property will be subject to probate.

(h) Disclaimers

When preparing a revocable living trust, the estate planner should include a disclaimer provision giving the surviving spouse the opportunity to reduce or eliminate future estate taxes. The trust would provide that, on the death of the first of the spouses to die, the designated successor trustee of the deceased spouse's trust

---

[190] See § 3.7.

[191] It is because of these incidents of ownership that the grantor is personally taxable on income generated by the trust assets.

[192] See § 8.6(i).

will set aside the trust assets for the benefit of the surviving spouse in a separate trust share, for example, Trust A. Any property allocated to Trust A should qualify for the unlimited marital deduction and, therefore, will not be subject to any federal estate tax at the death of the first of the spouses to die.

Trust A would provide that while the surviving spouse is living, he or she will be entitled to all of the net income of Trust A, as well as trustee-approved distributions of principal from Trust A for the surviving spouse's health, education, maintenance, and support. Also, the surviving spouse would have the absolute right to withdraw any or all of the principal of Trust A. Therefore, unless the surviving spouse is incapacitated, in which case the successor trustee will hold the assets for the surviving spouse's benefit, the surviving spouse will have complete control over the assets of Trust A and will most likely withdraw those assets and add them to his or her own trust.

Each trust would, however, also direct a different distribution of property that the surviving spouse disclaims. (A *disclaimer* is an irrevocable and unqualified refusal to accept a gift of property.) Under this arrangement, the surviving spouse can elect to refuse to accept any or all of the property that would otherwise pass to the surviving spouse from Trust A. The trusts would provide that, in the event the surviving spouse decides to disclaim any of the assets that would otherwise be distributed to the surviving spouse, the disclaimed assets will be set aside by the trustee in another trust share, for example, Trust B. Any assets that are disclaimed and added to Trust B will still be held for the benefit of the surviving spouse. The surviving spouse will receive the net income of Trust B and trustee-approved distributions of principal for the surviving spouse's health, education, maintenance, and support. The surviving spouse will not, however, have the ability to withdraw the assets from Trust B and, therefore, will be more restricted with respect to any assets disclaimed and added to Trust B.

The reason the surviving spouse will disclaim some of the assets and allow them to pass to Trust B is to make certain that the applicable exclusion amount[193] of the first spouse to die is used (not wasted). The surviving spouse's decision to make a disclaimer will depend on the facts and circumstances that exist at the time of the death of the first spouse to die, the primary one likely being the size of the estate. Again, the balance of the assets transferred can be protected by the marital deduction.[194] Consequently, the disclaimer trust provisions offer the surviving spouse flexibility to determine whether and to what extent Trust B will be funded.

At the death of the surviving spouse, any remaining assets (after payment of taxes and expenses) would be divided into appropriate shares to provide for transfer to any children and/or to others. These shares would be transferred free of trust, except to the extent the trust instrument limits distributions to beneficiaries who are minors.

(i) Last Will

In addition to a trust, a last will and testament should be prepared. One purpose of a will is to provide for distribution of the individual's tangible personal

[193] See § 8.4.
[194] See § 8.6(e).

property at death. Usually, these items, or at least most of them, will be transferred to the surviving spouse. Otherwise, this property can be distributed by way of a written list, which designates which beneficiaries are to receive which items of tangible personal property.

Another purpose of a will is to provide that, at death, any property (other than tangible personal property) the individual owns in his or her name—that is, that has not been transferred to a trust prior to death or is not owned in joint tenancy or the like—will pour over into the trust after it passes through probate. A *pourover will* ensures that any property that the individual has not placed in a trust during his or her lifetime will ultimately end up in, and be subject to the dispositive provisions of, the trust.

A will also designates the *personal representative* of the estate (also known as the *executor* or *executrix*). This person administers the probate estate and works with the probate court to properly distribute assets to heirs. If probate is avoided, by transferring property to a trust or owning it in joint tenancy or the like, there will be no probate estate and the personal representative will not have any function.

(j) Durable Power of Attorney

An individual should have a *durable power of attorney* document, designating an attorney-in-fact to make economic decisions for the individual and deal with his or her property should the individual become incapacitated. Durable powers of attorney can avoid the necessity of a court-appointed guardian and/or conservator in the case of incapacity.

Another such document is the *durable power of attorney for health care decisions*. This instrument allows an individual to designate an attorney-in-fact to act in the individual's place in the making of medical decisions. Decisions of this nature include signing medical consents and hiring and discharging physicians.

(k) Living Will

A *living will* enables an individual to direct the termination of artificial life support in the event the individual is terminally ill.[195]

§ 8.7 REMAINDER INTERESTS

Outright bequests to charity by will qualify for the estate tax charitable deduction. To qualify for an estate tax charitable deduction, if a remainder interest

[195] A court considered a motion for summary judgment filed by the federal government in a case against an individual who pled guilty to tax fraud. The government alleged that certain transfers of property by him were fraudulent under state law and that other defendants were merely alter egos of trusts into which assets were placed. Each of this individual's seven children were beneficiaries of trusts. Title to his residence, including a recreation building and boathouse, was transferred to a trust for consideration of less than $100 (although he and his wife continued to live there). The motion for summary judgment nonetheless failed. The reason for this defeat handed to the government was that the defendants were able to raise questions of material fact as to their actions. They asserted that these transactions were merely effective estate planning techniques. *United States v. Kattar*, 99-2 U.S.T.C. ¶ 50,834 (D.N.H. 1999).

bequest to charity is made using a split-interest trust, the trust must be a charitable remainder trust[196] or a pooled income fund.[197]

(a) In General

In one instance, the estate tax charitable deduction was denied because the recipient of a bequest did not qualify as a charitable entity. The executor of the estate secured from the organization an affidavit certifying that it was a charitable organization. He failed, however, to review the IRS's Cumulative List of Charitable Organizations;[198] the organization had been deleted from the list prior to the transfer from the estate.[199]

In another instance, a charitable deduction for a portion of the residue of a decedent's estate, transferred to a testamentary trust for the benefit of specified charities, was imperiled because of provisions in the trust document that arguably enabled distributions to noncharitable beneficiaries. A federal district court interpreted the language to permit distributions for private benefit, although on appeal the court construed the evidence in a manner showing that the decedent's intent was to benefit only charitable entities.[200] The appellate court did not address a point relied on by the district court, which was that the trust document failed to—as some courts are requiring—restrict the trustees to holding, using, and distributing the trust property exclusively for charitable purposes.[201]

An estate tax charitable deduction is not available for the bequest to charity of a contingent remainder interest in a farm.[202] Under a will, a decedent bequeathed a farm to a child for life, with the remainder to a charitable organization. The will also provided, however, that if another child survived the first child, the remainder interest in the farm would vest in the second child instead of the charity. Both individuals were 45 years of age as of the death of the decedent. It was this remainder interest that the IRS found to be too contingent to merit a charitable deduction. The law is that, in the case of a charitable transfer subject to a condition, no deduction is available "unless the possibility that the charitable transfer will not become effective is so remote as to be negligible."[203] The IRS referred to its position that a charitable deduction is not allowable when the probability exceeds 5 percent that a noncharitable beneficiary will survive the exhaustion of a fund in which the charity has a remainder interest.[204] Under this rule, any probability in excess of 5 percent that such a contingency will occur and defeat the charity's interest is not considered so remote as to be negligible. Because the two children were of equal age, the actuarial possibility that the second child would survive

[196] See ch. 12.
[197] See ch. 13.
[198] IRS Publication No. 78.
[199] *Estate of Clopton v. Commissioner*, 93 T.C. 275 (1989).
[200] *Estate of Starkey v. United States*, 2000-2 U.S.T.C. ¶ 60,381 (7th Cir. 2000), *rev'g* 58 F. Supp. 2d 939 (S.D. Ind. 1999).
[201] E.g., *Continental Ill. Nat'l Bank & Trust Co. v. United States*, 403 F.2d 721 (Ct. Cl. 1968); *Estate of Bennett v. Commissioner*, 100 T.C. 42 (1993).
[202] Rev. Rul. 85-23, 1985-1 C.B. 327.
[203] Reg. § 20.2055-2(b).
[204] Rev. Rul. 70-452, 1970-2 C.B. 199; Rev. Rul. 77-374, 1977-2 C.B. 329. See § 12.10.

the first (and thus divest the charity of its remainder interest) was 50 percent. Fifty percent being greater than 5 percent, the IRS held that the ''possibility that the charitable remainder transfer in this case will not take effect in possession and enjoyment is not so remote as to be negligible.''[205] Thus, the IRS concluded that the bequest did not give rise to an estate tax charitable contribution deduction, even though it otherwise complied with the requirements.

(b) Will Contests

In 1989, the IRS ruled that, in situations involving settlements of bona fide will contests, when the will creates a charitable remainder trust, the IRS would no longer challenge the deductibility of immediate payments to charitable organizations on the ground that they were made as part of a split-interest arrangement that would not support an allowable estate tax charitable contribution deduction.[206] In so doing, the IRS revoked its prior contrary position[207] and modified a 1978 pronouncement.[208] This alteration of position was prompted by court opinions.[209]

For example, consider the situation in which someone dies, leaving a charitable bequest in the form of a gift to a trust, with income payable to an individual and the remainder interest to a charitable organization. The trust fails to qualify as a charitable remainder trust or pooled income fund, so there is no estate tax charitable deduction. There is a will contest, resulting in a settlement, pursuant to which the estate makes a single payment to the income beneficiary and a distribution to the charitable organization. The IRS's original position in this regard was that no estate tax charitable deduction is available in these circumstances because the accelerated payment to the charity under the settlement is, in effect, a post-mortem modification of a will that did not satisfy the statutory requirements.[210] The courts held, however, that these requirements are not applicable, on the ground that the settlements do not create split interests; the interests passing to the charitable and noncharitable beneficiaries are not interests in the same property. Despite this change in position, the IRS warned that ''settlements of will contests will continue to be scrutinized in order to assure that the settlement in question is not an attempt to circumvent . . . [the rule requiring split interests to be in certain forms] by instituting and settling a collusive contest.''[211]

A court may be called on to give effect to a settlement of the obligations of an estate reached for nontax reasons, and to determine the amount of an estate tax charitable contribution deduction in relation to the way in which the estate's administrative expenses were allocated. A 1993 court case illustrates this point.[212]

---

[205] Rev. Rul. 85-23, 1985-1 C.B. 327, 328.
[206] Rev. Rul. 89-31, 1989-1 C.B. 277.
[207] Rev. Rul. 77-491, 1977-2 C.B. 332.
[208] Rev. Rul. 78-152, 1978-1 C.B. 296.
[209] E.g., *Flanagan v. United States*, 810 F.2d 930 (10th Cir. 1987); *Estate of Strock v. United States*, 655 F. Supp. 1334 (W.D. Pa. 1987). Also *Estate of Burdick v. Commissioner*, 979 F.2d 1369 (9th Cir. 1992).
[210] IRC § 2055(e)(2)(A).
[211] Rev. Rul. 89-31, 1989-1 C.B. 277, 278.
[212] *Estate of Warren v. Commissioner*, 981 F.2d 776 (5th Cir. 1993).

The estate involved in the case had a value of approximately $28 million, the bulk of which was in two equal charitable lead trusts. Two charitable organizations were the income interest beneficiaries; they were each to receive an 8.5 percent annual annuity for 20 years. The annuity amount was specified as that percentage of the ''initial net fair market value of the assets constituting the trust.'' At the end of the income payment period, the assets of these trusts were to be distributed to the children and grandchildren of the decedent. When the will was admitted to probate in 1983, the estate attracted 16 lawsuits. In addition, several of the businesses that constituted a substantial part of the estate were reorganized. By the close of 1989, the administrative expenses of the estate were more than $9 million ($2 million from estate principal). Because of the length of the probate period, the estate received substantial income from its assets (*postmortem income*). The will provided that all of the debts and expenses of the estate were to be paid out of the residuary estate. The residuary estate was defined to be the entire estate after the satisfaction of gifts and payment of expenses.

The charitable organizations were concerned that their annuity amounts would be substantially reduced if the residuary estate were determined by subtracting the huge administrative expenses. They filed a lawsuit claiming that the administrative expenses should be paid out of the postmortem income. In this and other suits, the parties argued extensively about whether the administrative expenses should be charged to the residuary corpus or to postmortem income. The settlement that was ultimately reached included an agreement to pay all administrative expenses out of postmortem income and not the residuary corpus. Because of the nature of allocations of income to the estate, however, the court modified the settlement so that 72.5 percent of the expenses would be allocated to postmortem income and 27.5 percent of the expenses would be charged to the corpus. The final settlement also set a minimum annuity payment to the charities of $1.47 million.

The IRS then determined an estate tax deficiency and the matter went to the U.S. Tax Court. The IRS argued that, in computing the ''initial net fair market value of the assets constituting the trust,'' the base amount for the annuities should be reduced by all of the administrative expenses. The estate maintained that the reduction should be by only the 27.5 percent pursuant to the probate court's judgment. The Tax Court agreed with the IRS, relying on state law rather than the probate court's determination. This decision reduced the minimum annuity amount to $878,000 and reduced the estate tax charitable contribution deduction from $16.9 million to $10 million. The estate appealed.

The court of appeals had to decide whether to give effect to the ruling of the probate court. It wrote that, in the estate tax charitable deduction area, ''controlling effect has frequently been given to *bona fide* settlements of adversarial litigation not instituted for tax purposes.''[213] It added that ''what the charity receives it receives *as a result and by virtue of* the provision made for it in the decedent's will, whether or not it receives precisely what it would be entitled to if no settlement had been made.''[214]

---

[213] *Id*. at 781. There is authority for the view, however, that state court decisions are not controlling in this regard in the income tax charitable contribution deduction area. See, e.g., *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967).

[214] *Id*. at 782 (emphasis in original).

The IRS challenged the bona fides of this settlement. The appellate court characterized the government's position as being that the settlement, ''at least as far as it dealt with the allocation of administrative expenses, was collusive and designed simply to avoid payment of taxes, and that the IRS should not now be forced to abide by a settlement in which it had no voice.''[215] But the court rejected this view, holding that ''[i]t is indisputably clear that the litigation, and its settlement, were to resolve adversarial, nontax, *bona fide* disputes between the parties.''[216] It also observed that the terms of the will provide ''independent verification of the adversarial interests involved in the probate contest,'' in that, ''to the extent the charitable annuities are reduced, the children and grandchildren benefit.''[217] (Over the 20-year period, the swing amount between the charities and the decedent's children and grandchildren was nearly $12 million.) Thus, the charitable deduction for this estate was to be calculated on the basis of what the charities would receive.[218]

(c) Reformations

To qualify for the charitable deduction for a remainder interest, certain provisions must be included in a charitable remainder trust.[219] These requirements apply with respect to the income, estate, and gift tax charitable deductions. There is a procedure, however, by which these trusts—both those created during lifetime and testamentary trusts—can be adjusted to bring them into compliance with the appropriate tax law requirements, for income tax,[220] estate tax,[221] and gift tax[222] consequences. Federal law permits a charitable deduction for a *qualified reformation* of a trust, when the trust does not meet the requirements of a charitable remainder annuity trust or a charitable remainder unitrust, for purposes of qualifying for the estate tax charitable deduction.[223] The IRS issues rulings from time to time as to the qualified reformation of remainder trusts under these rules;[224] occasionally the agency rules that the reformation is not a qualified one.[225] The qualified reformation procedure requires that the interest be a

---

[215] *Id*. at 783.
[216] *Id*.
[217] *Id*.
[218] The outcome in this case appears to be identical to the position taken by the IRS in Rev. Rul. 89-31, 1989-1 C. B. 277. A court ruled that the amount of an estate's charitable contribution deduction is the amount that actually passed to charity in accordance with a settlement agreement; it is not limited to the amounts that would have been distributed to charity under the will and its codicils. *Estate of Hubert v. Commissioner*, 101 T.C. 314 (1993). The court also held that the charitable deduction must be reduced by the portion of administrative expenses allocated to principal (and not to income) and that the charitable deduction is not to be reduced by any imputed income (though it may be reduced by any appropriate charges to principal). A dissent in the case mused about whether ''a settlement agreement can transform a nonqualifying interest into a qualifying interest,'' but concluded that the best course of action would have been to accept the IRS's concession in the case that the split-interest rules (IRC § 2055(e)) did not bar the estate tax charitable contribution deduction ''and leave that question for another day.'' *Hubert*, 101 T.C. at 339. See § 8.3(b)(iii).
[219] See § 12.7.
[220] IRC § 170(f)(7).
[221] IRC § 2055(e)(3).
[222] IRC § 2522(c)(4).
[223] IRC § 2055(e)(3)(A).
[224] E.g., Priv. Ltr. Rul. 8605003.
[225] E.g., Priv. Ltr. Rul. 9327006.

reformable interest that can be changed (such as by amendment or construction) into a *qualified interest*.[226] Also, for the reformation to be effective:

- Any difference between the actuarial value (determined as of the date of the decedent's death) of the qualified interest and the actuarial value (as so determined) of the reformable interest may not exceed 5 percent of the actuarial value (as so determined) of the reformable interest[227]
- In the case of a charitable remainder interest, the nonremainder interest (before and after the qualified reformation) must terminate at the same time[228]
- In the case of any other interest, the reformable interest and the qualified interest must be for the same period[229]
- The change must be effective as of the date of death of the decedent[230]

A nonremainder interest (before reformation) for a term of years in excess of 20 years is treated as satisfying the second of these requirements if the interest (after reformation) is for a term of 20 years.[231]

In general, a *reformable interest*, for estate tax law purposes, is any interest for which a charitable deduction would be allowable at the time of the decedent's death but for the requirement that the interest be in one of the specified forms.[232] For example, an interest was ruled not to be a reformable interest because the trustees of the trust had the discretion to transfer trust property to a cemetery association, which would be a noncharitable transfer under federal law.[233]

The term *reformable interest* does not include any interest unless, before the remainder vests in possession, all payments to noncharitable persons[234] are expressed either in specified dollar amounts or a fixed percentage of the property.[235] This rule does not apply, however, to any interest if a judicial proceeding is commenced to change the interest into a qualified interest not later than the 90th day after the last date (including extensions) for filing the return (if an estate tax return is required to be filed), or the last date (including extensions) for filing the income tax return for the first tax year for which a return is required to be filed by the trust (if an estate tax return is not required to be filed).[236] Moreover, this rule does not apply in the case of any interest passing under a will executed before January 1, 1979, or under a trust created before that date.[237] There has been considerable litigation in this setting, particularly with respect to application of the estate tax rules.

---

[226] IRC § 2055(e)(3)(B).
[227] IRC § 2055(e)(3)(B)(i).
[228] IRC § 2055(e)(3)(B)(ii)(I).
[229] IRC § 2055(e)(3)(B)(ii)(II).
[230] IRC § 2055(e)(3)(B)(iii).
[231] IRC § 2055(e)(3)(B), last sentence.
[232] IRC § 2055(e)(3)(C)(i). Thus, the rules as to reformable interests also apply in the charitable lead trust (see ch. 16) context. E.g., Priv. Ltr. Rul. 200746010.
[233] Tech. Adv. Mem. 9327006.
[234] That is, entities that are the income interest beneficiaries.
[235] IRC § 2055(e)(3)(C)(ii).
[236] IRC § 2055(e)(3)(C)(iii).
[237] IRC § 2055(e)(3)(C)(iv). See also IRC § 2055(e)(3)(J).

In one case, a court held that the estate tax charitable contribution deduction was not available for a transfer to a charitable organization because the gift flowed through a nonqualifying charitable trust.[238] The decedent left a will that created a trust with three purposes: to support his three sisters, to maintain the graves of his family members, and to provide funds for religious education in certain parishes in a state. Two years after the estate tax return was filed, the estate secured from a state court the authority to establish a charitable foundation. The court later authorized the funding of the foundation with substantial assets from the estate. The estate claimed a charitable deduction for the funds transferred to the foundation; the IRS denied the claim. Five years later, two of the three sisters having died, the state court interpreted the will as establishing three trusts: one for support of the surviving sister, one for grave maintenance, and one for the education of future clergy. The net assets of the trust for the surviving sister were to roll over to the foundation. A federal court ruled that the decedent's will provided for three trusts and that, therefore, a split-interest bequest inconsistent with the tax rules has not been created. An appellate court disagreed, ruling that the estate's claim for a refund on the basis of a charitable deduction must fail because the estate did not satisfy any of the specifically prescribed methods of creating[239] or reforming a split-interest trust. In part, the court was concerned about the amount that might have to be expended for medical care and other support for the surviving sister. Wrote the appellate court: "There is no justification for a judicial divination of an unstated congressional intent to make an exception for the charitable bequest in this case."[240]

The estate in this case relied heavily on an earlier opinion from another court of appeals, in which an estate tax charitable deduction was allowed when a split-interest problem was resolved so that the entire estate could be accurately and permanently separated between charitable and noncharitable beneficiaries.[241] In that case, the government made the same argument as it did in the more recent case. The court distinguished the earlier case from the more recent case, however, on the ground that in the prior case, the "amount payable to the noncharitable beneficiaries was limited, and could be firmly assessed and separated from the charitable bequest."[242] Moreover, in the earlier case, the split interest could have been reformed. For the outcome in the prior case to occur, held the court, the property in which the noncharitable beneficiary had an interest must be capable of being measured and severed from the solely charitable property in the estate. In the more recent case, the court continued, "there is no way to divide the entire estate between the charitable and noncharitable beneficiaries because their interests continue to conflict."[243]

In another case, a court held that a trust met the requirements for reformation, for federal estate tax charitable deduction purposes, including the requirement that the will containing the trust be executed prior to 1979, even though a

---

[238] *Estate of Johnson v. United States*, 941 F.2d 1318 (5th Cir. 1991).
[239] See ch. 12.
[240] *Estate of Johnson v. United States*, 941 F.2d 1318, 1321 (5th Cir. 1991).
[241] *Oetting v. United States*, 712 F.2d 358 (8th Cir. 1983).
[242] *Estate of Johnson v. United States*, 941 F.2d 1318, 1320 (5th Cir. 1991).
[243] *Id.* at 1321.

codicil to the will was executed in 1982.[244] An individual executed her first will in 1971, creating a trust with a charitable remainder for the benefit of a college and an annuity payment to an individual. A 1972 codicil changed a nontrust portion of the will; a 1977 codicil again made some nontrust changes and increased the annuity payment; a 1982 codicil again increased the annuity amount. Each codicil stated that, in all other respects, the provisions of the will were confirmed. After this individual died, the personal representative of the estate caused the trust to be reformed, in that it originally did not meet the statutory requirements, so that the estate could benefit from the estate tax charitable deduction. The IRS subsequently determined that the trust did not meet certain of the reformation requirements, including the rule that the will be executed before 1979,[245] and denied the refund claim for estate taxes paid. The IRS contended that a codicil republishes a will as of the date the codicil is executed, so that the subject will must be deemed to have been executed in 1982—and thus not before 1979, so that the trust was not reformable. The representative of the estate contended that, under applicable state law, the doctrine of republication is not applied when it would defeat a testator's intent. The court accepted the representative's view and strictly construed statutory language stating that the will must be executed before 1979.[246]

In still another case, a court held that a split-interest charitable trust that failed to qualify for the estate tax charitable deduction could not be converted into a qualifying trust under the reformation rules, because there was not a timely judicial proceeding.[247] The trust involved did not qualify as an eligible charitable remainder trust. It was subsequently amended pursuant to state law; the estate contended that this amendment constituted a change in the trust so that it was reformed into a qualified remainder trust, eligible for the estate tax charitable deduction. The IRS, however, asserted that the reformation was not timely,[248] in that the proceeding that led to amendment of the trust took place nearly two years after the deadline. The estate argued that a filing with the state probate court commenced the requisite judicial proceeding (the filing was before the deadline). The filing was technically corrected on a point of law; this prompted the estate to contend that, because the correction was made shortly before the case was submitted, the reformation was timely. But the court rejected that reasoning, observing that it contravened congressional intent, in that it would enable an estate to qualify simply by obtaining a retroactive trust amendment after passage of the reformation rules deadline.[249]

---

[244] *Wells Fargo Bank v. United States*, 91-1 U.S.T.C. ¶ 60,067 (C.D. Cal. 1990).

[245] See text accompanied by *supra* note 237.

[246] In a case applying the effective date rule (see *supra* note 230), an individual executed his will on November 9, 1978, and died on December 31, 1978. The court held that his estate and a split-interest trust were governed by the law in effect on July 17, 1984, so that the reformation provision was not available (thus precluding any estate tax charitable deduction for remainder interests passing to charity). *Estate of Reddert v. United States*, 96-1 U.S.T.C. ¶ 60,230 (D.N.J. 1996). An instance of application of the effective date rule allowing reformation if the will was executed before January 1, 1979, is Tech. Adv. Mem. 8817004, wherein the date of death was after July 17, 1984.

[247] *Estate of Hall v. Commissioner*, 93 T.C. 745 (1989), *aff'd*, 1991 WL 158697 (6th Cir. 1991).

[248] See text accompanied by *supra* note 229.

[249] Also, *Estate of Tamulis v. Commissioner*, 509 F.3d 343 (7th Cir. 2007); *ESB Financial v. United States*, 2008-2 U.S.T.C. ¶ 60,567 (D. Kan. 2008).

By contrast, a court allowed an estate tax deduction for a distribution to a public charity from a trust that was not a qualified split-interest trust and was never reformed.[250] The trust was terminated because of conflicts of interest; various income beneficiaries were paid first, on the basis of life-expectancy calculations. A court upheld the deduction because the family beneficiaries had no interest in the outright distribution of the funds to the charitable organization and the claimed deduction equaled the amount distributed. In light of the ''good faith termination'' of the trust, the court ruled that the charitable deduction was appropriate for this ''direct, indivisible, and fixed'' distribution to the charity.

It has been held that the federal government is not entitled to interest against an estate, when the entirety of the estate's assets passed to a charitable organization following reformation of a testamentary trust.[251] The decedent's will contained a defective split-interest trust. The estate tax return included a claim for a charitable deduction for the value of the remainder interest passing to charity, in anticipation of a successful reformation. Subsequently, the IRS assessed interest, on the premise that no deduction was allowable at the time the estate tax return was filed, until reformation of the trust. The first court to review this matter read overall tax law as meaning that a tax is due as of the time a return must be filed and that interest begins to accumulate as of the return due date. In this case, wrote the court, the estate was not entitled to the charitable deduction at the time the return was due, so the interest obligation began to run. An appellate court disagreed, however, holding that an amendment to a will made pursuant to the reformation procedure is retroactive to the date of the testator's death. It concluded that the legislative history of the provision established that this retroactivity is applicable for all purposes. The court of appeals wrote that, in enacting this provision, ''Congress took the unusual step of allowing a will to be amended after the testator's death for the purpose of eliminating estate taxes that diminished bequests to charity.''[252] This court decided that ''[e]xacting a price from charities in the form of interest on the eliminated tax is inconsistent with congressional intent to benefit charities.''[253]

If, by reason of the death of an individual or by termination or distribution of a trust in accordance with its instrument, a reformable interest goes into a wholly charitable trust or passes to a person for a charitable purpose by the due date for filing the estate tax return (including extensions), an estate tax charitable deduction is allowed for the reformable interest as if it had met the general requirements[254] on the date of the decedent's death.[255]

---

[250] *Estate of Jackson v. United States*, 408 F. Supp. 2d 209 (N.D. W. Va. 2005).
[251] *Oxford Orphanage, Inc. v. United States*, 775 F.2d 570 (4th Cir. 1985).
[252] *Id.* at 575.
[253] *Id.*
[254] IRC § 2055(e)(2).
[255] IRC § 2055(e)(3)(F). In general, this reformation procedure is designed for a trust (or will) that was improperly created (i.e., there was invalid or incorrect documentation) and yet in operation conforms to the charitable remainder trust requirements; the procedure cannot be used to correct an operational failure of a properly created trust. *Estate of Atkinson v. Commissioner*, 115 T.C. 26 (2000), *aff'd*, 2002-2 U.S.T.C. ¶ 60,449 (11th Cir. 2002).

§ 8.8 ASCERTAINABILITY

Another issue that can operate to defeat an estate tax charitable contribution deduction is the rule that the value of a charitable interest must be ascertainable as of the death of the decedent, so that it is severable from the noncharitable interest. This rule is often at issue when there is vague language in the will and/or a substantial amount of discretion is vested in the trustee. The Supreme Court held that the standard must be "fixed in fact and capable of being stated in definite terms of money."[256] More recently, a federal court of appeals wrote that the case law on the point "indicate[s] that the test has not been construed to require mathematical certainty such that the dollar amount which the charitable remainderman would receive could be accurately calculated" as of the date of death.[257]

In one instance, a federal court of appeals upheld an IRS determination that claimed federal estate tax charitable contribution deductions were not allowable because the personal representatives of the estate had unfettered discretion to divert the amount stated for the charities to noncharitable beneficiaries.[258] The representatives were empowered by the will to make posthumous gifts to various individuals who had contributed to the decedent's well-being or were otherwise helpful to him. As is typical in these instances, the amount provided for the charitable organizations was the residue of the estate. As noted, the law requires that the amount destined for charity must be presently ascertainable at the time of death; what actually happens to the money and/or property thereafter is irrelevant.[259]

The will involved in this case gave the personal representatives "sole and complete" discretion to make these gifts. The court lamented the absence of any fixed standard to be applied to this discretion. It noted that there was no limit as to the number of persons who might be so compensated; the decedent lived 60 years and the court observed that many persons had probably been "helpful" to him during his lifetime. The court did not know how to set limits on the meaning of words such as "well-being" and "helpful." Other unanswered questions plagued the court, such as the size of the various contributions and the period of time over which they were to be made. Wrote the court: "These elements are uncertain and cannot be measured with any precision, and therefore they make the amount going to charity unascertainable at the time of death."[260] This vagueness in the language of the will forced the court to rule that the charitable deduction was not available.

This opinion, and others like it, do not stand for the proposition that any amount of discretion or lack of certainty will always doom an estate tax charitable contribution deduction. If a standard is fixed and can be stated in definite terms of money, and if there is a reasonable likelihood that money and/or property will

---

The IRS ruled that a split-interest trust did not qualify under IRC § 2055(e)(2), because the income interest beneficiary invaded the trust. The agency thus denied the estate tax charitable contribution deduction. Nonetheless, a court ruled that the charitable deduction was available under IRC § 2055(e)(3)(F), because the income beneficiary died before the estate filed its estate tax return. *Harbison v. United States*, 2000-2 U.S.T.C. 60,389 (N.D. Ga. 2000). The court, however, reversed itself and held that IRC § 2055(e)(3)(F) was inapplicable, in that the income interest beneficiary was permitted by the will to invade the corpus of the trust and exercised that right. *Harbison v. United States*, 2001-1 U.S.T.C. ¶ 60,398 (N.D. Ga. 2001).

[256] *Ithaca Trust Co. v. United States*, 297 U.S. 151, 154 (1929).

[257] *Wells Fargo Bank v. United States*, 1 F.3d 830 (9th Cir. 1993).

[258] *Estate of Marine v. Commissioner*, 990 F.2d 136 (4th Cir. 1993).

[259] See, e.g., *Henslee v. Union Planters Nat'l Bank & Trust Co.*, 335 U.S. 595 (1949).

[260] *Estate of Marine v. Commissioner*, 990 F.2d 136, 139 (4th Cir. 1993).

in fact be transferred for charitable purposes, the deduction will not be defeated. As the Supreme Court stated years ago, on that point, there is ''no uncertainty appreciably greater than the general uncertainty that attends human affairs.''[261]

What often happens in this area is that the will enables the personal representative to invade the principal of the estate (the amount that is, on the face of the will, going to charity) for the comfort, support, maintenance, and/or happiness of the surviving spouse. On one occasion, the Supreme Court held that the discretion accorded a personal representative to determine elements such as ''happiness'' defeated the charitable deduction.[262] By contrast, an appellate court in prior (and somewhat similar) cases, found ascertainability. In one case, the representative's discretion was limited to the needs and prior lifestyles of the beneficiaries. The court wrote that the ''possibility that the charitable bequests would fail or be diminished was so remote as to be nil.''[263] In another instance, the court found that the representative's power to pay principal to a beneficiary was limited by an ascertainable standard and ''hence there is no argument that the deductibility of the charitable remainder is destroyed by the power of invasion.''[264]

In a subsequent case, the decedent's will provided for a charitable remainder in a reformed[265] charitable remainder trust. The will also provided, however, for money for an individual, for improvements on the decedent's house as long as this individual lived there, and for payment of this individual's hospital, medical, dental, and income tax obligations. The government contended that the provisions for improvements to the home and for the individual's personal income taxes failed the ascertainability test. The trial court, however, concluded that any expenses with respect to the residence could be satisfied out of an income interest. The fact that the trust could pay for the income interest beneficiary's unusual and exceptional expenses was neutralized by the facts of his age (87), independent sources of income, and insurance coverage.[266] On appeal, the appellate court agreed, sifting through the precedents to find ascertainability in ''comfort'' but not ''happiness,'' and an adequate standard in ''accident, illness, or other unusual circumstances'' but not in ''pleasure.''[267] It found that ''improvements'' to the house and the payment of income taxes were closely akin to ''comfort'' and allowed the charitable contribution deduction.[268]

Thus, when a trustee has considerable discretionary authority as to the making of charitable contributions from the assets of an estate, the estate tax charitable contribution deduction will not be available.[269] When the amount of the

---

[261] *Ithaca Trust Co. v. United States*, 297 U.S. 151, 154 (1929).
[262] *Merchants Bank v. Commissioner*, 320 U.S. 256 (1943).
[263] *Commissioner v. Estate of Robertson*, 141 F.2d 855, 858 (4th Cir. 1944).
[264] *Greer v. United States*, 448 F.2d 937, 944 (4th Cir. 1971).
[265] See § 8.7(b).
[266] *Wells Fargo Bank v. United States*, 91-1 U.S.T.C. ¶ 60,067 (C.D. Cal. 1990).
[267] *Wells Fargo Bank v. United States*, 1 F.3d 830, 835 (9th Cir. 1993).
[268] The majority in this opinion wryly observed that the amount of the individual's annual income taxes has nothing to do with ''such untrammeled standards'' as his ''happiness'' or ''pleasure.'' *Id.* at 836. The dissenter wrote: ''While I am not absolutely immune from the pull of a sympathetic case, I have no power under tax laws to reform this ill-drafted will.'' *Id.* at 837. The lines drawn in this area amount to fine distinctions indeed.
[269] E.g., *First Trust Co. of St. Paul State Bank v. Reynolds*, 137 F.2d 518 (8th Cir. 1943); *Harbison v. United States*, 2001-1 U.S.T.C. ¶ 60,398 (N.D. Ga. 2001); *Delbridge v. United States*, 89 F. Supp. 845 (E.D. Mich. 1950); *Estate of Lockett v. Commissioner*, 75 T.C.M. (CCH) 1731 (1998).

bequest is not uncertain and the bequest has a ''legal reality'' in the will, however, the estate tax charitable contribution deduction will be allowed.[270] By contrast, when a charitable remainder interest in a residuary trust created under a decedent's will was deemed by the IRS not to be presently ascertainable, due to the lack of specificity of charitable beneficiaries, the interest was found to be ineligible for the estate tax charitable deduction.[271]

[270] Priv. Ltr. Rul. 9322025.
[271] Priv. Ltr. Rul. 9531003.

CHAPTER NINE

Special Gift Situations

§ 9.1 Works of Art **280**
- (a) Gifts of Art in General 280
- (b) Gifts of Fractional Interests 283
- (c) Loans 283

§ 9.2 Gems **284**

§ 9.3 Inventory **285**
- (a) Basic Rules 285
- (b) Restrictions on Use 286
- (c) Restrictions on Transfer of Contributed Property 289
- (d) Requirements of Written Statement 290
- (e) Compliance with Food, Drug, and Cosmetic Act 291
- (f) Amount of Reduction 291
- (g) Recapture Excluded 292
- (h) Special Rule for Food Inventory 293
- (i) Special Rule for Book Inventory 293

§ 9.4 Scientific Research Property **294**

§ 9.5 Computer Technology or Equipment **295**

§ 9.6 License to Use Patent **297**
- (a) Factual Situations 297
- (b) Law and Analysis 297

§ 9.7 Conservation Property **298**
- (a) Qualified Real Property Interests 299
- (b) Qualified Organizations 300
- (c) Conservation Purpose 301
- (d) Exclusivity Requirement 304
- (e) Valuation 306
- (f) Substantiation 307
- (g) Relationship to Rehabilitation Tax Credit 307
- (h) Donative Intent 309
- (i) Special Rules for Capital Gain Real Property 310
- (j) Special Rules for Farmers and Ranchers 311

§ 9.8 S Corporation Stock **312**
- (a) Background and Introduction 312
- (b) Gifts from Donor's Perspective 313
- (c) Gifts from Donee's Perspective 313
- (d) Conclusion 320

§ 9.9 Section 306 Stock **320**

§ 9.10 Retirement Plan Accounts **321**
- (a) Income in Respect of Decedent 321
- (b) Charitable Contribution Planning 322
- (c) Potential Problems and Solutions 323
- (d) Individual Retirement Arrangement in General 326
- (e) Temporary Statutory Rule 327

§ 9.11 Commodity Futures Contracts **329**

§ 9.12 Donors' Creations **331**

§ 9.13 Charity Auctions **332**
- (a) Charity Auctions as Businesses 332
- (b) Charitable Contribution Deductions—Donors of Items to Be Auctioned 333

(c) Charitable Contribution Deductions—Acquisition of Items at Auction 334
(d) Substantiation Rules 336
(e) Quid Pro Quo Contribution Rules 337
(f) Sales Tax Rules 337
(g) Reporting Rules 338

§ 9.14 Services 338

§ 9.15 Unreimbursed Expenses 339
(a) Exempt Functions 340
(b) Inherent Nature of Services 341
(c) Substance of Services 341
(d) Duration of Services 342
(e) Excessive Expenditures 342
(f) Element of Pleasure 343

§ 9.16 Limitation on Deduction for Expenses Due to Pleasure 343
(a) Substance of Services 343
(b) Duration of Services 344
(c) Element of Pleasure 345

§ 9.17 Automobile Expenses 346

§ 9.18 Use of Property 347

§ 9.19 Bargain Sales 347
(a) Definition of *Bargain Sale* 347
(b) Allocation of Basis 348
(c) Interplay with Deduction Reduction Rule 350
(d) Interplay with Carryover Rules 350

§ 9.20 Property Subject to Debt 351

§ 9.21 Future Interests in Tangible Personal Property 354

§ 9.22 Contributions by Trusts 357
(a) General Rules 357
(b) Gifts of Interests in Properties 358
(c) Guaranteed Annuity Interests 359
(d) Unitrust Interests 360
(e) Valuation 361
(f) Recapture 362
(g) Denial of Deduction for Certain Contributions 362

§ 9.23 Partial Interests 363

§ 9.24 Taxidermy 365

§ 9.25 Clothing and Household Items 366

§ 9.26 Charitable Family Limited Partnerships 366

§ 9.27 Motor and Other Vehicles 368
(a) Background 368
(b) Statutory Regime 369
(c) Regulatory Gloss 372
(d) Other Issues 373

§ 9.28 Intellectual Property 374
(a) Background 374
(b) Statutory Regime 376
(c) Notification Requirement 377

§ 9.29 Foreign Tax Credit 378

§ 9.30 Subsistence Whaling Expenses 378

§ 9.31 Public Policy Considerations 379

§ 9.1 WORKS OF ART

Contributions of works of art may, of course, be made to charitable organizations. Works of art may also be loaned to these organizations.

(a) Gifts of Art in General

In general, the federal income tax charitable contribution deduction for a gift of a work of art is an amount equal to the fair market value of the property. There are, however, exceptions to this general rule:

1. The charitable deduction for any one year may be limited by one of the percentage limitations.[1]
2. The work of art that is contributed may be the creation of the donor, in which case the deduction is confined to the donor's basis in the property.[2]
3. The work of art may be put to an unrelated use by the charitable recipient, in which case the deduction is confined to the donor's basis in the property.[3]
4. The work of art constitutes taxidermy property.[4]

Of these elements, the third situation is the most likely to occur. A work of art, being an item of tangible personal property, is subject to a special rule: When a gift of tangible personal property is made to a charitable organization and the donee's use is unrelated to its tax-exempt purposes, the amount of the charitable deduction that would otherwise be determined must be reduced by the amount of gain that would have been long-term capital gain if the property contributed had been sold by the donor at its fair market value, determined at the time of the contribution.[5]

The greatest controversy surrounding the charitable deduction of a work of art is likely to be the value of the item. Not infrequently, there is a dispute between the IRS and a donor as to the fair market value of a work of art. Usually, these disputes are settled; sometimes they are resolved by a court. The appropriate value of an item of property is a question of fact, not law; thus, the testimony of one or more expert witnesses can be significant. A trial court's valuation of an item of property will be set aside on appeal only if the finding of value is clearly erroneous.[6]

Examples of the court opinions concerning valuation of works of art for charitable deduction purposes include:

- A promoter designed a plan to dispose of excess inventories of reprint books (republication of books in the public domain). Having located public libraries interested in receiving the books, the promoter solicited individuals to invest in the plan. Persons executed documents evidencing the purchase of the books at a cost equal to one-third of the catalog list price, waited out the capital gain holding period, then executed additional documents evidencing the gift of the books to the libraries. The charitable deduction was claimed to be an amount equal to the full publishers' list prices. The government argued that the transactions were shams, in that the donors neither really owned nor contributed the books, which remained in warehouses. Nonetheless, the court gave substantive effect to the documentation (including "bills of sale" and "warehouse receipts") and the role of the promoter as the investors' "agent," holding that title to the books and risk of loss passed to them. Having given economic effect to the transaction, the court then disemboweled the plan on the basis of

---

[1] See ch. 7.
[2] IRC §§ 170(e)(1) and 1221. See § 9.12.
[3] See § 4.6. A former limitation on the actual charitable contribution deduction was application of the alternative minimum tax; this is, however, no longer the case (see § 2.18).
[4] See § 9.24, text accompanied by *infra* note 645.
[5] IRC § 170(e)(1)(B)(i); Reg. § 1.170A-4(b)(2)(ii).
[6] E.g., *Anselmo v. Commissioner*, 757 F.2d 1208 (11th Cir. 1985).

valuation. In determining the fair market value of the books, the court said that the retail market must be used. Focusing on the immense number of books involved and the weak market for scholarly reprints, the court found the market price for them to have been substantially depressed. The court concluded that the fair market value of the books was 20 percent of the catalog retail list prices for the books, and allowed a charitable deduction for that amount only. (As noted, the donors purchased the books for one-third of the list price.)[7]

- Individuals purchased a substantial number of unframed lithographs, held them for the long-term capital gain treatment period, then donated them to charitable organizations. The court valued the lithographs on the basis of the market in which the donors purchased them, not ''on the prices paid in only a few sales.''[8]
- An individual was denied an income tax charitable deduction in excess of the amount allowed by the IRS for artwork and copyrights contributed to a museum. The court essentially rejected the opinions of the expert witnesses on both sides of the case.[9]
- An individual purchased a substantial number of Indian artifacts and etchings, held them for the requisite capital gain holding period, and then donated most of them to a museum. The court found that the donated items were grossly overvalued and that there was a pattern of abuse designed to achieve excessive valuations of the items. The value asserted by the IRS was found to be the appropriate value.[10]
- Individuals contributed African art objects to a charitable organization. The court substantially reduced the value of the items in relation to the amount claimed by the donors, finding that most of the artwork was not ''traditional'' African art but ''tourist'' or ''airport'' art.[11]
- Individuals contributed art objects to a museum and claimed charitable contribution deductions based on appraisals. The IRS contested the claimed charitable deduction. The court upheld the donor's value in full.[12]
- An individual contributed a statue to a state. The donor claimed a value of $800,000. The IRS asserted that the value was $50,000. The court found the value to be $600,000, concluding that the donor's expert witness was more persuasive than the witness provided by the government.[13]
- A court found that charitable contribution deductions claimed for gifts of artwork to colleges were deliberately inflated and were tax-motivated transactions.[14]

[7] *Skripak v. Commissioner*, 84 T.C. 285 (1985).
[8] *Lio v. Commissioner*, 85 T.C. 56, 71 (1985), *aff'd sub. nom. Orth v. Commissioner*, 813 F.2d 837 (7th Cir. 1987).
[9] *Harken v. Commissioner*, 50 T.C.M. (CCH) 994 (1985).
[10] *Johnson v. Commissioner*, 85 T.C. 469 (1985).
[11] *Neely v. Commissioner*, 85 T.C. 934 (1985).
[12] *Biagiotti v. Commissioner*, 52 T.C.M. (CCH) 588 (1986).
[13] *Koftinow v. Commissioner*, 52 T.C. 261 (1986).
[14] *Angell v. Commissioner*, 52 T.C.M. (CCH) 939 (1986).

- A court denied charitable deductions claimed for gifts of paintings and sculptures to museums because of valuation overstatements. The court based its valuations on expert testimony.[15]
- Two donors contributed lithographs to a charitable organization. They claimed that each lithograph had a value of $300. The IRS contested this valuation. The court found that each lithograph had a value of $100.[16] On appeal, the court wrote: ''This was an interesting tax-saving arrangement devised as an art transaction, but the art will have to be treasured for art's sake and not as a tax deduction.''[17]
- Individuals made a gift of posters to a charitable organization. They asserted a value of $5 per poster; the court allowed a deduction on the basis of 73 cents per poster—the amount originally determined by the IRS.[18]
- Individuals contributed works of art to a charitable organization. The value selected by the court for nine of these items was about halfway between the donor's values and the government's values.[19]

Gifts of art are likely to be subject to the appraisal requirements.[20] Penalties apply to the overvaluation of property for tax purposes[21] and these penalties are frequently applied in the context of a gift of artwork.

(b) Gifts of Fractional Interests

In general, a donor is entitled to a charitable contribution deduction for a gift of a fractional interest in an item of art (tangible personal property), provided the donor satisfies the basic requirements for deductibility,[22] and in subsequent years makes additional charitable contributions of interests in the same property.[23] In the instances of contributions, bequests, and gifts made after August 17, 2006, however, special statutory rules apply.[24]

(c) Loans

Rather than contribute a work of art or an interest in an item of art to a charitable organization, a person may decide to loan the artwork to a charity.[25] This type of transfer does not give rise to a federal income tax charitable contribution

[15] *Frates v. Commissioner*, 53 T.C.M. (CCH) 96 (1987).
[16] *Orth v. Commissioner*, 813 F.2d 837 (7th Cir. 1987).
[17] *Id*. at 843.
[18] *Ferrell v. Commissioner*, 53 T.C.M. (CCH) 209 (1987).
[19] *Winokur v. Commissioner*, 90 T.C. 733 (1988).
[20] See § 21.5.
[21] See § 10.14.
[22] E.g., the requirements concerning contributions of partial interests in property (see § 9.23) and future interests in property (see § 9.21), and the percentage limitations (see ch. 7).
[23] E.g., *Winokur v. Commissioner*, 90 T.C. 733 (1988).
[24] See § 15.3(b). In general, Polisher & Peeler, ''A Collector's Guide to Art, Taxes and Charitable Deductions,'' 136 *Trusts & Estates* (no. 10) 26 (Sep. 1997); Levine, ''The Complete Picture on Donations of Art,'' 4 *J. Tax. Exempt Orgs*. (no. 1) 23 (April 1992).
[25] E.g., Priv. Ltr. Rul. 200223013.

deduction. The transaction is nonetheless a gift. The transaction is disregarded as a transfer for gift tax purposes, however, when:

- the recipient organization is a charitable entity,[26]
- the use of the artwork by the charitable donee is related to the purpose or function constituting the basis for its tax exemption, and
- the artwork involved is an archaeological, historic, or creative item of tangible personal property.[27]

§ 9.2 GEMS

Contributions of gems may be made to a charitable organization. Essentially, the law concerning the deductibility of gifts of works of art is applicable in this context.[28] The specter of tax shelter abuse lurks about these gifts, however, because of the various deduction promotion schemes that have unfolded in this area in recent years. Once again, the principal issue in this setting is the value of the items transferred.

What follows are some examples of court opinions concerning the valuation of gems for charitable deduction purposes.

- A court considered a gift of gems to a museum, with the claimed charitable deduction based on a value of $80,680. Finding essentially for the government, the court concluded that the date-of-gift value of the gems was $16,800. The court, which delved deeply into the practices of the jewelry trade, rejected the view that the gems should be valued by reference to the prices charged by jewelry stores for individual items of jewelry and held that the value should be based on the price that would have been paid by a jewelry store to a wholesaler, with the sales of the gems individually rather than in bulk. Despite the emphasis in the opinion on valuation, the court was influenced by the tax results attempted by the donor in this case. The donor held the gems just long enough to satisfy the long-term capital gain holding period requirements, claimed a charitable deduction that was nearly five times the amount paid for the gift property, and purchased the gems after becoming motivated by tax shelter promotional material.[29]
- Two donors purchased gemstones over a three-year period and contributed them to a museum approximately one year after the last of the purchases. A court found that the fair market value of the gems was the cost of them to the donors.[30]
- A charitable deduction was claimed for gifts of gemstones and similar items to a museum; a court found the transfers to be tax-motivated and found the value of the items to be equal to the acquisition cost.[31]

---

[26] That is, an organization described in IRC § 501(c)(3).
[27] IRC § 2503(g).
[28] See § 9.1.
[29] *Anselmo v. Commissioner*, 757 F.2d 1208 (11th Cir. 1985).
[30] *Chiu v. Commissioner*, 84 T.C. 716 (1985).
[31] *Dubin v. Commissioner*, 52 T.C.M. (CCH) 456 (1985).

- A donor contributed opals to a museum. A court confined the deduction amount to the donor's cost, finding no evidence that there was any increase in value in the jewels since the time of their purchase.[32]
- Two donors contributed an opal to a university. They claimed a value of $70,000. The IRS contested this valuation. The court concluded that the opal had a value of $50,000, largely because the jewel was part of a set, so that the separate gift diminished its value.[33]

Gifts of gems may be subject to the appraisal requirements.[34] Penalties apply to the overvaluation of property for tax purposes.[35] These penalties are frequently applied in the context of gifts of gems.

§ 9.3 INVENTORY

Special federal tax rules govern charitable contributions of items of inventory of a corporation. The term *inventory* means property that is stock in trade of a business enterprise, held for sale to customers. When the property is sold, the resulting income is ordinary income.[36]

In general, the amount of the charitable deduction for contributions of property is measured by using the fair market value of the property.[37] When a corporation makes a charitable contribution of property out of its inventory, however, the gift deduction is generally confined to an amount that may not exceed the donor's cost basis in the property.[38] That is, the amount that might otherwise be deductible must be reduced by the amount of ordinary income that would have resulted had the items been sold.

Nevertheless, a special rule provides an augmented deduction under certain circumstances, pursuant to which the charitable deduction for contributions of inventory may be an amount equal to as much as twice the cost basis in the property.[39] These gifts of inventory are known as *qualified contributions*.[40]

(a) Basic Rules

The charitable contribution deduction for a gift of inventory generally must be reduced by an amount equal to one-half of the amount of gain that would not have been long-term capital gain if the property had been sold by the donor at fair market value at the date of the contribution.[41] If, after this reduction, the amount of the deduction would be more than twice the basis in the contributed

[32] *Schachter v. Commissioner*, 51 T.C.M. (CCH) 1428 (1986).
[33] *Rhoades v. Commissioner*, 55 T.C.M. (CCH) 1159 (1988).
[34] See § 21.5.
[35] See § 10.14.
[36] The term *inventory* is discussed in § 2.13.
[37] IRC § 170(e). See § 4.3.
[38] IRC § 170(e)(1)(A).
[39] IRC § 170(e)(3); Reg. § 1.170A-4A(a).
[40] IRC § 170(e)(3)(A).
[41] Reg. § 1.170A-4A(a). In the only case in point, a court held that four-day-old bread donated under these rules could be valued at full retail value, rather than utilizing the 50 percent price discount used in the industry for bread removed from the shelves after three days. *Lucky Stores v. Commissioner*, 105 T.C. 420 (1995).

property, the amount of the deduction must be further reduced to an amount equal to twice the cost basis in the property.[42]

This augmented deduction is available under the following circumstances:

1. The gift is of property that is
   - Stock in trade of the taxpayer or other property of a kind that would properly be included in the taxpayer's inventory if on hand at the close of the tax year,[43]
   - Property held by the taxpayer primarily for sale to customers in the ordinary course of the trade or business,[44]
   - Property, used in a trade or business, of a character that is subject to the allowance for depreciation,[45] or
   - Real property used in a trade or business.[46]
2. The donor is a C corporation.[47]
3. The donee is a charitable organization.[48]
4. The donee is not a private foundation.[49]
5. The donee's use of the property is related to the donee's tax-exempt purposes.[50]
6. The property ''is to be used by the donee solely for the care of the ill, the needy, or infants.''
7. The property is not transferred by the donee in exchange for money, other property, or services.
8. The donor receives from the donee a written statement representing that its use and disposition of the property will be in accordance with these rules.
9. The property is in compliance with all applicable requirements of the Federal Food, Drug, and Cosmetic Act.

A contribution of property, to be deductible pursuant to these rules, must be a qualified contribution. A *qualified contribution* is one that satisfies the foregoing nine requirements.[51]

(b) Restrictions on Use

For a contribution to qualify under these rules, the contributed property must be subject to certain restrictions on use. If the transferred property is used or transferred by the donee organization (or by any subsequent transferee that furnished

[42] Reg. § 1.170A-4A(a).
[43] IRC § 1221(1).
[44] *Id.*
[45] IRC § 1221(2).
[46] *Id.*
[47] That is, a corporation described in IRC § 1361(a)(2). Thus, in general (see § 9.3(h)), the donor may not be an S corporation (an entity described in IRC § 1361(a)(1)).
[48] That is, an organization described in IRC § 501(c)(3).
[49] See § 3.5. The donee, however, can be a private operating foundation.
[50] See § 3.5.
[51] Reg. § 1.170A-4A(b)(1).

to the donee the requisite written statement[52]) in a manner inconsistent with the requirements of these rules, the donor's deduction is only the amount allowable with regard to gifts of inventory in general.[53] As noted, this general deduction is confined to the donor's cost basis.

If the donor is, however, able to establish that, at the time of the contribution, the donor reasonably anticipated that the property would be used in a manner consistent with these requirements, then the donor's deduction will nonetheless be computed using these special rules.[54]

Exempt Purpose Use. Under these rules, the use of the property must be related to the purpose or function constituting the ground for tax exemption as a charitable entity of the organization to which the contribution is made.[55] The gift property may not be used in connection with any activity that gives rise to unrelated business income.[56]

Ultimate Beneficiaries. The gift properties must be used for the care of the ill, needy, or infants. The property itself must ultimately either be transferred to (or for the use of) the ill, needy, or infants for their care or be retained for their care. No other individual may use the contributed property except as incidental to primary use in the care of the ill, needy, or infants. The donee organization may satisfy these requirements by transferring the property to a relative, custodian, parent, or guardian of the ill or needy individual or infant, or to any other individual if it makes a reasonable effort to ascertain that the property will ultimately be used primarily for the care of the ill or needy individual, or infant, and not for the primary benefit of any other person.[57]

The donee organization may transfer the gift properties to other qualified tax-exempt public charitable organizations, within or outside the United States. For these rules to be satisfied, however, the transferring organization must obtain a written statement from the transferee organization.[58] If the property is ultimately transferred to, or used for the benefit of, ill or needy persons, or infants, who are outside the United States, the organization that transfers the property outside the United States must be a corporation. For these purposes, if the donee organization charges for its transfer of contributed property (other than an allowable fee),[59] the requirements of these rules are not met.[60]

In one instance, a pharmaceutical company created a private operating foundation to distribute medicines and medical supplies in conformity with these rules. One of the ways the medicines or supplies were distributed was through a voucher system: the eligible recipients of these items took the vouchers to a commercial pharmacy or other dispensing agent and received the items at no charge. The pharmacy or other agent thereafter returned the vouchers to the company to receive, without charge, replacement items for the agent's inventory. Because this

---

[52] See text accompanied by *infra* note 74.
[53] Reg. § 1.170A-4A(b)(2).
[54] *Id*.
[55] Reg. § 1.170A-4A(b)(2)(i).
[56] *Id*. The unrelated business income rules are summarized at § 3.5.
[57] Reg. § 1.170A-4A(b)(2)(ii)(A).
[58] This written statement must conform to the requirements described in *infra* notes 72–74.
[59] See text accompanied by *infra* notes 69 and 70.
[60] Reg. § 1.170A-4A(b)(2)(ii)(A).

system was intended to facilitate distribution of the products, and because the substance of the transaction was distribution of the products by the foundation, the IRS ruled that use of this voucher system would not violate these rules.[61]

The term *ill person* is defined for these purposes as follows:

> An ill person is a person who requires medical care . . . [[62]] Examples of ill persons include a person suffering from physical injury, a person with a significant impairment of a bodily organ, a person with an existing handicap, whether from birth or later injury, a person suffering from malnutrition, a person with a disease, sickness, or infection which significantly impairs physical health, a person partially or totally incapable of self-care (including incapacity due to old age). A person suffering from mental illness is included [in this definition] if the person is hospitalized or institutionalized for the mental disorder, or, although the person is nonhospitalized or noninstitutionalized, if the person's mental illness constitutes a significant health impairment.[63]

The term *care of the ill* means ''alleviation or cure of an existing illness and includes care of the physical, mental, or emotional needs of the ill.''[64]

The term *needy* is defined for these purposes as follows:

> A needy person is a person who lacks the necessities of life, involving physical, mental, or emotional well-being, as a result of poverty or temporary distress. Examples of needy persons include a person who is financially impoverished as a result of low income and lack of financial resources, a person who temporarily lacks food or shelter (and the means to provide for it), a person who is the victim of a natural disaster (such as fire or flood), a person who is the victim of a civil disaster (such as a civil disturbance), a person who is temporarily not self-sufficient as a result of a sudden and severe personal or family crisis (such as a person who is the victim of a crime of violence or who has been physically abused), a person who is a refugee or immigrant and who is experiencing language, cultural, or financial difficulties, a minor child who is not self-sufficient and who is not cared for by a parent or guardian, and a person who is not self-sufficient as a result of previous institutionalization (such as a former prisoner or a former patient in a mental institution).[65]

The phrase *care of the needy* is defined as follows:

> Care of the needy means alleviation or satisfaction of an existing need. Since a person may be needy in some respects and not needy in other respects, care of the needy must relate to the particular need which causes the person to be needy. For example, a person whose temporary need arises from a natural disaster may need temporary shelter and food but not recreational facilities.[66]

These rules define an *infant* as ''a minor child'' (as determined under the laws of the jurisdiction in which the child resides).[67] The phrase *care of an infant* means ''performance of parental functions and provision for the physical, mental, and emotional needs of the infant.''[68]

---

[61] Priv. Ltr. Rul. 9321057.

[62] This term is, in turn, defined in Reg. § 1.213-1(e).

[63] Reg. § 1.170A-4A(b)(2)(ii)(B).

[64] Reg. § 1.170A-4A(b)(2)(ii)(C).

[65] Reg. § 1.170A-4A(b)(2)(ii)(D).

[66] Reg. § 1.170A-4A(b)(2)(ii)(E). The IRS determined that gifts of books to prisoners in state correctional facilities did not qualify under these rules; general prison population statistics as to those who are disabled and lacking a high school education were deemed insufficient to support this augmented deduction. Tech. Adv. Mem. 9631005.

[67] Reg. § 1.170A-4A(b)(2)(ii)(F).

[68] Reg. § 1.170A-4A(b)(2)(ii)(G). The IRS determined that gifts of calendars and books by the manufacturer of them did not qualify for this augmented deduction, inasmuch as the manufacturer failed to show that the contributed property was transferred to or used for the care of the ill, needy, or infants. Tech. Adv. Mem. 200003005.

(c) Restrictions on Transfer of Contributed Property

In general, a contribution will not satisfy these rules if the donee organization or any transferee of it requires or receives any money, property, or services for the transfer or use of the property contributed. For example, if an organization provides temporary shelter for a fee, and also provides free meals to ill or needy individuals, or infants, using food contributed under these rules, the determination of the deduction for the contribution of food is subject to these rules. The fee charged by the organization for the shelter may not, however, be increased merely because meals are served to the ill or needy individuals or infants.[69]

A contribution may qualify under these rules if the donee organization charges a fee to another organization in connection with its transfer of the donated property, if (1) the fee is "small or nominal in relation to the value of the transferred property and is not determined by this value," and (2) the fee is "designed to reimburse the donee organization for its administrative, warehousing, or similar costs."[70]

An example of the application of these rules follows:

EXAMPLE 9.1

A pharmaceutical company (not an S corporation) had a basis in certain products (inventory) of $1 per item. The products are normally sold for $10 each. The company donated the products to charity for qualified purposes shortly before their expiration date; because of the imminence of the expiration date, the products were valued at $5 at the time of the gift. The corporation claimed a charitable deduction of $10 per item. Following an audit, however, the IRS said that the proper deduction was $2 per item. This conclusion was reached as follows.

First, the amount of the potential deduction had to be reduced by one-half of the amount of gain that would not have been long-term capital gain if the property had been sold by the donor at its fair market value on the date of the contribution. If the amount of the charitable contribution that remains after this reduction exceeds twice the basis of the contributed property, the amount of the charitable contribution must be reduced a second time to an amount that is equal to twice the amount of the basis of the property.

Under these rules, if the company had sold the property at its fair market value on the date of its contribution, the company's amount of gain would have been $4 per item. This gain would have been ordinary income, rather than long-term capital gain. Thus, the company was required to reduce the fair market value of its contribution ($5 per item) by one-half of the gain ($4 per item ÷ $2 per item), leaving an amount of $3 per item. Because the amount of the charitable deduction that remained after the first reduction (that is, $3 per item) is in excess of twice the basis of the contributed property, a second reduction must occur in the amount of $1 per item, resulting in a charitable contribution deduction of $2 (twice the basis) per item.[a]

[a] Rev. Rul. 85-8, 1985-1 C.B. 59. The IRS had some difficulties with this rule. A substantially similar ruling was published in 1983 (Rev. Rul. 83-29, 1983-1 C.B. 65), but the formula was incorrectly applied. The IRS tried to correct this mistake later in the year (Ann. 83-128, 1983-32 I.R.B. 30), but again misapplied the formula. The 1983 ruling as permanently published correctly applied the formula. Nonetheless, the IRS clarified it in the 1985 ruling by stating that "[n]o inference should be drawn [from this ruling] as to the fair market value of any products donated by any corporation shortly before the expiration date of the products" and that the "fair market value of the products donated will depend on the facts and circumstances surrounding those particular products at that particular time." (Rev. Rul. 85-8, 1985-1 C.B. 59, at 60). For more on this point, see the discussion in *Lucky Stores v. Commissioner*, 105 T.C. 420 (1995).

[69] Reg. § 1.170A-4A(b)(3)(i).
[70] Reg. § 1.170A-4A(b)(3)(ii).

Here is an example of this rule as it concerns fees:

EXAMPLE 9.2

X is a food bank, organized and operated as a tax-exempt charitable organization. X receives surplus food from donors out of their inventory and distributes the food to other charities, which in turn give the food to needy persons. X charges a small fee to cover administrative, warehousing, and similar costs. X permissibly charges this fee on the basis of the total number of pounds of food distributed to the transferee charities. X may not, however, charge a fee on the basis of the value of the food distributed.[a]

[a] Rev. Rul. 85-8, 1985-1 C.B. 59.

This special rule does not apply to a transfer of donated property directly from an organization to ill or needy individuals, or infants.[71]

(d) Requirements of Written Statement

Statement to Donor. Under these rules, the donee organization must furnish each donor with a written statement that

- describes the contributed property, stating the date of its receipt,
- represents that the property will be used in compliance with this body of law,[72]
- represents that the donee organization is a charitable organization and is not a private foundation,[73] and
- represents that adequate books and records will be maintained and made available to the IRS upon request.[74]

This written statement must be furnished within a ''reasonable period'' after the contribution. In any event, it must be furnished no later than the date (including extensions) by which the donor is required to file its federal corporate income tax return for the year of the contribution. The required books and records need not trace the receipt and disposition of specific items of donated property if they disclose compliance with the requirements by reference to ''aggregate quantities'' of donated property. The books and records are ''adequate'' if they reflect ''total amounts received and distributed'' (or used), and outline the procedure used for determining that the ultimate recipient of the property is an ill or needy individual, or infant. These books and records need not, however, reflect the names of the ultimate individual recipients or the property distributed to (or used by) each one.[75]

---

[71] *Id*.
[72] The IRS expects this written statement to specifically provide as follows: ''The property will be used in compliance with section 170(e)(3) of the Internal Revenue Code and paragraphs (b)(2) and (3) of Regulation § 1.170A-4A.''
[73] As noted, however (see *supra* note 49), the donee may be a private operating foundation.
[74] Reg. § 1.170A-4A(b)(4)(i).
[75] Reg. § 1.170A-4A(b)(4)(i). A charitable contribution deduction under these rules was denied to a corporation in part because it did not timely obtain the requisite written statement from the charitable donee. Tech. Adv. Mem. 20003005.

Statements to Transferring Organization. If an organization that received a contribution under these rules transfers the contributed property to another organization, the transferee organization must furnish to the transferring organization a written statement containing the information referenced in the first, second, and fourth requirements for a statement to a donor (see above). This statement must also represent that the transferee organization is a charitable organization that is not a private foundation (or, if a foreign organization, that it would meet that test). This written statement must be furnished within a "reasonable period" after the transfer.[76]

(e) Compliance with Food, Drug, and Cosmetic Act

If the contributed property is subject to the Federal Food, Drug, and Cosmetic Act, the property must comply with that law at the date of contribution and for the immediately preceding 180 days. In the case of specific items of contributed property not in existence for the entire 180-day period immediately preceding the date of contribution, this requirement is met if the contributed property complied with that law during the period of its existence and at the date of contribution and if, for the 180-day period prior to contribution, other property (if any) held by the donor at any time during that period (which property was fungible with the contributed property) was in compliance with that law during the period held by the donor.[77]

EXAMPLE 9.3

Z, a grocery store, contributed 12 crates of navel oranges to a public charity for distribution to the needy. The oranges were picked and placed in the grocery store's stock two weeks before the date of contribution. The contribution satisfied the requirements of these rules if Z complied with the Act for 180 days prior to the date of contribution with respect to all navel oranges in stock during that period.[a]

[a] Reg. §1.170A-4A(b)(5)(ii).

(f) Amount of Reduction

The amount of the charitable contribution under these rules must be reduced before application of the percentage limitation on the charitable deduction.[78] These rules mandate two reductions. The amount of the first reduction is equal to one-half of the amount of gain that would not have been long-term capital gain if the property had been sold by the donor at fair market value on the date of its contribution (excluding, however, any amount involving certain recapture rules).[79] If the amount of the charitable contribution remaining after this reduction exceeds twice the basis of the contributed property, then the amount of the charitable

---

[76] Reg. § 1.170A-4A(b)(4)(ii).
[77] Reg. § 1.170A-4A(b)(5)(i).
[78] IRC § 170(e)(3)(B); Reg. § 1.170A-4A(c)(1). These rules are also applied without regard to the deduction reduction rules, which are the subject of §§ 4.4–4.6 (also see text accompanied by *supra* notes 41 and 42). The percentage limitation applicable to corporations is discussed in § 7.18.
[79] See § 9.3(g).

contribution is reduced a second time to an amount equal to twice the amount of the basis of the property.[80]

The basis of contributed property that is inventory must be determined under the donor's method of accounting for inventory for purposes of federal income tax. The donor must use as the basis of the contributed item the inventoriable carrying cost assigned to any similar item not included in closing inventory.[81] For example, under the *last in-first out* (LIFO) dollar value method of accounting for inventory, the tax regulations provide that "where there has been an invasion of a prior year's layer, the donor may choose to treat the item contributed as having a basis of the unit's cost with reference to the layer(s) of prior year(s) cost or with reference to the current year cost."[82]

The donor of the property that is inventory contributed under these rules must make a corresponding adjustment to cost of goods sold, decreasing the cost of goods sold by the lesser of the fair market value of the contributed item or the amount of basis (determined under the rules described in the preceding paragraph).[83]

EXAMPLE 9.4

Y, a corporation using the calendar year method of reporting taxes, made a qualified contribution of women's coats.[a] The fair market value of the property at the date of contribution was $1,000 and the basis of the property was $200. The amount of the charitable contribution that would have been taken into account under the general charitable deduction rules is $1,000. The amount of gain that would not have been long-term capital gain if the property had been sold was $800 ($1,000 – $200). The amount of the contribution had to be reduced by one-half of the amount that would not have been capital if the property had been sold, or $400 (1/2 of $800).

After this reduction, the amount of the contribution that was taken into account was $600 ($1,000 – $400) A second reduction had to be made in the amount of the charitable contribution because this amount (as first reduced to $600) was more than an amount equal to twice the basis of the property, or $400. The amount of the further reduction is $200 [$600 – (2 × $200)], and the amount of the contribution as finally reduced was $400 [$1,000 – ($400 + $200)]. Y also had to reduce its cost of goods sold for the year of the contribution by $200.[b]

[a] The coats were stock in trade of Y (inventory). IRC § 1221(1). See text accompanied by *supra* notes 44, 45.

[b] Reg. § 1.170A-4A(c)(4), Example (1).

(g) Recapture Excluded

A deduction is not allowed under these rules for any amount that would have been treated as ordinary income if the property had been sold by the donor, on the date of its contribution, for an amount equal to its fair market value.[84]

[80] Reg. § 1.170A-4A(c)(1).

[81] Reg. § 1.170A-4A(c)(2).

[82] *Id*.

[83] Reg. § 1.170A-4A(c)(3).

[84] This property might be treated as ordinary income property pursuant to IRC §§ 617, 1245, 1250, 1251, or 1252.

EXAMPLE 9.5

The facts of this example are based on Example 9.4, except that the basis of the property was $600. The amount of the first reduction was $200 (($1,000 – $600)/2). As reduced, the amount of the contribution that was taken into account was $800 ($1,000 – $200). There was no need for a second reduction because $800 is less than $1,200, which is twice the basis of the property. Y, however, had to decrease its cost of goods sold for the year of contribution by $600.[a]

[a] Reg. § 1.170A-4A(c)(4), Example (2).

Thus, before making either of the two reductions (see above), the fair market value of the contributed property must be reduced by the amount of gain that would have been recognized (if the property had been sold) as ordinary income by reason of one of these recapture rules.[85]

(h) Special Rule for Food Inventory

Any person, whether or not a C corporation,[86] engaged in a trade or business is eligible to claim this enhanced deduction in the case of certain contributions of food inventory.[87] For entities other than C corporations, the total deduction for donations of food inventory in a tax year generally may not exceed 10 percent of the person's net income for the year from all sole proprietorships, S corporations,[88] or partnerships (or other entity that is not a C corporation) from which contributions of apparently wholesome food are made.[89]

The term *apparently wholesome food* means food intended for human consumption that meets all quality and labeling standards imposed by federal, state, and local laws, even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions.[90]

When these rules were originally enacted, they were applicable with respect to contributions made after August 28, 2005, and before January 1, 2006.[91] In 2006, Congress extended this effective date to encompass contributions of this nature made before January 1, 2008.[92]

In 2008, Congress extended this effective date again, this time to encompass contributions of this nature made before January 1, 2010.[93]

(i) Special Rule for Book Inventory

The enhanced deduction for C corporations was extended in 2005 to qualified book contributions made after August 28, 2005, and before January 1, 2006.[94]

[85] Reg. § 1.170A-4A(d).
[86] See *supra* note 47.
[87] IRC § 170(e)(3)(C)(i).
[88] See *supra* note 47.
[89] IRC § 170(e)(3)(C)(ii).
[90] 42 U.S.C. § 1791(b)(2), as enacted (and in effect on August 17, 2006) by the Bill Emerson Good Samaritan Food Donation Act (Pub. L. No. 104-210). IRC § 170(e)(3)(C)(iii).
[91] IRC § 170(e)(3)(C)(iv), as enacted by § 305(a) of the Katrina Emergency Tax Relief Act of 2005 (Pub. L. No. 109-73).
[92] IRC § (e)(3)(C)(iv), as amended by § 1202(a) of the Pension Protection Act of 2006 (Pub. L. No. 109-280).
[93] IRC § 170(e)(3)(C)(iv), as amended by § 323 of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, which is Division C of the financial markets stabilization legislation (Pub. L. No. 110-343).
[94] IRC § 170(e)(3)(D), as enacted by § 306(a) of the Katrina Emergency Tax Relief Act of 2005 (Pub. L. No. 109-73).

A *qualified book contribution* is a charitable contribution of books to a public school that provides elementary education or secondary education and that is an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.[95] This enhanced deduction is not allowed unless the donee organization certifies in writing that the contributed books are suitable, in terms of currency, content, and quantity, for use in the donee's educational programs and that the donee will use the books in such educational programs.[96]

In 2006, this special rule was made effective for contributions made before January 1, 2008.[97]

In 2008, this special rule was extended, by being made effective for contributions made before January 1, 2010.[98]

§ 9.4 SCIENTIFIC RESEARCH PROPERTY

Special federal tax rules govern the deductibility of charitable contributions of scientific research property.[99] To qualify under these rules, the property that is the subject of the gift must be:

- tangible personal property, and
- stock in trade of a corporation or other property of a kind that would properly be included in the inventory of the corporation[100] if on hand at the close of the tax year, or property held by the corporation primarily for sale to customers in the ordinary course of its trade or business.[101]

This deduction is available only to corporations.[102] It is not, however, available to a small business corporation,[103] a personal holding company,[104] or a service corporation.[105]

In addition to the foregoing, for this charitable deduction to be available, all of the following requirements must be satisfied:

---

[95] IRC § 170(e)(3)(D)(ii).
[96] IRC § 170(e)(3)(D)(iii).
[97] IRC § 170(e)(3)(D)(iv), as amended by § 1204(a) of the Pension Protection Act of 2006 (Pub. L. No. 109-280).
[98] IRC § 170(e)(3)(D)(iv), as amended by § 324 of the Tax Extenders and Alternative Tax Relief Act of 2008, which is Division C of the financial markets stabilization legislation (Pub. L. No. 110-343). In general, Borders & Hughes, "Corporate Donors May Get an Enhanced Deduction for Gifts of Inventory," 4 *J. Tax. Exempt Orgs*. (no. 4) 19 (Jan./Feb. 1993).
[99] IRC § 170(e)(4).
[100] See the discussion of the term *inventory* in §§ 2.13, 9.3.
[101] IRC § 170(e)(4)(B). This second criterion is the subject of IRC § 1221(1).
[102] IRC § 170(e)(4)(B).
[103] These are known as *S corporations*. IRC § 1371(b).
[104] IRC § 542.
[105] IRC § 170(e)(4)(D). Thus, eligible corporate donors are those that are C corporations. Service corporations are the subject of IRC § 414(m)(3).

1. The contribution must be to an eligible institution of higher education[106] or an eligible scientific research organization[107]
2. The property must be constructed by the donor corporation[108]
3. The contribution must be made not later than two years after the date on which construction of the property is substantially completed[109]
4. The original use of the property must be by the charitable recipient[110]
5. The property must be scientific equipment or apparatus substantially all of the use of which by the charitable recipient is for research or experimentation,[111] or for research training, in the United States in physical or biological sciences[112]
6. The property must not be transferred by the charitable recipient in exchange for money, other property, or services[113]
7. The corporation must receive from the charitable recipient a written statement representing that its use and disposition of the property will be in accordance with the fifth and sixth of these requirements[114]

This deduction is computed in the same manner as is the case with respect to the special rule concerning gifts of inventory.[115]

§ 9.5 COMPUTER TECHNOLOGY OR EQUIPMENT

Special federal tax rules govern the deductibility of charitable contributions of computer technology or equipment.[116] The property that is eligible for this

[106] That is, an institution of higher education that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. IRC § 170(b)(1)(A)(ii). See § 3.4, text accompanied by notes 355–359. This type of eligible institution is required by IRC § 170(e)(4)(B)(i), by cross-reference to IRC § 41(e)(6)(A), which in turn cross-references IRC § 3304(f), which imposes the following additional criteria: the institution (1) admits as regular students only individuals having a certificate of graduation from a high school or the recognized equivalent of this type of certificate; (2) is legally authorized within a state to provide a program of education beyond high school; (3) provides an educational program for which it awards a bachelor's degree or higher degree, or provides a program that is acceptable for full credit toward this type of degree, or offers a program of training to prepare students for gainful employment in a recognized occupation; and (4) is a public or other nonprofit institution.

[107] That is, to an organization that meets the following criteria: it is (1) not an eligible institution of higher education (see note 89); (2) exempt from federal income taxation under IRC § 501(a) because it is described in IRC § 501(c)(3) (see § 3.2); (3) organized and operated primarily to conduct scientific research; and (4) not a private foundation (see § 3.4). IRC § 170(e)(4)(B)(i), by cross-reference to IRC § 41(e)(6)(B).

[108] IRC § 170(e)(4)(B)(ii). Property is considered constructed by the donor corporation only if the cost of the parts used in the construction of the property (other than parts manufactured by the corporation or a related person) does not exceed 50 percent of the corporation's basis in the property. IRC § 170(e)(4)(C).

[109] IRC § 170(e)(4)(B)(iii).

[110] IRC § 170(e)(4)(B)(iv).

[111] This phrase is the subject of IRC § 174.

[112] IRC § 170(e)(4)(B)(v).

[113] IRC § 170(e)(4)(B)(vi).

[114] IRC § 170(e)(4)(B)(vii).

[115] IRC § 170(e)(4)(A). See § 9.3(f). This deduction for contributions of scientific property used for research was slightly expanded by enactment of the Tax Relief and Health Care Act of 2006.

[116] IRC § 170(e)(6).

deduction must be computer software,[117] computer or peripheral equipment,[118] and fiber-optic cable related to computer use.[119] The contribution must be made by a C corporation[120] and satisfy the following criteria:

1. The recipient must be an educational institution,[121] a tax-exempt entity that is organized primarily for purposes of supporting elementary and secondary education, or a public library[122]
2. The contribution must be made no later than three years after the date the donor acquired the property (or, in the case of property constructed by the donor, the date on which construction of the property was substantially completed)[123]
3. The original use of the property must be by the donor or the donee[124]
4. Substantially all of the use of the property by the donee must be for use within the United States for educational purposes that are related to the purpose or function of the donee organization[125]
5. The property may not be transferred by the donee in exchange for money, other property, or services, except for shipping, installation, and transfer costs[126]
6. The property must fit productively into the donee's education plan[127]
7. The donee's use and disposition of the property must be in accordance with the fourth and fifth of these requirements[128]
8. The property involved must meet any standards that the IRS may promulgate to assure that the property meets minimum functionality and suitability standards for educational purposes[129]

A qualifying contribution may be made to a private foundation if the gift satisfies the second and fifth of the above criteria, and, within 30 days of the gift, the foundation grants the property to a qualified recipient that satisfies the fourth through the seventh of the above criteria and notifies the donor of the grant.[130]

This deduction is computed in the same manner as is the case with respect to the special rule concerning gifts of inventory.[131]

This body of law was extended through 2007,[132] then again through 2009.[133]

---

[117] This term is defined in IRC § 197(e)(3)(B).
[118] This term is defined in IRC § 168(i)(2)(B).
[119] IRC § 170(e)(6)(F)(i).
[120] IRC § 170(e)(6)(F)(ii)
[121] That is, an organization described in IRC § 170(b)(1)(A)(ii). See § 3.4, text accompanied by notes 355–359.
[122] IRC § 170(e)(6)(B)(i).
[123] IRC § 170(e)(6)(B)(ii).
[124] IRC § 170(e)(6)(B)(iii).
[125] IRC § 170(e)(6)(B)(iv).
[126] IRC § 170(e)(6)(B)(v).
[127] IRC § 170(e)(6)(B)(vi).
[128] IRC § 170(e)(6)(B)(vii).
[129] IRC § 170(e)(6)(B)(viii).
[130] IRC § 170(e)(6)(C).
[131] IRC § 170(e)(6)(A). See § 9.3(f).
[132] Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432 § 116.
[133] Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (§ 321), which is Division C of financial markets stabilization legislation (Pub. L. No. 110-343).

§ 9.6 LICENSE TO USE PATENT

The IRS addressed various aspects of contributions to qualified charitable organizations of licenses to use patents.[134]

(a) Factual Situations

This guidance posited three situations. In the first situation, a person contributes to a tax-exempt university a license to use a patent, but retains the right to license the patent to others.

In the second situation, a person contributes a patent to an exempt university subject to the condition that a faculty member of the university who is an expert in the technology covered by the patent continue to be a member of the faculty of the institution during the remaining life of the patent. If this condition is not satisfied, the patent is to revert to the donor. The patent will expire 15 years after the date of gift. On the date of the contribution, the likelihood that this individual will cease to be a member of the faculty before the patent expires was not so remote as to be negligible.

In the third situation, a person contributes to an exempt university all of the person's interest in a patent. The transfer agreement provides that the university may not sell or license the patent for three years. This restriction does not result in any benefit to the donor; under no circumstances can the patent revert to the donor.

(b) Law and Analysis

A charitable contribution deduction is denied for certain contributions of partial interests in property.[135] A charitable deduction is denied for a contribution of less than the taxpayer's entire interest in property unless the value of the interest contributed would be allowable as a deduction[136] if the donor were to transfer the interest in trust.[137]

This rule does not disallow a deduction for a contribution of an interest that, even though partial, is the taxpayer's entire interest in the property. If, however, the property in which the partial interest exists was divided in order to create the interest, the deduction is not allowed.[138]

There is a deduction for a contribution, not in trust, of a partial interest that is less than the donor's entire interest in property if the partial interest is an undivided portion of the donor's entire interest.[139] A contribution of the right to use property that the donor owns, such as a contribution of a rent-free lease, is a contribution of less than the taxpayer's entire interest in the

[134] Rev. Rul. 2003-28, 2003-1 C.B. 594.
[135] See § 9.23.
[136] IRC § 170(f)(2).
[137] IRC § 170(f)(3)(A).
[138] Reg. § 1.170A-7(a)(2)(i).
[139] IRC § 170(f)(3)(B)(ii).

property.[140] If a taxpayer contributes an interest in motion picture films, but retains the right to make reproductions of the films and exploit the reproductions commercially, the contribution is less than the taxpayer's entire interest in the property.[141]

The IRS ruled that the contribution in the first of the situations stipulated in this guidance was a transfer of a partial interest, for which no charitable contribution deduction is allowable. The license granted to the university was deemed similar to the rent-free lease and the partial interest in motion picture films, in that it constituted neither the person's entire interest in the patent, nor a fraction or percentage of each and every substantial interest or right that the person owns in the patent.

If, as of the date of a gift, a transfer of property for charitable purposes is dependent on the performance of an act or the happening of a precedent event to become effective, there is no charitable deduction, unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.[142] If, as of the date of a gift, a transfer of property for charitable purposes may be defeated by the performance of an act or the happening of an event, no deduction is allowable unless the possibility that the act or event will occur is so remote as to be negligible.[143] Thus, a charitable deduction was not allowed in the second situation.

When a donor places a restriction on the marketability or use of property, the amount of the charitable contribution deduction is the fair market value of the property at the time of the contribution, determined in light of the restriction.[144] Generally, then, in the third situation, there is a deductible contribution. The restriction, however, reduced what would otherwise have been the fair market value of the patent, and therefore reduced the amount of the charitable contribution.

§ 9.7 CONSERVATION PROPERTY

Special federal tax rules pertain to contributions to charity of real property for conservation purposes. These rules are an exception to the general rule that there is no charitable contribution deduction for contributions of partial interests in property.[145] This exception involves the qualified conservation contribution,[146] which is the subject of several IRS rulings.[147]

These rules are in the context of the income tax charitable contribution deduction for qualified conservation contributions. There are, however, somewhat comparable rules in the estate tax and gift tax charitable deduction settings. An estate may claim a charitable contribution deduction[148] for the value of the portion of a

[140] Reg. § 1.170A-7(a)(1).
[141] Reg. § 1.170A-7(b)(1)(i).
[142] Reg. § 1.170A-7(b)(1)(i). See § 10.4(b).
[143] Reg. § 1.170A-7(a)(3). See § 10.4(b).
[144] See § 10.1(a).
[145] IRC § 170(f)(3)(A). See § 5.3, note 6.
[146] IRC § 170(f)(3)(B)(iii); Reg. § 1.170A-14(a).
[147] E.g., Priv. Ltr. Rul. 8605008.
[148] IRC § 2055(f).

conservation easement includible in the estate; individuals claim an income tax charitable deduction for the balance of the easement.[149]

A *qualified conservation contribution* has three fundamental characteristics; it is a contribution

- of a qualified real property interest,[150]
- to a qualified organization,[151]
- exclusively for conservation purposes.[152]

The amount allowed as a charitable contribution deduction for a qualified conservation easement is the difference between the fair market value of the burdened property[153] before the gift and the value of it following the gift.[154]

(a) Qualified Real Property Interests

A *qualified real property interest* is one of the following interests in real property:

- The donor's entire interest in the property other than a qualified mineral interest[155]
- A remainder interest[156]
- A restriction (granted in perpetuity) on the use that may be made of the real property[157]

A *qualified mineral interest* is the donor's interest in subsurface oil, gas, or other minerals, and the right to access to these minerals.[158]

---

[149] Priv. Ltr. Rul. 200143011. The IRS became aware of instances where a charitable organization purchases real property and places a conservation easement on it, then sells the property subject to the easement for a price that is substantially less than the price paid for the property by the organization. The buyer makes a second payment to the organization, claiming it as a charitable contribution. The two payments from the buyer to the charitable organization fully reimburse the charity for its purchase of the property. The agency stated that it will treat these transactions in accordance with their substance, by regarding the total of the buyer's payments to the charity as the buyer's purchase price for the property and deny the charitable deduction (Notice 2004-41, 2004-2 C.B. 31). A trust cannot claim a charitable deduction (nor a distribution deduction) for contributions of trust principal that satisfy the requirements of a qualified conservation contribution. Rev. Rul. 2003-123, 2003-2 C.B. 1200. See § 9.22.

[150] IRC § 170(h)(1)(A).

[151] IRC § 170(h)(1)(B).

[152] IRC § 170(h)(1)(C).

[153] See § 10.1(a).

[154] *Symington v. Commissioner*, 87 T.C. 893 (1986).

[155] IRC § 170(h)(2)(A).

[156] IRC § 170(h)(2)(B).

[157] IRC § 170(h)(2)(C).

[158] IRC § 170(h)(6); Reg. § 1.170A-14(b)(1)(i). These matters can turn on the definition of a word—in one case, the word *subsurface*. A corporation claimed a charitable contribution deduction, of about $19 million, for a gift of two conservation easements in favor of a state. The government, however, convinced a court that the charitable deduction was not available for these transfers because the donor retained the right to extract subsurface minerals from the easement lands using surface mining techniques. *Great N. Nekoosa Corp. v. United States*, 97-2 U.S.T.C. ¶ 50,591 (Fed. Cl. 1997). In the absence of a definition of the term *subsurface* in the statute or regulations, the court wrote that it "would be incongruous with the purposes of the statute to adopt a definition of 'subsurface' which would allow disruption of the landscape by surface, or strip mining, to access gravel and sand." 97-2 U.S.T.C. at 89,371). The court added that the minerals at issue "should be defined as subsurface minerals since they are not exposed to the atmosphere, and have soil or some other type of covering." *Id*. at 89,372).

A real property interest is not treated as an entire interest in the property (other than a qualified mineral interest) if the property in which the donor's interest exists was divided prior to the contribution to enable the donor to retain control of more than a qualified mineral interest or to reduce the real property interest donated.[159] Minor interests, that will not interfere with the conservation purposes of the gift, such as rights-of-way, may, however, be transferred prior to the conservation contribution without adversely affecting the treatment of a property interest as a qualified real property interest.[160] An entire interest in real property may consist of an undivided interest in the property.[161]

A perpetual conservation restriction is a qualified real property interest. A *perpetual conservation restriction* is a ''restriction granted in perpetuity on the use which may be made of real property—including an easement or other interest in real property that under state law has attributes similar to an easement (e.g., a restrictive covenant or equitable servitude).''[162] This definition does not preclude the deductibility of a gift of affirmative rights to use a land or water area.[163] Any rights reserved by a donor in the contribution of a perpetual conservation restriction must conform to the law on this subject.

(b) Qualified Organizations

A *qualified organization* is one of the following entities:

- A unit of government[164]
- A publicly supported charitable organization that is the donative type[165]
- A publicly supported charitable organization that is the service provider type[166]
- A supporting organization that is controlled by one or more of the foregoing three types of entities[167]

In addition, to be an eligible donee, an organization must have a ''commitment to protect the conservation purposes of the donation, and have the resources to enforce the restrictions.''[168] A qualified organization is not required to set aside funds to enforce the restrictions that are the subject of the contribution.[169]

---

[159] Reg. § 1.170A-14(b)(1)(ii). See also Reg. § 1.170A-7(a)(2)(i).

[160] Reg. § 1.170A-14(b)(1), last sentence.

[161] Reg. § 1.170A-14(b)(ii). As discussed below, however, the conservation purpose that is the subject of the contribution must be protected in perpetuity.

[162] Reg. § 1.170A-14(b)(2). For these purposes, the terms *easement*, *conservation restriction*, and *perpetual conservation restriction* have the same meaning. *Id*.

[163] *Id*.

[164] IRC § 170(h)(3)(A). A *governmental unit* is described in IRC § 170(b)(1)(A)(v). See § 3.4, text accompanied by notes 381–382.

[165] IRC § 170(h)(3)(A). This type of publicly supported organization is described in IRC §§ 170(b)(1)(A)(vi) and 509(a)(1). See § 3.4, text accompanied by notes 383–403.

[166] IRC § 170(h)(3)(B)(i). This type of publicly supported organization is described in IRC § 509(a)(2). See § 3.4, text accompanied by notes 404–420.

[167] IRC § 170(h)(3)(B)(ii); Reg. § 1.170A-14(c)(1). A *supporting organization* is an organization that is not a private foundation by reason of IRC § 509(a)(3). See § 3.4(a)(iv).

[168] Reg. § 1.170A-14(c)(1). A conservation group organized or operated primarily or substantially for one of the conservation purposes (see § 9.7(c)) is considered to have the requisite commitment. *Id*.

[169] *Id*.

A deduction is allowed for a contribution under these rules only if, in the instrument of conveyance, the donor prohibits the donee from subsequently transferring the easement (or, in the case of a remainder interest or the reservation of a qualified mineral interest, the property), whether or not for consideration, unless the donee, as a condition of the subsequent transfer, requires that the conservation purposes which the contribution was originally intended to advance be carried out. Moreover, subsequent transfers must be restricted to organizations qualifying, at the time of the subsequent transfer, as eligible donees.[170] Nonetheless, when a later ''unexpected'' change in the conditions surrounding the property that is the subject of a donation makes ''impossible or impractical'' the continued use of the property for conservation purposes, these requirements will be met if the property is sold or exchanged and any proceeds are used by the donee organization in a manner consistent with the conservation purposes of the original contribution.[171]

(c) Conservation Purpose

General Rules. The term *conservation purpose* means one of the following:

- Preservation of land areas for outdoor recreation by, or for the education of, the public[172]
- Protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem[173]
- Preservation of open space (including farmland and forest land), when the preservation
  - is for the scenic enjoyment of the public
  - is pursuant to a clearly delineated federal, state, or local governmental policy, and/or
  - will yield a significant public benefit[174]
- Preservation of an historically important land area or a certified historic structure.[175]

In connection with the first of these definitions (recreation or education), conservation purposes include the preservation of a water area for the use of the public for boating or fishing, or a nature or hiking trail for the use of the public.[176] The recreation or education must, however, be for the substantial and regular use of the general public.[177]

In connection with the second of these definitions (protection of an environmental system), the fact that the habitat or environment has been altered to some

---

[170] Reg. § 1.170A-14(c)(2).
[171] *Id.*
[172] IRC § 170(h)(4)(A)(i).
[173] IRC § 170(h)(4)(A)(ii).
[174] IRC § 170(h)(4)(A)(iii).
[175] IRC § 170(h)(4)(A)(iv); Reg. § 1.170A-14(d)(1).
[176] Reg. § 1.170A-14(d)(2)(i).
[177] Reg. § 1.170A-14(d)(2)(ii).

extent by human activity will not result in a denial of a charitable deduction under these rules if the fish, wildlife, or plants continue to exist there in a relatively natural state. For example, the preservation of a lake formed by a man-made dam or a salt pond formed by a man-made dike would meet the conservation purposes test if the lake or the pond were a natural feeding area for a wildlife community that included rare, endangered, or threatened native species.[178]

Also, in connection with the second of these definitions, the tax regulations add the requirement that the ''relatively natural habitat'' be significant.[179] Significant habitats and ecosystems include habitats for rare, endangered, or threatened species of animals, fish, or plants; natural areas that represent high-quality examples of a terrestrial community or aquatic community, such as islands that are undeveloped or not intensely developed and where the coastal ecosystem is relatively intact; and natural areas that are included in, or that contribute to, the ecological viability of a local, state, or national park, nature preserve, wildlife refuge, wilderness area, or other similar conservation area.[180]

As to the third of these definitions (preservation of open space), the preservation (1) must be pursuant to a clearly delineated federal, state, or local governmental conservation policy and yield a significant public benefit; or (2) must be for the scenic enjoyment of the general public and yield a significant public benefit.[181] A governmental policy in this regard must be more than a general declaration of conservation goals by a single official or legislative body. The requirement is met by contributions that further a specific, identified conservation project; that preserve a wild or scenic river; or that protect the scenic, ecological, or historic character of land that is contiguous to or an integral part of the surroundings of existing recreation or conservation sites.[182] A contribution made for the preservation of open space may be for the scenic enjoyment of the general public. Preservation of land may be for the scenic enjoyment of the general public if development of the property would impair the scenic character of the local rural or urban landscape or would interfere with a scenic panorama that can be enjoyed from a park, nature preserve, road, body of water, trail, or historic structure or land area, and the area or transportation way is open to or utilized by the public. The regulations contain criteria for evaluating the requisite scenic enjoyment[183] and, for both definitions, the necessary significant public benefit.[184]

In connection with the fourth of these definitions (historic preservation), the donation of a qualified real property interest to preserve an historically important land area or a certified historic structure meets the requirements.[185] When restrictions to preserve a building or land area within a registered historic district permit future development on the site, a charitable contribution deduction is allowed under these rules only if the terms of the restrictions require that the

[178] Reg. § 1.170A-14(d)(3)(i).
[179] *Id.*
[180] Reg. § 1.170A-14(d)(3)(ii).
[181] Reg. § 1.170A-14(d)(4)(i).
[182] Reg. § 1.170A-14(d)(4)(iii).
[183] Reg. § 1.170A-14(d)(4)(ii)(A).
[184] Reg. § 1.170A-14(d)(4)(iv).
[185] Reg. § 1.170A-14(d)(5)(i).

development conform to appropriate local, state, or federal standards for construction or rehabilitation within the district.

An *historically important land area* includes:

- An independently significant land area, including any related historic resources that meet the National Register Criteria for Evaluation[186]
- Any land area within a registered historic district, including any buildings on the land area that can reasonably be considered as contributing to the significance of the district
- Any land area adjacent to a property listed individually in the National Register of Historic Places, when the physical or environmental features of the land area contribute to the historic or cultural integrity of the property[187]

A *certified historic structure* is a building, structure, or land area that is listed in the National Register or located in a registered historic district[188] and is certified by the Secretary of the Interior to the Secretary of the Treasury as being of historic significance to the district.[189] The structure must satisfy this definition either as of the date of the transfer or on the due date (including extensions) for filing the transferor's tax return for the year in which the transfer is made.[190]

For a conservation contribution to be deductible, some visual public access to the donated property is required. In the case of an historically important land area, the entire property need not be visible to the public for a donation to qualify under these rules.[191] The regulations contain criteria for determining the required type and amount of public access.[192] The amount of access afforded the public by the contribution of an easement is determined with reference to the amount of access permitted by the terms of the easement established by the donor, rather than the amount of access actually provided by the donee charitable organization.[193]

Buildings in Registered Historic Districts. A charitable contribution deduction generally is not allowable with respect to a structure or land area located in a registered historic district (by reason of the structure's or land area's location in such a district).[194] A charitable deduction is allowable with respect to buildings but the qualified real property interest that relates to the exterior of the building must preserve the entire exterior of the building, including the space above the building, the sides, the rear, and the front of the building.[195] Also, this qualified real property interest must provide that no portion of the exterior of the building

[186] 36 C.F.R. § 60.4.
[187] Reg. § 1.170A-14(d)(5)(ii).
[188] This term is defined in IRC § 47(c)(3)(B).
[189] IRC § 170(h)(4)(C); Reg. § 1.170A-14(d)(5)(iii).
[190] IRC § 170(h)(4)(C), last sentence.
[191] Reg. § 1.170A-14(d)(5)(iv)(A).
[192] Reg. § 1.170A-14(d)(5)(iv)(B).
[193] Reg. § 1.170A-14(d)(5)(iv)(C).
[194] IRC § 170(h)(4)(B). This rule applies with respect to contributions made after July 25, 2006.
[195] IRC § 170(h)(4)(B)(i)(I).

may be changed in a manner inconsistent with the historical character of the exterior.[196]

For any contribution relating to a registered historic district made in a tax year after August 17, 2006, persons must include with their return for the tax year of the contribution a qualified appraisal[197] of the qualified real property interest (irrespective of the claimed value of the interest[198]) and attach the appraisal to the return, photographs of the entire exterior of the building, and descriptions of all current restrictions on development of the building, including, for example, zoning laws, ordinances, neighborhood association rules, and restrictive covenants.[199] Failure to obtain and attach an appraisal or to include the required information results in disallowance of the deduction. Also, the donor and donee must enter into a written agreement certifying, under penalty of perjury, that the donee is a qualified organization,[200] with a purpose of environmental protection, land conservation, open space preservation, or historical preservation, and that the donee has the resources to manage and enforce the restriction and has a commitment to do so.[201]

Persons claiming a charitable deduction for a qualified conservation contribution with respect to the exterior of a building, located in a registered historic district, in excess of $10,000 must pay a $500 fee to the IRS for the deduction to be allowed.[202] Amounts paid are required to be dedicated to IRS enforcement of qualified conservation contributions.[203]

(d) Exclusivity Requirement

To satisfy these rules, a contribution must be *exclusively* for conservation purposes. A conservation deduction will not be denied, however, when an incidental benefit inures to the donor merely as a result of conservation restrictions limiting the uses to which the donor's property may be put.[204] In general, a conservation deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would also permit destruction of other significant conservation interests.[205] Nonetheless, a use that is destructive of conservation interests will be permitted if the use is necessary for protection of the conservation interests that are the subject of the contribution.[206]

A contribution cannot be treated as being exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.[207] Thus, any interest in the property retained by the donor (and the donor's successors in interest) must be subject to legally enforceable restrictions that will prevent uses of the

---

[196] IRC § 170(h)(4)(B)(i)(II).
[197] See § 21.2(b).
[198] See § 10.1.
[199] IRC § 170(h)(4)(B)(iii).
[200] See § 9.7(b).
[201] IRC § 170(h)(4)(B)(ii).
[202] IRC § 170(f)(13)(A), (B). This rule applies with respect to contributions made after February 13, 2007.
[203] IRC § 170(f)(13)(C).
[204] Reg. § 1.170A-14(e)(1).
[205] Reg. § 1.170A-14(e)(2).
[206] Reg. § 1.170A-14(e)(3).
[207] IRC § 170(h)(5)(A); Reg. § 1.170A-14(a).

retained interest that are inconsistent with the conservation purposes of the donation.[208] A deduction is not permitted under these rules for a contribution of an interest in property that is subject to a mortgage, unless the mortgagee subordinates its rights in the property to the right of the charitable organization to enforce the conservation purposes of the gift in perpetuity.[209] A conservation deduction will not be disallowed, however, merely because the interest that passes to, or is vested in, the donee charitable organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that the act or event will occur is so remote as to be negligible.[210]

In general, if the contribution is of any interest as to which a qualified mineral interest is retained, this requirement of exclusivity is not regarded as met if at any time there may be extraction or removal of minerals by any surface mining method.[211] Also, the requirement that the conservation purposes be protected in perpetuity is not satisfied if any method of mining that is inconsistent with the particular conservation purposes of a contribution is permitted at any time.[212] A *qualified mineral interest* is the donor's interest in subsurface oil, gas, or other minerals and the right of access to the minerals.[213]

A court concluded that contributions of conservation easements to a public charity constituted gifts of qualified conservation easements because they protect a ''relatively natural habitat'' of threatened plants and other wildlife on a segment of a lake's shoreline and were exclusively for conservation purposes, and thus gave rise to charitable contribution deductions.[214] The court found that the nature of the encumbered shoreline legally limited as to development enabled it to fit the definitions of ''habitat'' and ''community.''[215] The contributions of the easements were held by the court to ''operate to protect or enhance the viability of an area or environment in which a wildlife community and a plant community normally live or occur.''[216] Determining that both portions of the encumbered shoreline ''also have natural values that make them possible places to create or promote'' this habitat, the court concluded that the contributions of the easements were for a conservation purpose; the requirement as to exclusivity was satisfied, according to the court, by reason of a ''focus on the contributee's holding of a qualified real property interest and, more specifically, [because the gifts] require that the

[208] Reg. § 1.170A-14(g)(1).

[209] Reg. § 1.170A-14(g)(2).

[210] Reg. § 1.170A-14(g)(3). A court held that a grant of an easement over the facades of the condominium apartment building in which the donors owned interests was not a qualified conservation contribution, because it was not contributed exclusively for conservation purposes. The easement was not protected in perpetuity because a security interest in the building had priority over the easement. *Satullo v. Commissioner*, 66 T.C.M. (CCH) 1697 (1994).

[211] IRC § 170(h)(5)(B)(i). The law allows a charitable contribution deduction (for income or estate tax purposes) to persons making a contribution of a permanent conservation easement on property when a mineral interest has been retained and surface mining is possible, but the probability of exercise of the rights retained is so remote as to be negligible. IRC § 170(h)(5)(B)(ii).

[212] Reg. § 1.170A-14(g)(4).

[213] Reg. § 1.170A-14(b)(1)(i).

[214] *Glass v. Commissioner*, 124 T.C. 258, 282 (2005). This opinion was affirmed by the Sixth Circuit (471 F.3d 698).

[215] See text accompanied by *supra* notes 179 and 180.

[216] *Glass v. Commissioner*, 124 T.C. 258, 282 (2005).

contributee hold such an interest in perpetuity.''[217] This court observed that these donors ''gratuitously surrendered valuable property rights in the encumbered shoreline, that those restrictions are legally enforceable to limit in perpetuity any inconsistent use of the encumbered shoreline, and that any subsequent holder of the conservation easements must be an entity fully committed to carrying out the contributions' charitable purpose.''[218]

Conversely, a deed conveying an ostensible conservation easement did not give rise to a charitable contribution deduction because the open space or historic preservation requirements necessary for a qualified conservation contribution were not met.[219] The developer involved was held to have merely developed the property to its maximum yield within the property's zoning classification (designation as a floodplain). The deed did not limit the size of the homes to be constructed (in terms of square footage or height) or any other development, or preclude the landowner's ability to seek rezoning to denser development classifications. As to the historic preservation requirement, there was no historic structure on the property to preserve; the easement's limitation on development on the land did not preserve the historic structures on neighboring properties. The court wrote that the ''mere possibility or conjecture of a quieter and more peaceful atmosphere that might have been engendered by limited development'' was not sufficient to satisfy this requirement.[220]

(e) Valuation

The amount of the charitable contribution deduction, in the case of a contribution of a donor's entire interest in conservation property (other than a qualified mineral interest), is the fair market value of the surface rights in the property contributed.[221] The value for the deduction is computed without regard to the mineral rights.[222] In the case of a contribution of a remainder interest in real property, depreciation and depletion of the property must be taken into account in determining the value of the interest.[223] The value of a charitable contribution of a

---

[217] *Id*.

[218] *Id*. at 283.

[219] *Turner v. Commissioner*, 126 T.C. 299 (2006).

[220] *Id*. at 316. A charitable contribution deduction was held to be available to a limited liability company for its grant to a qualified public charity of a perpetual conservation easement covering a golf course that it owned (*Kiva Dunes Conservation, LLC v. Commissioner*, 97 T.C.M. (CCH) 1818 (2009)) and to an individual who granted such an easement to such a charity relating to two parcels of land (*Hughes v. Commissioner*, 97 T.C.M. (CCH) 1488 (2009)). Contributions of two façade easements gave rise to charitable deductions despite the fact that the qualified charitable donee can consent to changes in the façades (*Simmons v. Commissioner*, 98 T.C.M. (CCH) 211 (2009)). A contribution of a conservation easement concerning unused development rights over property held by the donor's wholly owned limited liability company did not give rise to a charitable deduction because the gift did not preserve a *certified historic structure* or a *historically important land area* (*Herman v. Commissioner*, 98 T.C.M. (CCH) 197 (2009)). In general, Gerzog, ''Conservation Easements Under *Turner* and *Glass*,'' 53 *Ex. Orgs. Tax Rev.* (No. 2) 175 (Aug. 2006).

[221] E.g., *The Stanley Works v. Commissioner*, 87 T.C. 389 (1986) (the value of a conservation easement donated to charity is based on the highest and best use of the land; *Hillborn v. Commissioner*, 85 T.C. 677 (1985) (the value of a façade contribution generally is determined by applying the ''before and after'' valuation approach); *Richmond v. United States*, 699 F. Supp. 578 (E.D. La. 1988) (same); Priv. Ltr. Rul. 199933029 (a preservation and conservation easement relating to the façade and certain interior portions of a fraternity house ruled to be a qualified conservation contribution).

[222] Reg. § 1.170A-14(h)(1).

[223] IRC § 197(f)(4); Reg. § 1.170A-14(h)(2).

perpetual conservation restriction is the fair market value of the restriction at the time of the contribution.[224] In the case of a contribution of a qualified real property interest for conservation purposes, the basis of the property retained by the donor must be adjusted by the elimination of that part of the total basis of the property that is properly allocable to the qualified real property interest granted.[225]

(f) Substantiation

If a donor makes a qualified conservation contribution and claims a charitable contribution deduction for it, the donor must maintain written records of:

- the fair market value of the underlying property before and after the contribution, and
- the conservation purpose furthered by the donation.

This information may have to be part of the donor's income tax return.[226]

This requirement is in addition to the general charitable contribution substantiation requirements.[227]

(g) Relationship to Rehabilitation Tax Credit

General Rules. An investment tax credit is allowed as part of the general business credit.[228] The amount of the investment tax credit includes the amount of a rehabilitation credit.[229] The rehabilitation tax credit for a tax year is the sum of 10 percent of the qualified rehabilitation expenditures with respect to a qualified rehabilitated building other than a certified historic structure and 20 percent of the qualified rehabilitation expenditures with respect to a certified historic structure.[230]

In general, a *qualified rehabilitated building* is a depreciable building (and its structural components) if the building has been substantially rehabilitated,[231] was placed in service before the beginning of the rehabilitation, and (except for a certified historic structure) in the rehabilitation process a certain percentage of the existing internal and external walls, and internal structural framework are retained in place as internal and external walls and internal structural framework.[232] A *qualified rehabilitation expenditure* is, in general, an amount properly chargeable to a capital account (1) for depreciable property that is nonresidential real property, residential rental property, real property that has a class life of more than 12.5 years, or an addition or improvement to any such property, and (2) in connection with the rehabilitation of a qualified rehabilitation building.[233]

---

[224] Reg. § 1.170A-14(h)(3). In general, McClure, Hollingworth & Brown, "Courts to IRS: Ease Up on Conservation Easement Valuations," 124 *Tax Notes* (no. 6) 551 (Aug. 10, 2009).
[225] Reg. § 1.170A-14(h)(3)(iii).
[226] Reg. § 1.170A-14(i).
[227] See § 21.3.
[228] IRC § 38(b)(1).
[229] IRC § 46(1).
[230] IRC § 47(a).
[231] IRC § 47(c)(1)(C).
[232] IRC § 47(c)(1)(A).
[233] IRC § 47(c)(2)(A).

It was held that a partnership must recapture a portion of a rehabilitation tax credit and reduce its basis in the underlying rehabilitated property, upon its donation to a charitable organization of an historical facade easement, when the gift occurred in the same year the partnership claimed the tax credit.[234] The partnership was formed to acquire, rehabilitate, and operate a building, which became designated as a certified historic structure. The partnership ''substantially rehabilitated'' the building, causing it to become a qualified rehabilitation building. The partnership incurred qualified rehabilitation expenditures in the amount of $2.8 million in the course of restoring the building. Later in the same year, the partnership deeded a facade and conservation easement to a charitable organization formed to preserve and protect the architectural heritage of the state involved. The easement was granted in perpetuity, was intended to benefit the public, and constituted a qualified conservation contribution.[235] Thus, the transaction qualified as a charitable contribution.[236] The fair market value of the easement was $422,000. The parties stipulated that the easement value was allocable as follows: $4,413 to the building ''shell,'' $41,267 to the land, and $376,320 to the rehabilitated building. The partnership claimed a rehabilitation tax credit in the amount of $2.2 million—the amount expended during the year in rehabilitation of the building. The IRS concluded, and the court agreed, that the tax credit should be $1.8 million—the amount expended less the portion of the easement value allocated to the rehabilitated building ($376,320).

The law is that if property for which an investment tax credit[237] has been taken in prior years is disposed of, or otherwise ceases to qualify for the credit before the end of the useful life used in computing the credit, a portion of the tax credit must be recaptured.[238] The tax regulations provide that this requirement is triggered when a person disposes of a portion of the basis of a qualified rehabilitated building that is attributable to qualified rehabilitated expenditures. In this case, the IRS took the position that the donation of the facade easement was a *disposition* of the property. The partnership contended that the federal tax law does not require the recapture of a portion of a rehabilitation tax credit upon the donation of a facade easement. It also argued that the charitable donation of a facade easement is not a disposition for these purposes because it is not a gift within the meaning of the regulations. The court, however, concluded that the ''plain meaning'' of the term *disposition* is ''to transfer or otherwise relinquish ownership of property.''[239] The court added that ''[w]e believe that requiring recapture of a portion of the rehabilitation tax credit upon the donation of a facade easement is in accordance with Congress' purpose in enacting'' these rules.[240]

The matter troubling the court was the creation of a double deduction if this recapture was not required. Therefore, it ruled that the donation of the facade easement was a gift. Because the easement qualified as property eligible for an investment tax credit, the court followed the tax regulations stating that this

[234] *Rome I Ltd. v. Commissioner*, 96 T.C. 697 (1991).
[235] IRC § 170(h)(1).
[236] IRC § 170(f)(3)(B)(iii).
[237] IRC § 38.
[238] IRC § 47(a).
[239] *Rome I Ltd. v. Commissioner*, 96 T.C. 697 (1991).
[240] *Id*. at 704.

disposition triggered the recapture provision. Thus, the court announced that the "rehabilitation credit, like the investment tax credit, is subject to recapture in the event of the early disposition of the property attributed to the qualified rehabilitation expenditures."[241] Consequently, this rule was announced: "When a qualified real property interest is donated for conservation purposes, the basis of the donor's remaining property is adjusted by eliminating that part of the total basis of the property that is properly allocable to the donated qualified real property interest"; hence, the donor must recapture a portion of the rehabilitation tax credit.[242]

The IRS published its stance in this regard in 1989.[243] The court wrote that it agreed with the IRS position, "not because we rely upon it for authority, but because we have independently arrived at the same conclusion."[244]

Deduction Reduction Requirement. In the case of a qualified conservation contribution, the amount of the charitable deduction must be reduced by an amount that bears the same ratio to the fair market value of the contribution as the sum of the rehabilitation tax credits for the preceding five tax years with respect to a building that is part of the contribution bears to the fair market value of the building on the date of the contribution.[245]

EXAMPLE 9.6

An individual made a qualified conservation contribution with respect to a building. This individual claimed a rehabilitation tax credit with respect to the building during the five tax years preceding the year in which the charitable contribution was claimed. This individual must reduce the amount of the contribution in adherence to this deduction reduction rule. If the aggregate amount of the credits claimed by this individual with this five-year period is $100,000, and the fair market value of the building with respect to which the contribution is made is $1 million, the individual must reduce the amount of the charitable deduction by 10 percent ($100,000/$1,000,000).

(h) Donative Intent

A court ruled that a gift of a scenic easement was a transfer of value to the charitable recipient, despite a variety of restrictions imposed by the donors, but also held that the donors' motivation for making the gift must be subsequently explored.[246] The issues in the case related to a contribution to a conservancy organization of a scenic easement over approximately 170 acres of the donors' real property. The IRS, in challenging the tax deductions claimed for this gift, asserted that there was no true gift, because the donors reserved numerous rights in the scenic easement property, and also that they lacked the requisite donative intent and exclusive conservation purpose when they conveyed the scenic easement.

---

[241] *Id.* at 706.
[242] *Id.*
[243] Rev. Rul. 89-90, 1989-2 C.B. 3.
[244] *Rome I Ltd. v. Commissioner*, 96 T.C. 697, 707 (1991). *Cf.* Gen. Couns. Mem. 39664, in which the IRS took the position that recapture of a rehabilitation tax credit under these circumstances was not required.
[245] IRC § 170(f)(14). This rule applies with respect to contributions made after August 17, 2006.
[246] *McLennan v. United States*, 91-1 U.S.T.C. ¶ 50, 230 (Cl. Ct.); 91-2 U.S.T.C. ¶ 50,447 (Ct. Cl. 1991).

Because of the reservation of certain rights, the IRS contended that the donors retained dominion and control over the easement property and thus transferred nothing of value to the charitable organization. The court, however, ruled that some of these restrictions enabled the recipient charity to ''adequately preserve the scenic quality of the easement property.''[247] Thus, the court held that the donors transferred ''value'' to the conservancy organization through the scenic easement conveyance and concluded that the easement placed material restrictions on the donors' use of the property, as required by the law.[248]

The issue the court declined to resolve at the time was that of the donors' intent in making the contribution. The court observed that, in general, the tax law ''permits charitable deductions for bona fide gifts irrespective of a taxpayer's motivations.''[249] But, the court added, a donor ''must not expect a substantial benefit as a *quid pro quo* for the transfer.''[250] To this end, then, courts will be looking at the ''external features''[251] of a transaction.

The IRS took the position that the donors did not transfer the scenic easement for an exclusive conservation easement purpose. This assertion was in addition to the one that the donors lacked the necessary donative intent. The donors argued that they granted the scenic easement for the ''purpose of protecting the area . . . from further development so as to preserve the beauty and environmental systems of that area.''[252] The IRS, however, countered that the donors had granted the easement with the ''expectation of preserving property values and achieving desired zoning restrictions for the property.''[253] The court wrote that it was unable at the time to determine whether the benefits accruing to the donors (other than the tax savings generated by the charitable deduction) ''were merely incidental to a greater public conservation benefit derived from the scenic easement conveyance'' and noted that the facts required ''further ventilation.''[254] The court observed that donors bear the burden ''of proving at trial that . . . [they] transferred the easement to the [c]onservancy with the requisite donative intent and exclusive conservation purpose.''[255]

(i) Special Rules for Capital Gain Real Property

The 30 percent contribution base limitation on contributions of capital gain property by individuals[256] is inapplicable to qualified conservation contributions.

[247] *Id.*, 91-1 U.S.T.C. ¶ 50,230, at 87,925.
[248] Reg. § 1.170A-7(b)(1)(ii).
[249] *McLennan v. United States*, 91-1 U.S.T.C. ¶ 50,230 (Ct. Cl. 1991), at 87,926.
[250] *Id.*
[251] *Id.*
[252] *Id.*
[253] *Id.*
[254] *Id.*
[255] *Id.* This opinion was affirmed on appeal in *McLennan v. United States*, 994 F.2d 839 (Fed. Cir. 1993). The matter of donative intent in the general charitable giving context is explored in § 3.1.

In *Osborne v. Commissioner*, 87 T.C. 575 (1986), a charitable deduction was allowed for the installation and transfer of drainage facilities and easements to a city. The IRS challenged the deduction, alleging that the facilities enhanced the value of the donors' property. The court allowed the deduction only to the extent the transfer ''gratuitously benefited'' the city. *Id.* at 583. The court allowed the deduction, using a value about twice that asserted by the government.

[256] See § 7.6.

Rather, individuals may deduct the fair market value of any qualified conservation contribution to a public charity[257] to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions.[258] These contributions are not taken into account in determining the amount of other allowable charitable contributions.[259]

Individuals are allowed to carry over any qualified conservation contributions that exceed the 50-percent limitation for up to 15 years.[260] This rule, as enacted was applicable to contributions made in tax years beginning after December 31, 2005, and before January 1, 2008.[261]

Thereafter, these rules were extended and made applicable to contributions made in tax years beginning before January 1, 2010.[262]

EXAMPLE 9.7

An individual with a contribution base of $100x makes a qualified conservation contribution (within the permitted time period) of property with a fair market value of $80x and makes other charitable contributions, subject to the 50-percent limitation, of $60x. This individual is allowed a deduction of $50x in the current tax year for the nonconservation contributions (50 percent of the $100x contribution base) and is allowed to carry over the excess $10x for up to 5 years.[a] A current deduction is not allowed for the qualified conservation contribution but the entire $80x qualified conservation contribution may be carried forward for up to 15 years.

[a] See § 7.5(b).

(j) Special Rules for Farmers and Ranchers

In the case of an individual who is a qualified farmer or rancher for the tax year in which a contribution is made, a qualified conservation contribution deduction is allowable up to 100 percent of the excess of the individual's contribution base over the amount of all other allowable charitable contributions.[263] A *qualified farmer or rancher* is a person whose gross income from the trade or business of farming[264] is greater than 50 percent of the person's gross income for the tax year.[265]

In the case of a corporation (the stock of which is not publicly traded) that is a qualified farmer or rancher for the tax year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income[266] over the amount of all other allowable charitable contributions.[267] Any excess may be carried forward for up to 15 years as a contribution subject to the 100 percent limitation.[268]

---

[257] That is, an organization described in IRC § 170(b)(1)(A). See § 3.4.
[258] IRC § 170(b)(1)(E)(i).
[259] IRC § 170(b)(1)(E)(iii).
[260] IRC § 170(b)(1)(E)(ii).
[261] IRC § 170(b)(1)(E)(vi).
[262] Food and Energy Security Act of 2008, Pub. L. No. 110-234 § 15302.
[263] IRC § 170(b)(1)(E)(iv)(I).
[264] See IRC § 2032A(e)(5).
[265] IRC § 170(b)(1)(E)(v).
[266] IRC § 170(b)(2)(C).
[267] IRC § 170(b)(2)(B)(i).
[268] IRC § 170(b)(2)(B)(ii).

As an additional condition of eligibility for the 100 percent limitation, with respect to any contribution of property in agriculture or livestock production, or that is available for such production, by a qualified farmer or rancher, the qualified real property interest must include a restriction that the property remains generally available for such production.[269] (There is no requirement as to any specific use in agriculture or farming, or necessarily that the property be used for such purposes; it is sufficient that the property merely remain available for such purposes.) This additional condition does not apply to contributions made after December 31, 2005, and on or before August 17, 2006.

This rule, as enacted was applicable to contributions made in tax years beginning after December 31, 2005, and before January 1, 2008.[270]

Thereafter, these rules were extended and made applicable to contributions made in tax years beginning before January 1, 2010.[271]

EXAMPLE 9.8

Using the facts of Example 9.7, if the individual is a qualified farmer or rancher, in addition to the $50x deduction for the nonconservation contributions, an additional $50x deduction for the qualified conservation contribution is allowed and $30x may be carried forward for up to 15 years as a contribution subject to the 100 percent limitation.

§ 9.8 S CORPORATION STOCK[272]

S corporations are small business corporations that, for federal income tax purposes, are treated as partnerships.[273] Prior to 1998, charitable organizations were prohibited from owning stock issued by these corporations.[274] If a charity became a shareholder of one of these entities, the corporation immediately lost its S corporation status and became subject to many of the disadvantageous provisions of the income tax laws generally applicable to corporations.

(a) Background and Introduction

Charities now have access to gifts of stock of closely held businesses that were previously inaccessible to them. Many of these business owners have the opportunity to make charitable gifts of this type of stock.

---

[269] IRC § 170(b)(1)(E)(iv)(II).

[270] IRC §§ 170(b)(1)(E)(vi), 170(b)(2)(B)(iii). The IRS issued guidance as to these rules (Notice 2007-50, 2007-25 I.R.B. 1430), including an explanation as to how the percentage limitations and carryovers apply in a year in which an individual has made a qualified conservation contribution and one or more other charitable gifts; addresses the definition of the terms qualified conservation contribution, qualified farmer, and qualified rancher; and explains the nature of a restriction that the property is available for agriculture or livestock production.

[271] Food and Energy Security Act of 2008, Pub. L. No. 110-234 § 15302. In general, Small, "Proper—and Improper—Deductions for Conservation Easement Donations, Including Developer Donations," 46 *Ex. Org. Tax Rev*. (no. 2) 177 (Nov. 2004).

[272] This section is based in part on materials prepared by Christopher R. Hoyt, Esq., Professor of Law, University of Missouri-Kansas City, with Professor Hoyt's permission.

[273] IRC §§ 1361–1379.

[274] Former IRC § 1361(c)(7).

The major tax problem in this regard for charitable organizations is that this type of interest is regarded as ownership in an unrelated business.[275] Items of income, loss, or deduction of an S corporation flow through to charitable organization shareholders as unrelated business income.[276] A charity is taxed on its share of an S corporation's income, as determined for accounting purposes, rather than simply on the corporation's actual cash distributions. Gain or loss on the disposition of stock in an S corporation results in unrelated business income.[277]

(b) Gifts from Donor's Perspective

A donor must initially determine whether he or she is willing to contribute S corporation stock to a charitable organization. This donor will consider many of the same factors that he or she would for a gift of an ownership interest in any type of closely held business. Two of these are (1) whether the donor would be comfortable with a charity having the legal rights of a minority shareholder, and (2) whether the stock is subject to a transfer restriction that would prevent the charity from selling or granting the stock to another party without the shareholder's approval.

The income tax deduction usually will be less than the appraised value of the stock. The tax law mandates that the income tax deduction for a charitable gift of S corporation stock be reduced under rules that are analogous to charitable gifts of partnership interests.[278] It may be possible to avoid a reduced deduction by having the donor terminate the S corporation status shortly before making the gift of the stock. The step transaction doctrine[279] may, however, foil this approach.

Otherwise, the charitable contribution deduction available to the donor is contingent upon compliance with the gift substantiation rules[280] and, most likely, the appraisal requirements.[281] If the charitable donee sells or otherwise disposes of the stock within three years of its receipt, there is a requirement to provide reports to the IRS and the donor.[282]

(c) Gifts from Donee's Perspective

Both tax and nontax issues face a charitable organization that is contemplating receiving or that holds stock of an S corporation.

Nontax Issues. Charitable organizations readily accept contributions of publicly traded marketable securities. A charity should, however, treat offers of S corporation stock in a manner similar to prospective gifts of real estate. Just as each parcel

[275] IRC § 512(e)(1)(A). See § 3.5.
[276] IRC § 512(e)(1)(B)(i).
[277] IRC § 512(e)(1)(B)(ii).
[278] IRC §§ 170(e)(1), 751. This is an addition to the body of law treating certain items as ordinary income, rather than capital gain, thereby necessitating a reduction in the charitable deduction. See § 4.4(b).
[279] See § 4.8.
[280] See § 21.3.
[281] See § 21.5.
[282] See § 24.10.

of real estate is unique, an S corporation is a separate business, the success or failure of which depends primarily on the management skills of the corporation's directors and shareholders. Although ownership of S corporation stock does not incur the maintenance responsibilities associated with real estate, a charity can incur additional bookkeeping burdens as the result of owning and selling this type of stock.

The crucial issue is whether the stock looks like an attractive investment in relation to the potential burdens that owning the stock could impose. Questions to be asked include how soon the stock can be sold and converted into productive marketable investments, and, if the stock is to be held for a period of time, if it can produce net cash flow (after payment of the unrelated business income tax) for use for charitable purposes. The tax consequences will generally be secondary to the basic economics of the transaction.

As a general rule, charities prefer to sell interests in closely held businesses that have been contributed to them, as these assets do not usually conform to charities' overall investment philosophy. Stock in an S corporation is not an exception to this basic policy; the charitable donee is almost certain to want to sell it (imposition of the unrelated business income tax will likely make the charity even more eager to sell the asset).

Donors may, however, expect the charity to hold the S stock for a significant period of time. Moreover, there is a restricted market for selling this type of stock; it is frequently confined to the corporation itself, existing shareholders, or purchasers who have been preapproved by the existing shareholders. Inasmuch as a charitable organization is almost certain to be a minority shareholder, it must rely on the controlling shareholders for fair treatment. For example, the charity should satisfy itself that the control group will not engage in practices that may prove damaging (or even embarrassing) to the charity.

Consequently, a charity is well advised not to accept a gift of S corporation stock unless it is reasonably satisfied that there will not be any resulting material financial difficulties. A charity should also investigate the possibility of problems under state law concerning ownership of S corporation stock. If the stock is to be sold several years after the contribution, the charity should be assured (by means including procurement of a timely appraisal) that it is receiving a fair price for the stock.

Another nontax issue is the credit to be given a donor of S corporation stock in the context of a major campaign. The choice is between the full fair market value of the stock or that value reduced by the amount of the unrelated business income tax burden. Likewise, if the stock is donated in exchange for a charitable gift annuity,[283] the choice is essentially already made: as only the after-tax amount will be left to pay the annuity, the annuity should be based on the amount of the after-tax proceeds.[284]

---

[283] See ch. 14.

[284] In the unrelated debt-financed income setting, the law requires only that the value of a charitable gift annuity be less than 90 percent of the value of the contributed property. IRC § 514(c)(5); see § 14.6. A charity is therefore free to issue a charitable gift annuity based on an amount that is lower than the fair market value of the donated property.

Tax Issues. The greatest potential tax burden that owning and selling S corporation stock presents to a charity is payment of the tax on unrelated business income.

If the income from the corporation is minimal, there presumably is not a tax problem. The first $1,000 of unrelated business income is not taxable[285] (and the unrelated business income tax return, Form 990-T, need not be filed). Quarterly estimates of the tax[286] need not be filed (on Form 990-W) if the total tax liability for the year is less than $500.[287] The charity can assess this situation by asking questions of the donor and by examining the Schedule K-1 information returns that the S corporation issued to the donor in recent years. Otherwise, the tax return must be filed and taxes paid, and quarterly estimates of the tax will have to be paid to avoid penalties.[288]

If the gift of S corporation stock is accepted, the charity should learn the donor's adjusted basis in the stock, because that will be used in determining the amount of taxable gain the charity will have on the sale of the stock.[289] A low basis could cause normally tax-exempt cash distributions (see below) to be taxable and could prevent the charity from deducting the business operating losses. Various administrative requirements, such as gift substantiation and an independent appraisal, are noted above.

Generally, the income of an S corporation is allocated to each shareholder in proportion to the number of shares owned by that shareholder.[290] If a shareholder acquires or disposes of S corporation stock during a year, the shareholder is taxed on a portion of the year's income based on the number of days that the shareholder owned the stock during that year.[291]

Unrelated business taxable income in this context consists of the charity's share of the accounting income shown on the shareholder's Schedule K-1, which the corporation attaches to its annual tax return (Form 1120S). The accounting income is rarely the same as the cash distributions that the charity receives from the S corporation. It is common for an S corporation to retain part of its profits to reinvest in growing the business. With rare exceptions, the cash distributions that the charity receives from the S corporation will be nontaxable, because the tax is levied on the accounting-based income instead.[292]

To the extent that the unrelated business income tax cannot be avoided,[293] a charity's primary tax concern should be that there is sufficient cash available to pay the tax as it comes due, usually in quarterly estimated tax payments.

---

[285] IRC § 512(b)(12).

[286] IRC § 6655(a)–(d), (g)(3).

[287] IRC § 6655(f).

[288] Reg. § 1.511-3(a).

[289] The donor's basis will carry over to the charity. IRC § 1223(2). The charity will adjust this basis amount over time to reflect its share of the corporation's income and distributions. IRC § 1367.

If the charity purchased the stock, rather than received it as a gift, and the corporation was previously a C corporation, any "dividends" attributable to the corporation's years as a C corporation reduce the basis in the stock. IRC § 512(e)(2).

[290] IRC § 1366(b).

[291] IRC § 1377(a)(1).

[292] IRC § 1368.

[293] For example, a charity may own interests in several S corporations and partnerships, some of which generate profits and others of which generate losses; if the losses exceed the profits, there is no unrelated taxable income.

Although most S corporations distribute sufficient cash to their shareholders to enable them to pay the income tax attributable to that income, a charity should address this issue before accepting a gift of S corporation stock. A charity should avoid accepting stock of an S corporation that is like a burned-out partnership tax shelter, with substantial accounting income and little in the way of actual cash distributions to pay the unrelated business income tax.

When the stock is sold, the charity will want adequate assurance that it is selling the stock for a fair price. Sales made close to the date of the gift can usually be done at a price that is at or near the original appraised value of the stock. If the sale will be several years later, the original appraisal will be outdated and the charity will require some other assurance (such as a contemporaneous appraisal) that the price is adequate. A charitable organization can sell the stock at a below-value price if it makes a valid business judgment that it should rid itself of the asset because of tax liabilities.

Unlike most other assets, gain from the sale of S corporation stock is subject to the unrelated business income tax that the charity must pay.[294] The amount of the gain from the sale of S corporation stock, however, is usually much less than that from comparable C corporation stock, because the basis of S corporation stock is usually increased by the amount of corporate profits that were retained by the S corporation.[295]

Other Tax Issues. As noted, actual distributions of cash and property by an S corporation (as contrasted with accounting-based income) are generally nontaxable. There are, however, three situations in which a distribution from an S corporation can be taxable. One is when the distribution is greater than the basis in the stock; the excess is taxable as capital gain.[296] The second is when the S corporation previously was a C corporation; a distribution of accumulated profits attributable to the C corporation years could be a taxable dividend to taxpaying shareholders, but it is probably not taxable as unrelated business income to a tax-exempt shareholder in the year paid. A tax-exempt shareholder that purchased S corporation stock may, however, ultimately have to pay tax on such a distribution in the year the stock is sold, because the distribution reduces the basis of the stock. The third situation can be the most serious: when the S corporation distributes appreciated property (such as real estate) to its shareholders. This type of distribution can trigger taxable income, irrespective of whether it is distributed as an ongoing distribution or a liquidation.[297] This could pose a burden for all shareholders, including charities, because they will have to spend money to pay the tax when all they might have received is illiquid property.

If a donor has a low basis in his or her S corporation stock, it increases the likelihood of two problems. The first, as noted, is that a distribution from the corporation might be taxable because distributions in excess of basis are taxable. The second problem is that if the S corporation has losses instead of profits, the charity might not be able to deduct the entire amount of the losses. The loss deduction

[294] IRC § 512(e)(1)(B)(ii). *Cf.* IRC § 512(b)(5) (general exclusion for capital gains).
[295] IRC § 1367(a), (b).
[296] IRC § 1368(b)(2), (c)(3).
[297] IRC §§ 311(b), 1371(a)(1).

is limited to the charity's basis in the stock and any unused loss is carried forward to future years.[298] This could be a problem if the charity owns interests in other S corporations or partnerships that generate unrelated business taxable income and the charity would like to use the losses to reduce the unrelated business tax liability. Further, a low basis means a potentially higher gain from sale of the S corporation stock, which will trigger a larger amount of unrelated business income.

If the S corporation has losses, there is a second issue: whether the passive loss limitation[299] applies to prevent a charity from deducting an S corporation's operating losses against the corporation's interest, dividend, and other portfolio income. This issue has not been previously addressed, in that the investment income of exempt organizations is generally excluded from unrelated business income taxation.[300] Because a significant number of S corporations report operating losses, however, the passive loss issue is likely to arise soon. Although arguments can be made that the passive loss limitation does not apply to unrelated business income, it would be helpful if the IRS clarified the point.

Because interest paid on state and local government bonds is normally tax-exempt income to individuals,[301] many partnerships and S corporations invest in these bonds. However, because unrelated business income is computed without reference to regular income tax statutes, and because the unrelated business income statute requires an exempt organization to treat all income attributable to an S corporation as unrelated business income, an S corporation's municipal bond interest attributable to charitable organizations may be subject to the unrelated business income tax.

When a charitable organization engages in an unrelated business that generates unrelated business income, it can claim a charitable deduction for an amount contributed to an unrelated charity.[302] The question thus arises as to whether an S corporation's charitable gifts are deductible by the charitable organization/shareholder in the same manner.[303] A related question is whether there is any reduction in the benefit of the charitable gift if the S corporation makes a gift to the charity that owns some of its stock. There certainly is a problem if the S corporation is a subsidiary of the charity,[304] but the tax outcome is unclear when the charity owns only a small percentage of the stock. This is another area where IRS guidance is needed.

The foregoing issues are related to another one: Does S corporation income retain or lose its character for unrelated business income purposes? This issue is most important for charitable trusts, in that they might be able to pay only the long-term capital gains tax[305] instead of a 39.6 percent tax rate if an S corporation's long-term capital gains keep their character, rather than being reclassified as ordinary income.

---

[298] IRC § 1366(d); IRC §§ 1367(2)(B) (for stock), 1367(b)(2) (for debt).
[299] IRC § 469.
[300] IRC § 512(b)(1).
[301] IRC § 103.
[302] IRC § 512(b)(10) (corporations); IRC § 512(b)(11) (trusts).
[303] IRC § 512(e)(1)(B)(i) states: "All items of income, loss, or *deduction* taken into account under section 1366 (a) . . . shall be taken into account in computing the unrelated business taxable income" of a tax-exempt organization" (emphasis added).
[304] See § 3.1(a).
[305] See § 2.16(a).

By way of background, the character of a shareholder's pro rata share of income of an S corporation is determined as if the shareholder had directly engaged in the transaction.[306] This means that the characteristics of different forms of income pass through to the shareholder. For example, an individual obtains the benefit of lower long-term capital gains rates from the corporation's capital gains. Similarly, the individual's ability to deduct the corporation's charitable contributions may be restricted based on the individual's own charitable gifts.

The law is not clear as to whether these principles carry over to a charity that owns S corporation stock. This complication arises out of the fact that the pertinent provision of the S corporation unrelated business income statute[307] only refers to the rules by which a shareholder's tax liability is determined.[308] The question is whether the omission of any reference to the character pass-through rule[309] means that the character of the income does not pass through. Guidance from the IRS on this point is critical, in that charitable trusts will pay a different amount of unrelated business income tax depending on whether the S corporation's long-term capital gain retains its character or is instead treated as ordinary income.

The closest comparable law is that pertaining to partnerships, and it is of little help. The instructions to the exempt organization unrelated business income tax return suggest that all partnership unrelated business income is condensed to a single line reflecting net partnership income. This may not have posed much of a problem in the past, when charities only paid the unrelated business income tax on the portion of the partnership's income that came from an unrelated business activity. A partnership's investment income is exempt from unrelated business income taxation.[310] The consequences can be different for income from an S corporation because its investment income is subject to the unrelated business income tax.

Most S corporations are required to use the calendar year, to coincide with the tax years of their shareholders,[311] who usually are individuals. A charitable organization may, however, have a different fiscal year. Until there is IRS guidance, probably the safest strategy is to conform to the rules that tax-exempt organizations use for reporting income from a partnership that has a different fiscal year: They include in income the amount shown on the partnership's schedule that is dated within their own fiscal year.[312]

Because a C corporation with fewer than 75 shareholders can easily convert to an S corporation by making an election, a series of special rules prevent converted C corporations from completely escaping some of the taxes that otherwise would have applied to them. Problems can therefore arise if an S corporation that was once a C corporation sells property that it owned at the time of the switch within 10 years of the conversion,[313] invests large portions of its assets in passive

[306] IRC § 1366(a), (b).
[307] IRC § 512(e)(1)(B)(i).
[308] IRC § 1366(a).
[309] IRC § 1366(b).
[310] IRC § 512(c); Reg. § 1.512(c)-1.
[311] IRC § 1378.
[312] IRC § 512(c)(2); Reg. § 1.512(c)-1.
[313] IRC § 1374.

investments,[314] had LIFO inventories at the time of conversion,[315] or distributes dividends attributable to its C corporation years.

Although the S corporation statutes seemingly permit a private foundation to own S corporation stock,[316] most private foundations are prohibited from owning this type of stock because of the rules prohibiting excess business holdings.[317] To the extent that a private foundation can hold S corporation stock, it is not liable for the 2 percent excise tax on net investment income,[318] because the S corporation income is subject to the unrelated business tax.[319] In appropriate circumstances, a supporting organization[320] may be used as a holder of S corporation stock in lieu of a private foundation.

Because S corporations were designed for small business, the law contemplates the possibility of mistakes as to some of the technical requirements. Congress instructed the IRS to forgive ''invalid elections'' and ''inadvertent terminations'' of S corporation status when the mistakes were innocent.[321] The IRS has been fairly lenient and forgiving in this regard.[322] To qualify for inadvertent termination relief, the disqualifying transaction should be undone and the parties returned to their original position. Inadvertent termination treatment might be an appropriate remedy if, for example, S corporation stock was mistakenly contributed to a charity's pooled income fund, which is not eligible to hold S corporation stock.[323] Otherwise, the general rule is that a corporation that has lost its S corporation status is ineligible to reelect that status for at least five years after that status was terminated.[324]

A corporation can have its S corporation status voluntarily or involuntarily revoked.[325] What happens to a charitable organization if this occurs while the charity owns the corporation's stock? Presumably, the charity would have to report as unrelated business income its share of the S corporation's income until the date of revocation. The converse should be the case if a charity owned stock of a C corporation that converted to an S corporation: The charity would begin to recognize unrelated business income as of the date of S corporation status. If a charity is a shareholder at the time of a C-to-S conversion, the C corporation would not be able to switch to an S corporation unless the charity consented to the conversion.

The much more complicated issue, in an instance of one of these conversions, is treatment of the gain on the sale by the charity of the corporation's stock. A donor may contribute S corporation stock to a charity, the corporation may subsequently convert to a C corporation, and the charity may later sell the stock. At

---

[314] IRC §§ 1375, 1362(d)(3).
[315] IRC § 1363(d).
[316] IRC §§ 1361(b)(1)(B) and 1361(c)(7) permit any charitable (IRC § 501(c)(3)) organization to be an eligible shareholder.
[317] IRC § 4943. See *Private Foundations* ch. 7.
[318] IRC § 4940. See *Private Foundations* ch. 10.
[319] IRC § 4940(c)(2).
[320] IRC § 509(a)(3). See *Private Foundations* § 15.7.
[321] IRC § 1362(f).
[322] E.g., Priv. Ltr. Rul. 9728022.
[323] IRC § 1362(d)(2).
[324] IRC § 1362(g).
[325] IRC § 1362(d)(1).

present, there is no guidance as to whether all, some, or none of the gain is taxable as unrelated business income.

(d) Conclusion

The ability of charities to own S corporation stock opens the door to charities' participation in the most common form of small business. Charities and donors should first focus on the fundamental economics of a potential gift of S corporation stock before wrestling with the unrelated business income issues. Certainly, if the transaction would not benefit the charity, the gift should not be accepted.

The interaction of the unrelated business income rules and the laws of S corporations, the latter now involving charities because of the new S corporation gift rules, poses many unique and unanswered legal issues that await guidance from the IRS.[326]

§ 9.9 SECTION 306 STOCK

The federal tax law recognizes a special type of stock known as *section 306 stock* (the term is derived from the section of the Internal Revenue Code that provides the tax rules for this type of security). Section 306 stock essentially is stock distributed to a shareholder in circumstances that make the value of the stock distributed not includible in the recipient's gross income.[327] The proceeds from the sale of section 306 stock are treated as ordinary income rather than as capital gain.[328]

In one case, an individual acquired section 306 stock as a dividend on common stock, and this receipt was not recognized as income.[329] He contributed the stock to a public charitable organization and claimed a contribution deduction for the full fair market value of the stock, while simultaneously not diminishing his control over the corporation. The IRS litigated the claimed deduction; the court involved held that this donor must reduce what would otherwise be the charitable contribution deduction (based on the fair market value of the stock) by the amount of ordinary income that would have been realized upon a sale of the stock.[330]

In a similar case, two individuals made charitable contributions of section 306 stock to a school and a college, and claimed charitable contribution deductions based on the fair market value of the stock. Once again, the IRS litigated the matter; in defense, the donors asserted an exception to the general rule concerning section 306 stock, which is that a disposition of section 306 stock will receive capital gains treatment "[i]f it is established to the satisfaction of the Secretary [IRS] that the distribution, and the disposition or redemption, was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax."[331]

---

[326] In general, see Hoyt, "Charitable Gifts of S Corporation Stock: How to Solve the Practical and Legal Problems," 2 *J. Planned Giving* (no. 1) 5 (Jan. 1998).
[327] IRC § 306(c)(1)(A).
[328] IRC § 306(a).
[329] IRC § 305(a).
[330] *Bialo v. Commissioner*, 88 T.C. 1132 (1987). The deduction reduction rule involved is discussed in § 4.4.
[331] IRC § 306(b)(4)(A).

During the trial, it was shown that the stock was issued as part of a reorganization that took the form it did to enable the individuals to retain control of and participate in the future growth of the issuing company and to "freeze" the value of a portion of their equity in the corporation for estate tax planning purposes. The trial court concluded: "We are not persuaded that he [one of the taxpayers] was unaware that the consequences of such a [charitable] deduction would be avoidance of ordinary income tax on the bail-out of corporate earnings."[332] The court concluded that the individuals did not meet their burden to "clearly negate" the assertion that avoidance of federal income tax was one of the principal purposes of the disposition of the section 306 stock.[333]

On appeal, the appellate court held that the burden of proof on the donors was "heavy"; it disagreed with the individuals' position. The appellate court concluded that "a finder of fact could reasonably infer that . . . [the principal individual] knew of the tax consequences at the time he made his donations."[334] This individual was characterized as a "successful and sophisticated businessman"; the court noted that he sought and received a ruling from the IRS that the stock, when originally issued, was section 306 stock.[335] His testimony at trial that he did not have the tax consequences of his charitable contributions in mind at the time he made them was held by the court of appeals to be self-serving and thus was disregarded. Although these charitable actions were found to be "generous, sincere, and praiseworthy,"[336] the appellate court found that these individuals failed to meet their burden of proof, thereby defeating their attempt to secure capital gain treatment for the stock should it have been sold and to secure a full fair market valuation for their gifts.

§ 9.10 RETIREMENT PLAN ACCOUNTS[337]

The federal tax laws embody preferences for charitable contributions of some forms of property over others. Thus, for example, while a donor is alive, he or she usually will enjoy preferential income tax benefits from giving long-term capital gain property rather than gifts of cash or ordinary income property.[338] Federal tax law also favors gifts of certain forms of property at death. Thus, donors and their heirs are generally in a preferred tax position if charitable bequests consist of property that generates income in respect of a decedent.

(a) Income in Respect of Decedent

Property that generates *income in respect of a decedent* (IRD) is inherited property that, had the decedent received it before death, would have been taxable income to the decedent. This is an important exception to the general rule that inherited

[332] *Pescosolido v. Commissioner*, 91 T.C. 52 (1988).
[333] *Id*. at 60.
[334] *Pescosolido v. Commissioner*, 883 F.2d 187 (1st Cir. 1989).
[335] *Id*. at 190.
[336] *Id*.
[337] § 9.10(a)-(c) is based in part on materials prepared by Christopher R. Hoyt, Esq., Professor of Law, University of Missouri-Kansas City, with Professor Hoyt's permission.
[338] In general, see § 4.3.

property is exempt from federal income tax.[339] When income in respect of a decedent is received, the estate (or, if paid directly to a person, the person) is required to include it on the federal income tax return for the year it was received.[340] The recipient can, however, claim an income tax deduction for the federal estate tax attributable to the income in respect of a decedent.[341]

There are many forms of income in respect of a decedent, such as uncollected lottery winnings and installment sales payments. Another common—and rapidly growing—source is distributions from a decedent's retirement plan account. These accounts include profit-sharing plans, individual retirement accounts, 401 (k) retirement plans, and 403(b) tax-sheltered annuity accounts.

EXAMPLE 9.9

This is an example of bequests of property in respect of a decedent in the absence of a charitable gift. A grandparent (GP) wishes to treat his grandson (GS) and granddaughter (GD) equally in his estate planning. His estate includes $100,000 of stock (with a basis of $60,000) bequeathed to GD and $100,000 in his 403(b) tax-sheltered annuity account to GS. Both these assets will be subject to the estate tax if the estate is valued in excess of $600,000. When GD receives her $100,000 of stock, she does not have to pay any income tax; indeed, she receives a stepped-up basis in the stock so that a subsequent sale of the stock for $100,000 will not trigger any tax on the capital gain.[a]

By comparison, when GS receives the $100,000 from the retirement plan, the entire amount becomes subject to income tax (as income in respect of a decedent). Although GS can deduct the applicable federal estate tax to lessen his income tax exposure, GP failed in his effort to treat his grandchildren equally, because GS will have fewer after-tax resources than GD.

[a] IRC § 1014.

(b) Charitable Contribution Planning

Charitable bequests should be made, to the extent possible, from property that constitutes IRD. In many instances, there is a gross misallocation of resources with respect to charitable bequests. Individuals fill out their retirement plan beneficiary designation forms to leave their taxable assets to family members and instruct their lawyers to prepare wills that leave tax-free assets to charities in the form of charitable bequests. Proper planning principles dictate reversal of this situation: The taxable assets (income in respect of a decedent) should be used for charitable bequests and the tax-free assets should be given to family members.[342]

Even individuals who had not planned on making a charitable bequest should consider giving IRD assets to charity at death. Although the highest marginal estate tax rate reaches 55 percent with estates in excess of $3 million,[343] the combination of estate and income taxes on IRD assets can exceed 75 percent in the instance of larger estates. At a cost to the heirs of less than 25 percent of the assets, an individual can have 100 percent of IRD assets devoted to a charitable purpose.

[339] IRC § 102(a), (b).
[340] IRC § 691.
[341] IRC § 691(c).
[342] An example of the appropriate manner in which to structure these transfers, when charitable organizations were not taxable on the IRD resulting from bequests of 403(b) annuity contracts and individual retirement accounts, was provided in Priv. Ltr. Rul. 200234019.
[343] See § 8.1.

A surviving spouse can roll over an inherited retirement plan distribution to an individual retirement account and thereby avoid paying income tax in the year of receipt.[344] No other individual, however, can do this. If someone will inherit large amounts of taxable retirement plan assets from a single, widowed, or divorced individual, he or she may be able to accomplish something close to a rollover by having the retirement plan assets distributed to a charitable remainder trust[345] rather than to the heirs or the probate estate.

(c) Potential Problems and Solutions

Overview. The transfer of retirement plan assets to charitable organizations and charitable remainder trusts involves multiple areas of legal specialization. These areas of the law include the retirement plan rules (chiefly, the Employee Retirement Income and Security Act (ERISA)), estate taxation, income taxation of estates, the law of tax-exempt organizations, and the laws regarding charitable remainder trusts.

It is not enough to solve the problems that exist solely in one area of the law. Every area could pose a significant problem that could prevent a donor or a charitable organization from obtaining the optimal result. The situation is further complicated by the paucity of law; the legal authority that is precisely on point consists of IRS private letter rulings.[346]

Retirement Plan Issues. As a general rule, the assets in a retirement plan must be distributed over an individual's life expectancy beginning at age 70½, so that the retirement plan account should be nearly empty at the time of the individual's death.[347] An exception is that an individual can add the life expectancy of the individual who is named as the successor beneficiary (for example, a spouse) so that there will be assets in the plan at the time of death to transfer to the successor beneficiary. The problem is, of course, that a charitable organization does not have a life expectancy, nor does the probate estate. Consequently, naming either a charity or the probate estate as a successor beneficiary will force distributions to be made over the donor's single life expectancy, so that nothing may be left for the charity at death.

The solution is to name an individual as the first successor beneficiary and a charitable organization as the contingent beneficiary. Within nine months of death, the first beneficiary can disclaim some or all of the assets so that they pass to the charity.[348] The charity can take several practical steps to assure that the property will in fact be disclaimed, such as obtaining a letter of intent.

Another problem is that, after an individual's death, all assets must generally be distributed from the individual's retirement plan account within five years of death. There are ways to avoid this, such as distributing assets over the life expectancy of the oldest successor beneficiary.[349] The problem is that naming a

[344] IRC § 402(c)(9).
[345] In general, see ch. 12.
[346] E.g., Priv. Ltr. Rul. 9237020.
[347] IRC § 401(a)(9).
[348] IRC § 2518.
[349] IRC § 401(a)(9)(B)(iii).

charitable organization as a successor beneficiary might eliminate the exceptions. The other beneficiaries might, therefore, have to receive all of the assets over the five-year period, which could be a shorter period than they want.

If a charitable organization will receive some retirement plan assets and individuals will receive the balance, it may be best to roll over the charity's assets to a separate individual retirement account so that the effect of naming a charity as a beneficiary will be limited to those assets and will not affect the other assets.

There has been a question as to whether a charitable remainder trust funded with income in respect of a decedent is to be treated as a ''fund trust'' under the economic benefit doctrine, so that the income beneficiary has income in the year of deposit. The IRS concluded, however, that neither the estate nor any income beneficiary has taxable income in the year IRD assets are deposited into a charitable remainder trust.[350]

Estate and Income Tax Issues. A specific bequest to a charitable organization usually qualifies for an estate tax charitable deduction on the estate tax return but not an income tax deduction on the estate's income tax return. To qualify for an income tax charitable deduction, the gift must consist of income, in which case the charitable deduction is usually taken only on the income tax return and not on the estate tax return.

EXAMPLE 9.10

D's will provides for a bequest of $500,000 to a charitable organization. Shortly after her death, her estate receives a $400,000 distribution of her account in a company's profit-sharing plan. Her estate's tax return will report both the transfer of $400,000 in profit-sharing plan assets and an offsetting $500,000 charitable estate tax deduction. The estate's income tax return, however, will report only the $400,000 distribution from the profit-sharing plan as income. It will not be entitled to an offsetting income tax charitable deduction, because the charitable gift is deemed to be made from corpus rather than from income.

Thus, every individual who plans to make a charitable bequest should have language in his or her will or governing trust instrument that, to the extent possible, every charitable bequest will be made with property that constitutes IRD. To facilitate the ''tracing'' requirement for an estate's charitable income tax deduction, the representative of the estate should establish a separate checking account to deposit amounts that are IRD and should make the charitable gifts from this account.[351]

By doing this, the estate has a strong argument that the estate is entitled to both an estate tax and an income tax charitable contribution deduction.[352] Although the courts and the IRS generally are of the view that a charitable deduction should be taken on only one return or the other, a good policy argument is

[350] Priv. Ltr. Rul. 9634019.

[351] The tracing rule is the subject of Reg. § 1.642(c)-3(b). The IRS ruled that proceeds passing from a decedent's retirement plans to a private foundation give rise to a charitable deduction for the decedent's estate and that these proceeds constitute IRD to the foundation. Priv. Ltr. Rul. 9818009. (These proceeds, however, are not a form of income that is subject to the private foundation excise tax on net investment income. IRC § 4940; Priv. Ltr. Rul. 9838028.)

[352] $400,000 in Example 9.10.

that an exception should be made for IRD inasmuch as, in the absence of a charitable gift, it would be taxed on both the estate and income tax returns.

This solution is not without complications if the transfer is to a charitable planned giving vehicle, such as a charitable remainder trust. (As explained,[353] pooled income funds[354] are to be avoided.) There is ample legal authority for an estate to claim an estate tax charitable deduction for a transfer to a charitable remainder trust, but there is virtually no guidance under which an estate may claim an income tax charitable deduction for this type of transfer.[355]

EXAMPLE 9.11

An estate receives a distribution in the amount of $100,000 from a retirement plan. The estate is required to transfer the entire amount to a charitable remainder trust that is to pay income to the donor's brother. The value of the remainder interest is $70,000. The estate tax return will report the $100,000 as an asset of the estate and will claim a charitable estate tax deduction in the amount of $70,000; the remaining $30,000 will be subject to estate tax. On the estate's income tax return, the entire $100,000 will be reported as income. Although the estate probably could claim a $70,000 charitable income tax deduction,[a] there is no legal authority to provide guidance as to the income tax consequences of the $30,000 noncharitable distribution. A better way to resolve this is to keep the income in respect of a decedent off the estate's income tax return, as discussed next.

[a] Reg. § 1.642(c)-3(a), (b).

The better option for retirement plan assets is to keep the IRD off the estate's income tax return. This can be accomplished by having the assets transferred directly from the retirement plan to the charitable organization or charitable remainder trust, rather than having amounts paid to the estate. This is done by naming the charity or the remainder trust, rather than the probate estate or a testamentary charitable remainder trust, as the successor beneficiary on the beneficiary designation form provided by the retirement plan. The distributions will not be reported on the estate's income tax return because the IRD is taxed directly to the beneficiary that receives the assets.[356] If the income is not reported on the estate's tax return, there is no corresponding income tax charitable deduction.[357]

The principal complications with this strategy are the ERISA distribution rules that apply if a charitable organization or charitable remainder trust is named as a beneficiary, as discussed earlier. The ERISA planning strategies (for example, a disclaimer) should therefore be used in conjunction with the income tax planning strategy of keeping income off the estate's income tax return.

If a transfer will be made to a charitable remainder trust, the trust probably should be established during the individual's lifetime, with the expectation that it will receive its largest contribution upon the individual's death. This will make it easier to keep the IRD off the estate's income tax return than if payments are made to a testamentary charitable remainder trust established in the decedent's will. If an inter vivos remainder trust is established, a unitrust would be more

[353] See text followed by reference to *infra* note 361.
[354] In general, see ch. 13.
[355] Compare the detail of IRC § 2055(e) (estate tax) with the buried reference in IRC § 4947 (split-interest trusts) to IRC § 642 (income tax).
[356] Reg. § 1.691(a)-2(a)(2).
[357] Reg. § 1.642(c)-3(b).

appropriate than an annuity trust, because an annuity trust can only receive a single contribution, whereas a unitrust can receive numerous contributions.[358]

Tax-Exempt Organization Issues. A charitable remainder trust is a tax-exempt organization;[359] a pooled income fund is not.[360] A pooled income fund avoids paying income tax by distributing all of its net income (with a special rule for long-term capital gains).[361] A contribution of IRD property to a pooled income fund causes special problems because it is generally treated as principal under the trust instrument and state law but as taxable income under the federal tax law. This produces a ''trapping distribution'' that will probably require a pooled income fund to pay income tax. Transfers of IRD property to pooled income funds should therefore be avoided.

There is no unrelated business income tax exposure when a charitable organization or a charitable remainder trust receives IRD property.[362]

Even though contributions to charitable remainder trusts are considered corpus under state trust law, the taxable nature of IRD property causes it to be classified as ordinary income rather than corpus.[363] There is no authority as to the tax consequences with respect to the applicable federal estate tax deduction if retirement plan assets are paid to a charitable remainder trust. This does not fit very well into the multitier distribution system.[364] Perhaps some or all of it can be deducted ratably over the expected life of the trust.[365]

(d) Individual Retirement Arrangements in General

Within limits, individuals may make deductible and nondeductible contributions to a traditional individual retirement arrangement (IRA). Amounts in a traditional IRA are includable in gross income when withdrawn (except to the extent the withdrawal represents a return of nondeductible contributions). Individuals also may make nondeductible contributions to a Roth IRA. Qualified withdrawals from a Roth IRA are excludable from gross income. Withdrawals from a Roth IRA that are not qualified withdrawals are includable in gross income to the extent attributable to earnings. Distributions from an IRA (other than a Roth IRA) are generally subject to withholding unless the individual elects to not have withholding apply.[366] Includable amounts withdrawn from a traditional IRA or a Roth IRA before attainment of age 59½ are subject to a 10-percent early withdrawal tax, unless an exception applies.

Minimum distributions are required to be made from tax-favored retirement arrangements, including IRAs. Minimum required distributions from a traditional IRA must generally begin by April 1 of the calendar year following the year in which the IRA owner attains age 70½. Minimum distribution rules also

[358] See § 12.8.
[359] See § 12.6.
[360] See § 13.8.
[361] IRC § 642(c)(3), (5).
[362] Priv. Ltr. Rul. 9634019.
[363] *Id*.
[364] See § 12.5.
[365] Reg. § 1.691(c)-1(d).
[366] IRC § 3405.

apply in the case of distributions after the death of an owner of a traditional or Roth IRA owner.

If an individual has made nondeductible contributions to a traditional IRA, a portion of each distribution from an IRA is nontaxable until the total amount of nondeductible contributions has been received. In general, the amount of a distribution that is nontaxable is determined by multiplying the amount of the distribution by the ratio of the remaining nondeductible contributions to the account balance. In making this calculation, all traditional IRAs of an individual are treated as a single IRA, all distributions during a tax year are treated as a single distribution, and the values of the contract, income on the contract, and investment in the contract are computed as of the close of the calendar year.

In the case of a distribution from a Roth IRA that is not a qualified distribution, in determining the portion of the distribution attributable to earnings, contributions and distributions are deemed to be distributed in this order: regular Roth IRA contributions, taxable conversion contributions,[367] nontaxable conversion contributions, and earnings. In determining the amount of taxable distributions from a Roth IRA, all Roth IRA distributions in the same tax year are treated as a single distribution, all regular Roth IRA contributions for a year are treated as a single contribution, and all conversion contributions during the year are treated as a single contribution.[368]

(e) Temporary Statutory Rule

An exclusion from gross income is available, for otherwise taxable distributions from a traditional or a Roth IRA, in the case of qualified charitable distributions;[369] this exclusion may not exceed $100,000 per taxpayer per tax year.[370] The rules regarding taxation of IRA distributions and the deduction of charitable contributions continue to apply to distributions from an IRA that are not qualified charitable distributions. Qualified charitable distributions are taken into account for purposes of the minimum distribution rules applicable to traditional IRAs to the same extent the distribution would have been taken into account pursuant to those rules had the distribution not been directly distributed under this temporary rule.

A *qualified charitable distribution* is any distribution from an IRA directly by the IRA trustee to a public (or certain other) charitable organization,[371] other than a supporting organization[372] or a donor-advised fund;[373] distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70½.[374]

This exclusion is available only if a charitable contribution deduction for the entire distribution otherwise would be allowable (under preexisting law),

---

[367] Conversion contributions means conversions of amounts in a traditional IRA to a Roth IRA.

[368] IRC §§ 408, 408A.

[369] This rule is inapplicable to distributions from employer-sponsored retirement plans, including simple IRAs and simplified employee pensions.

[370] IRC § 408(d)(8)(A).

[371] That is, an organization described in IRC § 170(b)(1)(A) (see § 3.4).

[372] That is, an organization described in IRC § 509(a)(3). See § 3.4(a), text accompanied by notes 421–451, and *Tax-Exempt Organizations*, § 12.3(c). A supporting organization that wishes to avoid this rule may make application to the IRS, pursuant to special procedures, to change its public charity status (Ann. 2006-93, 2006-48 I.R.B. 1017).

[373] That is, a fund defined in IRC § 4966(d)(2). See § 3.1(g)(2) and *Tax-Exempt Organizations* § 11.8.

[374] IRC § 408(d)(8)(B).

determined without regard to the generally applicable percentage limitations.[375] Thus, for example, if the deductible amount is reduced because of a benefit received in exchange[376] or if a deduction is not allowable because the gift substantiation rules[377] were not satisfied, the exclusion is not available with respect to any part of the IRA distribution.

If the IRA owner has any IRA that includes nondeductible contributions, a special rule applies in determining the portion of a distribution that would be includable in gross income (but for this temporary rule) and thus is eligible for qualified charitable distribution treatment. Pursuant to this special rule, the distribution is treated as consisting of income first, up to the aggregate amount that would be includable in gross income (but for the temporary rule) if the aggregate balance of all IRAs having the same owner were distributed during the same year. In determining the amount of subsequent IRA distributions includable in income, proper adjustments are to be made to reflect the amount treated as a qualified charitable distribution under this temporary rule.[378]

An IRA does not fail to qualify as an IRA merely because qualified charitable distributions have been made from the IRA. It may be expected that the IRS will promulgate rules under which IRA owners are deemed to elect out of withholding if they designate that a distribution is intended to be a qualified charitable distribution.

Distributions that are excluded from gross income by reason of this rule are not taken into account in determining any charitable contribution deduction.[379] This provision is inapplicable to distributions made in tax years beginning after December 31, 2009.[380]

In the examples that follow, it is assumed that the requirements for qualified charitable distribution treatment are otherwise met (such as the applicable age requirement, the requirement that contributions are otherwise deductible, and that the distribution occurred during the permissible time period) and that no other IRA distributions occur during the year.

EXAMPLE 9.12

Individual A has a traditional IRA with a balance of $100,000, consisting solely of deductible contributions and earnings. A does not have another IRA. This entire IRA balance is distributed to an eligible public charity. Under prior law, the entire distribution of $100,000 would have been includable in A's gross income. Under the temporary rule, however, the entire distribution is a qualified charitable distribution. Consequently, no amount is included in A's income as a result of the distribution; the distribution is not taken into account in determining the amount of A's charitable deduction for the year.

[375] IRC § 408(d)(8)(C). These limitations are the subject of ch. 7.
[376] See §§ 3.1(b), 22.2.
[377] See § 21.3.
[378] IRC § 408(d)(8)(D).
[379] IRC § 408(d)(8)(E).
[380] IRC § 408(d)(8)(F). This rule was originally enacted as part of the Pension Protection Act of 2006 (Pub. L. No. 109-280) and made available through 2007. The provision was extended by enactment of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (§ 205), which is Division C of the financial markets stabilization legislation (Pub. L. No. 110-343).

EXAMPLE 9.13

Individual B has a traditional IRA with a balance of $100,000, consisting of $20,000 of nondeductible contributions and $80,000 of deductible contributions and earnings. B does not have another IRA. A distribution of $80,000 is made from this IRA to an eligible public charity. Under prior law, a portion of this distribution from the IRA would be treated as a nontaxable return of nondeductible contributions. The nontaxable portion of the distribution would have been $16,000, determined by multiplying the amount of the distribution ($80,000) by the ratio of the nondeductible contributions to the account balance ($20,000/$100,000). Accordingly, under prior law, $64,000 of the distribution ($80,000–$16,000) would have been includable in B's gross income.

Under the temporary rule, notwithstanding the prior-law treatment of IRA distributions, this distribution is treated as consisting of income first, up to the total amount that would be includable in gross income (but for the rule) if all amounts were distributed from all IRAs otherwise taken into account in determining the amount of IRA distributions. The total amount that would be includable in income if all amounts were distributed from this IRA is $80,000. Accordingly, pursuant to this temporary rule, the entire $80,000 distributed to the charitable organization is treated as includable in B's gross income (before application of the temporary rule) and is a qualified charitable distribution. Consequently, no amount is included in B's gross income as a result of the distribution; the distribution is not taken into account in determining the amount of B's charitable deduction for the year. Further, for purposes of determining the tax treatment of other distributions from this IRA, $20,000 of the amount remaining in the IRA is treated as B's nondeductible contributions and thus not subject to tax on distribution.

§ 9.11 COMMODITY FUTURES CONTRACTS

The marked-to-market provisions of the federal tax law, concerning the transfer of commodity futures contracts, generally require that a transfer result in realization as income of the amount of the capital gain inherent in the contracts.[381]

A court held that, in the instance of a charitable contribution of futures contracts, the donor must mark the contracts to market and recognize as income the long-term capital gain portion of the contracts.[382] An individual donated commodities futures contracts to a charitable organization. He obtained a ruling from the IRS stating that he would be entitled to the charitable contribution deduction for the fair market value of the contracts and would not personally realize any capital gain or loss as long as certain conditions were satisfied. The conditions were met; gifts of this nature were made in 1974 through 1978 and 1980. The tax law as to commodities futures contracts was adjusted in 1981, with the revised law providing that gains or losses from any termination of a person's obligations or rights under these contracts are treated as 60 percent long-term capital gain or loss and 40 percent short-term capital gain or loss. This change in the law posed a problem for this donor, in that there is no charitable contribution deduction for the value of donated property to the extent that it would have given rise to short-term gain to the donor had the donor sold the property.[383]

---

[381] IRC § 1256.

[382] *Greene v. United States*, 79 F.3d 1348 (2d Cir.), *cert. denied*, 519 U.S. 1028 (1996), *rev'g Greene v. United States*, 864 F. Supp. 407 (S.D.N.Y. 1994). The argument was injected by the IRS in prior litigation involving the same donors in an appellate proceeding, but the court declined to review the issue because it was not raised at trial. *Greene v. United States*, 13 F.3d 577 (2d Cir. 1994).

[383] IRC § 170(e)(1)(A). See § 4.4.

The donor attempted to solve this problem by contributing to charity only the portion of the contracts that was characterized as long-term capital gain. Pursuant to an agreement, the contracts were transferred into a brokerage account controlled by the charity's trustee. When the contracts were sold, the portion of the proceeds representing long-term capital gain was transferred to a brokerage account for the charity. The donor paid the annual capital gains tax on the net short-term capital gain.

These tax rules pertaining to regulated futures contracts instruct taxpayers as to the correct method of income recognition when they sell or otherwise transfer futures contracts. These contracts are annually treated as if they had been sold for fair market value on the final business day of the tax year. As every contract is constructively sold each year, a taxpayer must recognize accrued gains and losses annually by marking the contracts to market.[384] This rule as to constructive recognition of accrued gain is an exception to the general rule, by which recognition of any capital gain or loss is delayed until the time of sale or exchange. The IRS asserted that these rules apply in the instance of charitable gifts.

This mark-to-market rule also applies to instances in which persons terminate or transfer their obligations or rights under a regulated futures contract. The statute lists a variety of ways that a futures contract can be terminated or transferred: ''[B]y offsetting, by taking or making delivery, by exercise or being exercised, by assignment or being assigned, by lapse, or otherwise.''[385]

It was the word *otherwise* that was held to embrace transfers by charitable gift. The appellate court wrote that these mark-to-market rules ''appear to govern all terminations and transfers of futures contracts.''[386] By contrast, the trial court mused that the language ''describe[s] economic activity that seems fundamentally different from charitable giving.''[387] But the appellate court stated that ''[t]here is no reason for excluding charitable donations from the definition of transfer.''[388] The court of appeals decided that the plain language of the statute mandates the marking of contracts to market even when they are contributed to a charitable organization. The appellate court was unwilling to create an ''additional exception to what is an already complex tax code.''[389]

The final argument formulated for this donor was that persons are able to donate other types of property to charity without realizing capital gains as income.[390] Although the court of appeals agreed with this view, it stated that Congress has created a rule that treats futures contracts differently in a variety of contexts (apparently including charitable giving). The court said that if Congress wants to create an exception in this setting for charitable gifts—as it did for hedging transactions[391]—it can do so. Concluded this court: ''Without such a

[384] IRC § 1256(a)(1).
[385] IRC § 1256(c)(1).
[386] *Greene v. United States*, 79 F.3d 1348, 1354 (2d Cir. 1996).
[387] *Greene v. United States*, 864 F. Supp. 407, 414 (S.D.N.Y. 1994).
[388] *Greene*, 79 F.3d 1348, 1355 (2d Cir. 1996).
[389] *Id*. at 1349.
[390] This argument prevailed in the district court. *Greene v. United States*, 864 F. Supp. at 416. In general, see § 4.3.
[391] IRC § 1256(e).

provision, we think it an inappropriate arrogation of legislative power for a court to amend the statute under the guise of judicial construction.''[392]

§ 9.12 DONORS' CREATIONS

An individual may make a contribution to a charitable organization of an item of property that was created by the donor, such as a painting or a manuscript. The charitable deduction for this type of gift is not based on the fair market value of the property; instead, it is confined to the donor's cost basis in the property.

This tax result is occasioned by the rule that requires a reduction in the charitable contribution deduction, created by a gift of property, by an amount equal to the amount of gain that would not have been long-term capital gain had the property been sold by the donor at its fair market value at the time of the contribution.[393] The federal tax law excludes from the definition of the term *capital asset* a ''copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property,'' held by:

- an individual ''whose personal efforts created such property,''
- ''in the case of a letter, memorandum, or similar property, a taxpayer [person] for whom such property was prepared or produced,'' or
- ''a taxpayer [person] in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of'' a person described in either of the foregoing two categories.[394]

Thus, as noted, this charitable deduction is confined to the amount equal to the cost to the donor of the creation of the item of property.

In one instance, a retired athlete decided to contribute various memorabilia accumulated over his career to a charitable organization, which in turn planned to construct a museum housing these items. Among the gifted properties were autographed photographs presented to him over the years as gifts from celebrities. The IRS held that the photographs were created in part by his efforts and thus the charitable contribution deduction was confined to his basis in the items. The IRS also so held with respect to diaries of his performances. By contrast, collectibles (such as art works and crystal), sports equipment, plaques, trophies, and awards given to him were considered by the IRS to be capital assets, so that the charitable deduction was not limited by this rule.[395]

Likewise, a lawyer who contributed, to a public charity, files of photocopied materials he obtained from the federal government in the course of discovery proceedings in connection with a high-profile criminal case was denied a charitable

---

[392] *Greene v. United States*, 79 F.3d at 1357. The court of appeals remanded this case and directed the trial court to follow its view of the law on the point; the district court held that the donors must mark their commodity futures contracts to market upon their contribution and recognize as income the long-term capital gain portion of the contracts. *Greene v. United States*, 975 F. Supp. 273 (S.D.N.Y. 1997), *aff'd*, 185 F.3d 67 (2d Cir. 1999).

[393] IRC § 170(e)(1)(A). See § 4.4.

[394] IRC § 1221(3).

[395] Priv. Ltr. Rul. 9335017.

deduction for the gift pursuant to these rules.[396] The trial court ruled that the deduction was zero because the individual whose personal efforts created the property was the donor of the property.[397] The appellate court, however, denied the deduction on the ground that the individual for whom the property was prepared or produced was the contributor.[398] The court of appeals conceded that the discovery materials were not originally created for the lawyer's benefit (they were first compiled to assist the government in its investigation and prosecution of the lawyer's client). Nonetheless, the court observed that copies of these materials were made "specifically" for this lawyer,[399] the government organized and categorized the materials for the lawyer's (and the client's) benefit, and the government prepared letters for the lawyer explaining the contents of the materials.

§ 9.13 CHARITY AUCTIONS

There is considerable confusion and misunderstanding as to the federal tax law applicable to the conduct of charity auctions, particularly as to how the charitable gift substantiation and quid pro quo contribution rules apply. This uncertainty was manifested in two articles in a personal finance magazine, where it was written that a "special circle of tax hell has been carved out for you if you're involved in one of today's hottest fund-raising activities: charity auctions."[400]

This body of law has seven elements: (1) the tax treatment, with respect to the charitable organization, of the funds expended by the patrons at the auction; (2) the charitable contribution deduction available to those who contribute something to be auctioned; (3) the charitable contribution deduction that may be available to those who acquire an item at a charity auction; (4) the substantiation rules; (5) the quid pro quo contribution rules; (6) the state sales tax rules; and (7) the federal tax rules for reporting the event to the IRS. There can be different and additional complexities when the fund-raising event is a lottery, raffle, or other game of chance.

(a) Charity Auctions as Businesses

The federal tax law envisions a tax-exempt organization as being a bundle of businesses. For this purpose, a *business* is any activity that entails the production of income from the sale of goods or the performance of services.[401] An activity does not lose its identity as a business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors of the organization.[402]

Some businesses are related ones, in that the conduct of them helps to advance the organization's exempt purposes (other than simply through the generation of funds). Other businesses are *unrelated*, because the conduct of them does

---

[396] *Jones v. Commissioner*, 129 T.C. 146 (2007), *aff'd*, 560 F.3d 1196 (10th Cir. 2009), *cert. den*., 2009 WL 2485546 (Oct. 5, 2009). Also see § 3.1(e).
[397] IRC § 1221(a)(3)(A).
[398] IRC § 1221(a)(3)(B).
[399] *Jones v. Commissioner*, 560 F.3d 1196 (10th Cir. 2009), *cert. den*., 2009 WL 2485546 (Oct. 5, 2009).
[400] "Taxing New Rules for Charitable Giving," 48 *Kiplinger's Pers. Fin. Mag*. (no. 5) 140 (July 1994).
[401] IRC § 513(c). See § 3.5(b).
[402] IRC § 513(c).

not relate to achievement of a charitable, educational, or similar purpose; this type of business usually is carried on solely for the purpose of generating income.[403]

Thus, a charity auction is a business; it is the performance of a service (selling items). These auctions are not inherently exempt functions; in the case of private schools, for example, the conduct of an auction is not an educational undertaking. Consequently, the conduct of a charity auction is the conduct of an unrelated business by the charitable organization.

The net revenue of a charity auction would, therefore, be taxable as unrelated business income were it not for one or more exceptions. The principal exception relates to the fact that, for an unrelated business to give rise to taxable income, it must be regularly carried on.[404] An annual auction held by a charitable organization is not an activity that is regularly carried on; thus, the net income is not taxable. (If a charity were to hold an auction every weekend, however, this exception would not be available.)

Another important exception is the one for businesses that constitute the sale of merchandise, substantially all of which was donated to the exempt organization.[405] Although this exception was written for thrift shops, it is available in the case of auctions. This exception alone shields charity auctions from taxation.

The third exception is for businesses in which substantially all the work of carrying it on is performed by volunteers.[406] If a charity auction is conducted entirely by volunteers, the net income from it is not taxed. (Some charity auctions can rely on all three exceptions.)

Thus, it is almost inconceivable that the net income yielded as the result of a charity auction would be subject to unrelated income taxation—but only because of specific statutory exceptions.

(b) Charitable Contribution Deductions—Donors of Items to Be Auctioned

In general, the contribution of an item to a charitable organization, for the purpose of being auctioned, gives rise to a charitable contribution deduction. The usual rule is that the deduction is equal to the fair market value of the contributed property.[407] (This analysis is based on the assumption that the charity holding the auction is a public charity and not a private foundation.[408])

If the item donated is tangible personal property that has appreciated in value, the charitable deduction is confined to the donor's basis in the property.[409] This is because the gift was made for an unrelated purpose—immediate resale by the donee.[410]

If the item donated has a value in excess of $5,000, the charitable deduction depends on a bona fide appraisal.[411] An appraisal summary must be included

---

[403] See § 3.5(d).
[404] IRC § 512(a)(1). See § 3.5(c).
[405] IRC § 513(a)(3). See § 3.5(f).
[406] IRC § 513(a)(1). See § 3.5(f).
[407] See §§ 4.1–4.5.
[408] See § 3.4.
[409] IRC § 170(e)(1)(B)(i).
[410] See § 4.6.
[411] See § 21.5.

with the donor's tax return. The charitable organization must report the sale to the IRS if the auction took place within three years of the gift.[412]

There is no charitable deduction for a gift of the right to use property.[413] Thus, for example, if someone contributes the opportunity to use his or her vacation property for two weeks, there is no charitable deduction equal to the fair rental value of the property. Moreover, the period of time during which the property is used by the winning bidder must be considered by the donating individual(s) as personal time for purposes of the rules regarding the deductibility of business expenses in connection with the property.[414]

There is no charitable deduction for a gift of services.[415] Thus, for example, if a lawyer donates his or her will-drafting services, there is no charitable deduction equal to the hourly rate the lawyer would normally charge for his or her time in preparing the will. Notwithstanding this rule in the regulations, there would be no deduction in any event, because there is no deduction for gifts of property created by the donor.[416]

Further, special rules apply when a business makes a charitable contribution of items from its inventory.[417]

The substantiation rules apply with respect to gifts of items, with a value of $250 or more, to be auctioned by a charitable organization.[418]

(c) Charitable Contribution Deductions—Acquisition of Items at Auction

The law, as sometimes applied in this area, is that for a payment to a charitable organization to be deductible as a gift, the payor had to have donative intent.[419] Were that an absolute requirement, almost no payments made at a charity auction would be deductible as charitable gifts. The law usually emphasizes a more mechanical computation: in general, deductible payments to a charity are those that exceed the fair market value of anything that the ''donor'' may receive in return, other than items of insignificant value.[420]

Whether one who acquires an item at a charity auction is entitled to a charitable contribution deduction is, consequently, problematic. Thus, it was correct to observe that, as to the enactment of the substantiation and *quid pro quo* rules,[421] ''it was widely assumed that Congress was after folks who buy stuff at auctions and then deduct most or even all of the price as a charitable contribution.''[422]

There are two schools of thought on this point, both of which are facially valid. One is that the auction is the marketplace, so that whatever is paid for an item at an auction is its fair market value at that time. Pursuant to this view, the

---

[412] IRC § 6050L. See § 24.10.
[413] Reg. § 1.170A-7(a)(1). See § 9.18.
[414] Rev. Rul. 89-51, 1989-1 C.B. 89.
[415] Reg. § 1.170A-1(g). See § 9.14.
[416] IRC §§ 170(e)(1)(A), 1221(3). See § 9.12.
[417] IRC § 170(e)(3). See § 9.3.
[418] See § 9.13(d).
[419] See § 3.1.
[420] See § 22.2. As discussed in that chapter, the tax regulations introduced a requirement of donative intent in this context (see text accompanied by notes 43 and 44).
[421] See §§ 9.13(d), (e).
[422] "Taxing New Rules for Charitable Giving," 48 *Kiplinger's Pers. Fin. Mag.* (no. 5) 140 (July 1994), at 140.

transaction is always a purchase in its entirety; there is no gift element and thus no charitable deduction.

The other school of thought is that an item auctioned at a charity auction has a fair market value irrespective of the amount paid for it at the auction. This approach would allow a charitable deduction for an amount paid at a charity auction that is in excess of the value of the property.

In actual practice, most items disposed of at a charity auction are acquired for a value that does not involve any gift element (because the amount paid is roughly equal to the value of the item, or perhaps less), and thus there is no charitable deduction. If a person wants to claim a charitable deduction, the burden of proof is on the putative donor to prove that what was paid was in excess of the fair value of the property. This burden of proof can probably be met when it is relatively easy to prove the fair market value of the item, such as an appliance or automobile. But when the value of an item is difficult to discern, it is likely to be a struggle for an auction patron to convince the IRS that a portion of the amount paid was a deductible gift.

The determination of the fair market value of an item is the work of appraisers. Essentially, they look at comparables. If a house sold for $200,000, all other factors being equal, that is the value at the time of sale of the neighboring houses. Thus, the critical factor is the determination of the market. This involves geographical, economical, and timing elements.

Some disparage the idea that the value of an item sold at a charity auction is set at the time of purchase.[423] There cannot be any dispute that the auction is a market, but these critics say it should not be presumed that the price paid for an item at a charity auction is its fair market value. This is particularly the case when the value is ascertainable commercially: if the amount paid at an auction for an item of property is in excess of that value, it is easier to make the case that the difference in amounts was a contribution. For example, if a charitable organization auctioned an automobile with a sticker price of $20,000, and received $25,000 for the vehicle, it is reasonable to assume that the individual who acquired the vehicle is entitled to a charitable deduction of $5,000.

Regulations contain an example concerning an individual who attends an auction held by a charitable organization.[424] Prior to the auction, the organization publishes a catalog that meets the requirements for a written disclosure statement under the quid pro quo rules,[425] including the charity's good faith estimate of the value of the items that will be available for bidding. A copy of the catalog is given to everyone in attendance at the auction. This individual reads in the catalog that the charitable organization's estimate of the value of a vase is $100. The individual has no reason to doubt the accuracy of this estimate. The individual successfully bids and pays $500 for the vase. Because this individual knew, prior to making the payment, that the estimate in the catalog was less than the amount of the payment, the individual satisfies the required element of intent.[426] Thus, this individual may treat the charity's estimate of the value of the vase as its fair

[423] *Id*. at 142–43.
[424] Reg. § 1.170A-1(h)(5), Example 2.
[425] See § 9.13(e).
[426] See § 22.2, text accompanied by notes 43 and 44.

market value in determining the amount of the charitable deduction (which, in general, would be $400).

The substantiation rules apply with respect to gifts made in the context of acquiring an item auctioned by a charitable organization, assuming the gift element is $250 or more.[427]

(d) Substantiation Rules

The position of the IRS on charity auctions can be found in rulings as far back as 1967.[428] There is little question, however, that charitable organizations and their donors have not, over the intervening years, understood the IRS's stance, which has been clear and sensible. Consequently, Congress believed it had to enact legislation in this area and, in 1993, it did.

At this point in the analysis, it is necessary to place the subject in context. Can it honestly be said that an individual who attends an auction sponsored by a charitable organization is there for the purpose of making a gift? Obviously, someone who wants to contribute to the charitable organization can do so without attending the charity's auction. Individuals participate in the auction to help support the charitable organization *and* to purchase items.

The statutory substantiation rule is this: To be able to deduct the gift, a donor who makes a separate charitable contribution of $250 or more in a year must obtain the requisite written substantiation from the donee charitable organization.[429] This substantiation must be an acknowledgment of the gift and must contain the following information: (1) the amount of money and a description (but not value) of any property other than money that was distributed; (2) whether the donee organization provided any goods or services in consideration, in whole or in part, for any money or property contributed; and (3) a description and good faith estimate of the value of any goods or services so provided.[430]

Clearly, these rules are applicable with respect to gifts of items to be auctioned (assuming a charitable contribution deduction is available or desired). Also, as far as acquisition of an item at a charity auction is concerned, if there is no gift element, it is clear that the rules do *not* apply.

However, when the patron at a charity auction is of the view that he or she has made a charitable contribution in the course of acquiring an item, the ostensible gift element is $250 or more, and a charitable deduction is desired, the rules come into play. The donor must notify the charitable organization that he or she believes a gift was made at the auction, with the intent of receiving the necessary acknowledgment. If the charity agrees that a gift was made, it issues a written substantiation showing the amount that was ''contributed'' (here, the full amount of the winning bid) and a description and good faith estimate of the value of the item acquired. The difference, then, would be the amount deductible as a charitable gift.

---

[427] See § 9.13(d).
[428] See § 22.1.
[429] IRC § 170(f)(8). See § 21.3(b).
[430] IRC § 170(f)(8)(B).

The process would not function quite so smoothly if the charitable organization believed that no part of the payment was a charitable gift. Certainly, it could refuse to issue the acknowledgment or refuse to commit itself to a good faith estimate of the value of the item auctioned; as a practical matter, relations with donors and patrons are such that a charity usually cannot be so cavalier.

These rules place considerable pressure on charitable organizations. To return to the preceding example, is the charitable organization willing to issue a substantiation acknowledgment that the auctioned automobile has a value of $20,000, so that the winning bidder can claim a charitable deduction of $5,000? A charitable organization that knowingly provides a false written substantiation to a donor may be subject to the penalty for aiding and abetting an understatement of tax liability.[431]

(e) Quid Pro Quo Contribution Rules

Congress has required this: When a person makes a payment to a charitable organization in excess of $75 and receives something of material value in return, the charitable donee is to make a good faith estimate of the value of the item and notify the donor that only the difference between the fair market value of the item and the amount paid for it (if any) is deductible as a charitable contribution.[432] The charitable organization is not, however, expected to function as an appraiser.

Here, the application of the tax rules in the charity auction context become less pellucid. Superficially, the quid pro quo rules would seem to apply in the charity auction setting when the amount transferred is in excess of $75 and there is a gift element.

A *quid pro quo contribution* is a payment "made partly as a contribution and partly in consideration for goods or services provided to the payor by the donee organization."[433] Thus, it can be argued that the purchase of an item at an auction, at a price known to be in excess of the fair market value of the item, is both a contribution and a payment made in consideration of something (a purchase). This law, however, contemplates a transfer that is predominately a contribution, with the purchase or consideration portion being minor.

Nonetheless, if the donor and the donee are in harmony, and if the amount paid at an auction is in excess of $75, the charity can make the necessary disclosure, notifying the donor that the deductible amount is confined to the payment less the value of the item.

(f) Sales Tax Rules

As discussed, every transaction at an auction is, in whole or substantial part, a purchase. Thus, the charity is engaging in sales, which can trigger application of the state's sales tax. This is a state-by-state matter, and thus it is difficult to generalize on the point, other than to say that the law of the applicable state should be reviewed.

---

[431] IRC § 6701. See § 10.14.
[432] IRC § 6115. See § 22.2.
[433] IRC § 6115(b).

A state is likely to exempt charitable organizations from having to pay the state's sales tax. This exemption, however, does not mean that the entity is exempt from the requirement to collect the sales tax.

(g) Reporting Rules

A charity auction is a type of a charitable organization's fundraising event.[434] As such, it is reported on Form 990 or Form 990-EZ, Schedule G, Part II (unless the organization is exempt from the requirement of filing an annual information return[435]), assuming the reporting threshold is satisfied.[436]

§ 9.14 SERVICES

An individual may contribute his or her services to a charitable organization. This is, of course, the action of a volunteer. A federal income tax charitable deduction is not, however, available for the contribution of services.[437]

Because the donor of services rarely takes the value of the services into income as imputed income, to allow a charitable deduction for the contribution of the services to a charitable organization would be to allow a double deduction under the circumstances. Also, it is the IRS's view that the difficulties associated with the valuation of services is in itself a policy reason for not allowing this type of deduction (along with the associated revenue loss).

In one case, a lawyer performed legal services for charitable organizations over a three-year period, for which he was not compensated. For each of these years, he deducted amounts reflecting the value of his time expended in rendering the services. The court involved found the regulation barring the deduction to be valid and held that the lawyer was not entitled to a charitable deduction for the gift of his time to charity.[438] The court rejected the argument that the lawyer was donating property: namely, the product of his services in the form of pleadings, resolutions, opinion letters, reports, deeds, and the like.[439]

In other instances, the IRS ruled that there is no tax deduction for the gift by a radio station to a charitable organization of broadcast time as part of the station's programming,[440] and that the contribution to a charitable organization by a newspaper of space in the newspaper is not deductible.[441] This rule of law should be contrasted with the rule that a contribution of a contract right to receive purchased services is deductible, because it is not a contribution of the donor's services.[442]

---

[434] See § 23.2.

[435] See *Tax-Exempt Organizations* § 27.2(b).

[436] Schedule G, Part II, is required if the organization (in the case of a Form 990 filer) reported more than $15,000 total on Form 990, Part VIII, lines 1c and 8a (see Part IV, line 18).

[437] Reg. § 1.170A-1(g). The lack of a charitable deduction for the gift of services does not defeat a charitable deduction for unreimbursed expenditures made incident to the rendering of the services. See § 9.15.

[438] *Grant v. Commissioner*, 84 T.C. 809 (1985), *aff'd*, 800 F.2d 260 (4th Cir. 1986). See also *Taylor v. Commissioner*, 63 T.C.M. (CCH) 2514 (1992); *Levine v. Commissioner*, 54 T.C.M. (CCH) 209 (1987).

[439] Even if this regulation (see note 356) did not exist, there nonetheless would not be any charitable deduction for an amount in excess of basis, because of the rule denying a deduction for an amount in excess of basis for gifts of property created by the donor. IRC §§ 170(e)(1)(A), 1221(3). See § 9.12.

[440] Rev. Rul. 67-236, 1967-2 C.B. 103.

[441] Rev. Rul. 57-462, 1957-2 C.B. 157.

[442] Rev. Rul. 84-1, 1984-1 C.B. 39.

Under the facts of the case that gave rise to this rule, a radio station received lodging and transportation rights from hotels and airlines in exchange for the provision of advertising time. The radio station included the value of the lodging and transportation in its gross income, and the hotels and airlines included in their gross incomes the value of the advertising time. The radio station donated the lodging and transportation rights to a governmental agency.

The IRS concluded that the radio station was entitled to a charitable deduction for the fair market value of the donated rights. In so doing, the IRS made an analogy to an earlier ruling, in which it upheld the deductibility of a gift to a charitable organization of a right to receive dance lessons that the donor purchased from a dance school.[443] Again, the gift was of property: namely, a purchased contract right to receive dance lessons.

§ 9.15 UNREIMBURSED EXPENSES

Unreimbursed expenditures incurred by an individual, in the course of rendering services that augment or further the program activities of one or more charitable organizations, may be deductible as charitable contributions.[444] This type of deduction, which may be thwarted if an element of personal pleasure is involved,[445] is in contrast to the rules that preclude a charitable contribution deduction for a gift of the services themselves[446] or for payments made directly to individuals by those who are assisting these individuals in their charitable endeavors.[447]

The range of expenditures that can be deductible in this regard is potentially sweeping, embracing expenses for the cost of a uniform without general utility, which is required to be worn in performing donated services; transportation expenses necessarily incurred in performing donated services; and meals and lodging necessarily incurred while away from home in the course of performing donated services.[448] The rationale for this deduction is that these expenses are not incurred for the benefit of the individual performing the services, but rather for the benefit of the charitable organization or organizations involved.[449]

The following unreimbursed expenses, incurred by volunteers, have been ruled to be deductible as charitable contributions:

- Expenses incurred by civil defense volunteers in the performance of their duties (such as traveling expenses and expenses of attending meetings)[450]
- Expenses incurred by a member of the Civil Air Patrol that are directly attributable to the performance of services (such as the expenses of

[443] Rev. Rul. 68-113, 1968-1 C.B. 80.
[444] Reg. § 1.170A-1(g).
[445] See § 9.16.
[446] See § 9.14.
[447] E.g., Rev. Rul. 55-4, 1955-1 C.B. 291.
[448] Reg. § 1.170A-1(g). The phrase "while away from home" has the same meaning as in the business expense deduction area (IRC § 162), which means that an individual's unreimbursed expenses for meals incurred while rendering services are deductible only if the nature of the travel requires the individual to sleep or rest. See, e.g., *United States v. Correll*, 389 U.S. 299 (1967); *Saltzman v. Commissioner*, 54 T.C. 722 (1970).
[449] Rev. Rul. 56-508, 1956-2 C.B. 126, *modified by* Rev. Rul. 84-61, 1984-1 C.B. 39.
[450] Rev. Rul. 56-509, 1956-2 C.B. 129.

acquiring and maintaining uniforms, and of maintenance and repair of a telescope)[451]

- Expenses incurred by elected or appointed government officials that are directly connected with and solely attributable to the performance of their official duties[452]
- Expenses incurred in rendering services at and for a church[453]
- Expenses incurred while rendering services to the American Red Cross as a nurses' aide (such as local transportation costs and expenses of acquiring and maintaining uniforms)[454]
- Expenses incurred while assisting underprivileged juveniles selected by a charitable organization (such as admission costs and expenses of meals)[455]
- Expenses incurred by an individual while participating in a church-established program[456]
- Expenses incurred by volunteer pilots in providing training services for an organization that promotes, fosters, and engages in aviation education activities[457]

There may be as many as six elements of this analysis: (1) whether the activities involved are exempt functions of the charitable organization; (2) the inherent nature of the services provided; (3) the substance of the services; (4) the duration of the services; (5) whether the outlays are excessive; and (6) the extent of any pleasure derived by the service provider.

(a) Exempt Functions

Thus, these expenses, to be deductible, must be directly connected to the performance of services in enhancement of a charitable organization's exempt functions. In most of the court opinions and IRS rulings on this subject, this aspect of the matter has not been at issue. Nonetheless, even in this area, some aspects of volunteer service may entail nondeductible expenses. For example, even though expenses incurred in connection with the rendering of services to a church may be deductible, the expenses of individuals attending church conventions, assemblies, or other meetings in accordance with their rights, privileges, or obligations as members of a church are not deductible.[458] Likewise, although unreimbursed expenses incurred by a volunteer for a charitable organization for the operation, maintenance, and repair of an automobile or airplane may be deductible, items such as the proportionate share of general maintenance and repairs, liability

[451] Rev. Rul. 58-279, 1958-1 C.B. 145.
[452] Rev. Rul. 59-160, 1959-1 C.B. 59.
[453] Rev. Rul. 61-46, 1961-1 C.B. 51; Rev. Rul. 56-508, 1956-2 C.B. 126.
[454] Rev. Rul. 61-46, 1961-1 C.B. 51; Rev. Rul. 56-508, 1956-2 C.B. 126.
[455] Rev. Rul. 70-519, 1970-2 C.B. 62, *modified by* Rev. Rul. 84-61, 1984-1 C.B. 39.
[456] Rev. Rul. 76-89, 1976-1 C.B. 89. See also Rev. Rul. 73-597, 1973-2 C.B. 69.
[457] Priv. Ltr. Rul. 9243043.
[458] Rev. Rul. 61-46, 1961-1 C.B. 51.

insurance, or depreciation in connection with use of an automobile for charitable purposes are not deductible.[459]

(b) Inherent Nature of Services

In general, anyone can serve as a volunteer for a charitable organization and be entitled to a charitable contribution deduction for unreimbursed expenses incurred. In other words, the individual who is a volunteer incurring expenses does not have to be a professional or other expert in a field to serve a charity that is functioning in that field. Thus, an individual may be a trustee, director, and/or officer of a charitable organization and incur deductible unreimbursed expenses in that capacity.[460] Likewise, an individual serving as a lay member of a church may incur deductible unreimbursed expenses.[461]

At the same time, the fact that an individual is a professional or other expert in a field does not, in and of itself, preclude deductibility of unreimbursed expenses. This factor may, however, increase the likelihood that pleasure, undue or otherwise, is being derived from the experience.[462]

(c) Substance of Services

It has been held that one element of the ''relevant inquiry'' in this area is the ''*extent*'' of the charitable services provided by the volunteer.[463] The term *substance* probably is preferable to the term *extent*. This subjective factor looks to the inherent value to the charitable organization of the services provided. This aspect of the matter is more fully developed in the context of the rules concerning permissible and impermissible pleasure.[464]

Nonetheless, as an illustration, it has been held that expenses incurred by a lay member of a church in attending a church convention as a delegate may be deductible as a charitable gift.[465] Similarly, expenses incurred by a member of the American Legion who is appointed as a delegate to and attends an American Legion convention may be deductible.[466] In limiting the reach of this aspect of deductibility, the IRS makes much of the word *delegate*, stating that the term ''is used in its general meaning of one appointed and sent by another, with authority to transact business as his [or her] representative.''[467] In other words, the IRS is, in this setting, equating a *delegate* with an *agent*. This position enabled the IRS to rule that expenses were not deductible when incurred by an individual in connection with a ''study mission,'' when the charity directly served did not conduct the mission, the travel arrangements were made by the individual, and the ''itinerary also covered other points of interest that are ordinarily a part of tourist sight-seeing schedules.''[468]

---

[459] Rev. Proc. 82-61, 1982-2 C.B. 849, § 3.01, 1(a), (b).
[460] E.g., *Cavalaris v. Commissioner*, 72 T.C.M. (CCH) 46 (1996).
[461] Rev. Rul. 58-240, 1958-1 C.B. 141.
[462] See § 9.15(c) and (f).
[463] *Cavalaris v. Commissioner*, 72 T.C.M. (CCH) 46, 54 (1996).
[464] See § 9.16.
[465] Rev. Rul. 58-240, 1958-1 C.B. 141.
[466] *Id*.
[467] Rev. Rul. 71-135, 1971-1 C.B. 94, *clarifying* Rev. Rul. 58-240, 1958-1 C.B. 141.
[468] Rev. Rul. 71-135, 1971-1 C.B. 94.

(d) Duration of Services

It has also been held that one element of the ''relevant inquiry'' in this area is the ''duration'' of the charitable service provided by the volunteer.[469] The little law there is on this point in this setting, and the law that may be extrapolated from the related context,[470] suggest that to give rise to deductible expenses, the charitable services must be carried on for the duration of the day (eight hours). Thus, an individual was allowed to deduct expenses incurred in attending the meetings of and otherwise providing services for a charitable organization when he ''routinely spent a full day'' doing so.[471]

This factor also relates to the matter of pleasure entailed by the activities. The more time there is for recreational and personal undertakings, the less time there is for the provision of substantive services and the more opportunity for impermissible pleasure.

(e) Excessive Expenditures

Unreimbursed expenditures for items such as meals and lodging, incurred in connection with charitable activities, must be *reasonable* to be deductible.[472] These outlays, and also those for transportation, must be *necessarily* incurred.[473] Inasmuch as a requirement of *reasonableness* is inherent in the concept of *necessary*,[474] these expenses for travel, meals, and lodging ''must be both reasonable and necessary.''[475]

In one case, an individual was active with three charitable organizations and undertook considerable travel in connection with his volunteer work for them. The IRS disallowed some of his deductions for unreimbursed expenses, in part on the ground that they were lavish or extravagant. The IRS asserted that he stayed in ''deluxe'' hotels; a court, however, allowed the deductions because, although the outlays were not ''frugal,'' they were for the hotels that hosted the particular meetings (or similarly priced ones nearby), and thus were ''convenient'' and saved him additional travel expense.[476] The rental of a hotel suite was found to be reasonable because the individual stayed one week and used the suite as a meeting place for officials of one of the charitable organizations. Also, this individual ''held relatively prestigious positions in large charitable organizations, such that staying in quality lodgings may have been acceptable practice.''[477] The court was of the view, however, that this individual was overly generous in his practice of dispensing gratuities and disallowed most of those outlays.

---

[469] *Cavalaris v. Commissioner*, 72 T.C.M (CCH) 46, 54 (1996).
[470] See § 9.16(b).
[471] *Cavalaris v. Commissioner*, 72 T.C.M (CCH) 46, 54 (1996).
[472] Reg. § 1.170A-1(g).
[473] *Id*.
[474] *Boser v. Commissioner*, 77 T.C. 1124 (1981).
[475] *Cavalaris v. Commissioner*, 72 T.C.M (CCH) 46, 51 (1996).
[476] *Id*.
[477] *Id*.

(f) Element of Pleasure

As noted, the rationale for the deductibility of these expenses is that they are incurred for the benefit of the charitable organization involved, not for the benefit of the participating individual.[478] Thus, the more the individual derives pleasure from his or her undertakings for a charitable organization, the less likely it is that the related unreimbursed expenses will be deductible. In one case, the court concluded that an individual who traveled to attend folk dance festivals could not deduct the expenses as a charitable contribution, even though he acquired knowledge that he used in rendering services to a charitable organization, because he derived ''substantial personal pleasure'' from participation in the festivals.[479]

This principle is more fully developed in the body of law summarized in the next section.

§ 9.16 LIMITATION ON DEDUCTION FOR EXPENSES DUE TO PLEASURE

There is no charitable contribution deduction for expenses incurred for traveling, meals, and lodging while away from home, whether paid directly or by reimbursement, ''unless there is no significant element of personal pleasure, recreation, or vacation'' involved.[480] This rule also applies when the expenses are paid ''by some indirect means such as by contribution to the charitable organization that pays for the taxpayer's travel [and other] expenses.''[481]

This body of law focuses on three of the six elements summarized in the previous section: the substance of the services, the duration of the services, and the extent of any pleasure derived by the individual providing the services.

(a) Substance of Services

As noted, one element of the ''relevant inquiry'' in this area is the ''extent''—or *substance*—of the charitable services provided by the volunteer.[482] The legislative history of this law states that the individual must be ''on duty in a genuine and substantial sense throughout the trip'' to be entitled to the deduction for unreimbursed expenses; the deduction is not available when the individual ''only has nominal duties relating to the performance of services for the charity.''[483] The history also indicates that Congress was concerned about situations in which the ''value of the services performed appeared to be minimal compared to the amount deducted.''[484]

For example, the IRS states that an individual ''who sails from one Caribbean Island to another and spends eight hours a day counting whales and other forms of marine life as part of a project sponsored by a charitable organization generally

---

[478] Rev. Rul. 56-508, 1956-2 C.B. 126.
[479] *Saltzman v. Commissioner*, 54 T.C. 722 (1970).
[480] IRC § 170(j).
[481] IRS Notice 87-23, 1987-1 C.B. 467, 469.
[482] *Cavalaris v. Commissioner*, 72 T.C.M (CCH) 46, 54 (1996). See § 9.15(c).
[483] H. Rep. No. 99-426, 99th Cong., 1st Sess. 129 (1985). See also *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), 99th Cong., 2d Sess. (1986) [hereinafter *General Explanation*], at 73.
[484] *General Explanation* at 63.

will not be permitted a charitable deduction.''[485] Aside from the unexplained insertion of the word ''generally,'' the implication is that whale-watching and like undertakings are not sufficiently substantive to constitute the type of charitable services that give rise to deductible unreimbursed expenses. Similarly, in the other setting, the IRS took the same position with respect to ''study missions.''[486]

The IRS also stated that an individual who ''works on an archaeological excavation sponsored by a charitable organization for several hours each morning, with the rest of the day free for recreation and sightseeing, will not be allowed a deduction even if the taxpayer works very hard during those few hours.''[487] Although this statement is intended to illustrate the element of *duration*,[488] it appears to indicate that the expense deduction would be available if the volunteer worked ''very hard'' on the archaeological dig eight hours a day. Consequently, the IRS view seems to be that passive whale-watching is too passive, whereas full-time hard work at an archaeological evacuation site amounts to sufficient charitable service to support a charitable deduction for the related unreimbursed expenses.

The IRS further wrote that a ''member of a local chapter of a charitable organization who travels to New York City and spends an entire day attending the organization's regional meeting will not be subject to this provision [denying the charitable deduction] even if he or she attends the theatre in the evening.''[489] Although it is unclear why New York City was singled out for this example, it illustrates that attending meetings for the benefit of a charitable organization constitutes substantive services that support the expense deduction.

In one case, an individual was denied a charitable deduction for unreimbursed travel expenses when he traveled as an ''official representative'' of a charitable organization or when he was merely an ''observer.''[490]

(b) Duration of Services

As noted, another element of the ''relevant inquiry'' in this area is the ''duration'' of the charitable services provided by the volunteer.[491] The legislative history of this law states that Congress was concerned about situations in which the ''amount of time spent during the day on activities benefiting the charitable organization was relatively small compared to the amount of time during the day available for recreation and sightseeing activities.''[492] As the foregoing section and the one pertaining to the related area of law[493] indicate, at least eight hours of charitable services per day appear to be necessary to meet the standard and support this aspect of the expense deduction. This is so irrespective of whether the services are provided out-of-doors or in meeting rooms.

[485] IRS Notice 87-23, 1987-1 C.B. 467, 469.
[486] See § 9.15(c), text accompanied by *supra* note 468.
[487] IRS Notice 87-23, 1987-1 C.B. 467, 469.
[488] See §§ 9.15(d), 16(b).
[489] IRS Notice 87-23, 1987-1 C.B. 467, 469.
[490] *Cavalaris v. Commissioner*, 72 T.C.M. (CCH) 46, 55 (1996).
[491] *Id*. at 54.
[492] *General Explanation* at 63.
[493] See § 9.15(d).

In one case, an individual stayed at resort hotels to attend meetings of charitable organizations. Although golf and tennis tournaments were held, he ''routinely spent a full day attending meetings or otherwise providing services while attending conferences,'' which ''preclud[ed] participation in the recreational activities.''[494] The deduction for his unreimbursed expenses was upheld.

As the previous section also indicates, there cannot be an allocation of services in support of an expense deduction for a portion of unreimbursed expenses. The legislative history of this law states that there is no deduction in a situation involving an individual ''who for significant portions of the trip is not required to render services.''[495] For example, at least according to the IRS's view of the law, an individual cannot provide substantive services for the benefit of a charitable organization for four hours a day and properly claim a charitable deduction for one-half of the unreimbursed expenses incurred for travel, meals, and lodging.

(c) Element of Pleasure

As noted, no charitable contribution deduction is available for expenses incurred for traveling, meals, and lodging while away from home, whether paid directly or by reimbursement, ''unless there is no significant element of personal pleasure, recreation, or vacation'' involved.[496] This requires identification and quantification of a pleasure element. Inexplicably, in interpreting this rule, a court wrote that the ''relevant inquiry is the extent [see above] and duration [see above] of the charitable services provided by the taxpayer, and not some quantum measure of pleasure derived by the taxpayer.''[497] Given the language of the statute, an assessment of a ''quantum measure of pleasure'' derived by a service provider in this setting seems unavoidable.

The only conceivable explanation for this dismissal of the pleasure element must be found in an analysis of the context in which it was written. In the case, the court allowed the claimed deduction for expenses for travel to a resort location, where golf and tennis activities were featured, because the individual service provider served on the charitable organization's executive committee and was forced to participate in meetings all day, and thus could not partake of social activities except in the evening. This approach correlates with the IRS's view that the expense deduction is available when the service provider participates in substantive meetings all day for the benefit of a charitable organization, notwithstanding pleasurable undertakings (such as the theater) after hours (such as in the evening).[498] The import of this approach seems to be that the element of pleasure, recreation, or vacation does not become *significant* when the day also includes at least eight hours of substantive activities engaged in for the advancement of charitable purposes. (This exercise nonetheless cannot ignore a ''quantum measure of pleasure,'' but rather should lead to a conclusion that the pleasure component is *insignificant*.)

---

[494] *Cavalaris v. Commissioner*, 72 T.C.M. (CCH) 46, 54 (1996).
[495] H. Rep. No. 99-426, 99th Cong., 1st Sess. 129 (1985).
[496] IRC § 170(j).
[497] *Cavalaris v. Commissioner*, 72 T.C.M. (CCH) 46, 54 (1996).
[498] See § 9.16(a), text accompanied by *supra* note 489.

In another case, an individual incurred expenses in connection with participation in a safari, in which he collected animals and donated them to a museum. The court allowed the deduction, emphasizing the factor of the individual's intent: that is, whether he undertook the trip primarily for furtherance of charitable purposes or for his ''personal pleasure, welfare or economic benefit or entertainment.''[499] Yet, in a nearly identical case, the deduction was not allowed.[500] A series of cases holds that the expenses of participating in ''People-to-People'' tours are not deductible, because the individual travelers are the primary beneficiaries of the payments.[501]

Another aspect of this component of the analysis is whether the individual *enjoys* providing the services to the charitable organization. Presumably, because these individuals are serving as volunteers, this type of enjoyment is always present, although there may be degrees of it. The legislative history of this law states that, in determining whether travel away from home involves a significant element of personal pleasure, recreation, or vacation, the ''fact that a taxpayer enjoys providing services to the charitable organization will not lead to denial of the deduction.''[502] The example is given of a troop leader for a tax-exempt youth group who takes children belonging to the group on a camping trip; the leader's travel expenses in this connection are deductible if he or she is ''on duty in a genuine and substantial sense throughout the trip, even if he or she enjoys the trip or enjoys supervising children.''[503]

§ 9.17 AUTOMOBILE EXPENSES

A standard mileage rate can be used, rather than itemization of expenses, in calculating the charitable deduction for use of a passenger automobile. That rate is 14 cents per mile.[504]

Rather than deduct automobile expenses, an individual may be reimbursed, by the charitable organization involved, for the expenses incurred. Generally, one who serves as a volunteer for and who provides services to a charitable organization, and is reimbursed by the organization for the expenses of providing the services, does not receive gross income as a result of the reimbursement.[505] If, however, this type of reimbursement exceeds the amount of the expenses, the excess amount constitutes gross income.[506] There are some relatively narrow exceptions to these rules, such as reimbursements made to an individual who functioned as a volunteer under a retired senior volunteers program governed by the Domestic Volunteer Service Act of 1973; these reimbursements are not forms

---

[499] *Jersig v. Commissioner*, 69-1 U.S.T.C. ¶ 9311 (W.D. Tex. 1968) (jury verdict).

[500] *LaGarde v. Commissioner*, 76-1 U.S.T.C. ¶ 9248 (N.D. Ala. 1975) (jury verdict).

[501] *Sheffels v. United States*, 264 F. Supp. 85 (E.D. Wash. 1967), *aff'd*, 405 F.2d 924 (9th Cir. 1969); *Seed v. Commissioner*, 57 T.C. 265 (1971); *MacMichael v. Commissioner*, 45 T.C.M. (CCH) 271 (1982).

[502] H. Rep. No. 99-426, 99th Cong., 1st Sess. 129 (1985).

[503] *Id*.

[504] IRC § 170(i); Rev. Proc. 2003-76, 2003-2 C.B. 924, § 7.01. In response to a request for an increase in this mileage reimbursement rate, because of rising gasoline prices, the IRS observed that it cannot change the rate, which is fixed by statute. INFO 2000-0049.

[505] E.g., Rev. Rul. 80-99, 1980-1 C.B. 10 (concerning reimbursements made in a nonemployment context).

[506] E.g., Rev. Rul. 67-30, 1967-1 C.B. 9 (involving a per diem allowance for a volunteer's travel expenses).

of gross income even if the reimbursement exceeded the expenses of providing the services.[507]

§ 9.18 USE OF PROPERTY

A person may contribute to a charitable organization the right to use an item of property. An example of this is a contribution, by an owner of an office building, of the rent-free use of office space to a charitable organization for a period of time. Another example is a gift by an owner of vacation property of the right to use the property for a period of time (such as two weeks). There is, however, no federal income tax charitable deduction for this type of gift.[508]

The reason for the lack of a deduction for a gift of this nature is the fact that the contribution is of a partial interest in the property;[509] this is not one of the forms of partial interests the gift of which gives rise to a charitable deduction.[510] Also, because the donor of the right to use an item of property rarely takes the value of the use of the property into income as imputed rent, to allow a charitable deduction for the use of the property by a charitable organization would be to allow a double deduction under the circumstances.

The IRS has provided an example of the application of this rule. The example concerns a common situation: an auction sponsored by a charitable organization, where one of the items that is donated to the charity is the right to use a vacation home for one week, with the donor of the home being its owner. The value of the fair rental amount foregone by the property owner is not the basis for a federal income tax charitable contribution deduction.[511] (Moreover, as noted, use of the property by the successful bidder at the auction is considered ''personal use'' by the owner, for purposes of determining any business expense deduction allowable with respect to the property.[512])

§ 9.19 BARGAIN SALES

The charitable deduction for an item of capital gain property is often based on the fair market value of the property; the donor is not required to recognize gain on the capital gain element in the property.[513] One of the exceptions to that rule involves the bargain sale.

(a) Definition of *Bargain Sale*

A *bargain sale* is a transfer of property to a charitable organization, when the transaction is in part a sale or exchange of the property and in part a charitable

---

[507] Rev. Rul. 74-322, 1974-2 C.B. 17. One of these programs is the Foster Grandparent Program; supplemental stipends paid by sponsoring state agencies to volunteers in this program are not includible in the recipient's gross income. Rev. Rul. 78-80, 1978-1 C.B. 22.

[508] Reg. § 1.170A-7(a)(1).

[509] IRC § 170(f)(3)(A).

[510] IRC § 170(f)(3)(A), last sentence. See, e.g., *Logan v. Commissioner*, 68 T.C.M. (CCH) 658 (1994) (charitable contribution deduction not allowed for fair rental value of portion of a garage used to house a fire engine owned by a county). In general, see § 5.3, note 6.

[511] Rev. Rul. 89-51, 1989-1 C.B. 89.

[512] *Id*. See IRC § 280A(d)(2)(C).

[513] See § 4.3.

contribution of the property.[514] Basically, a bargain sale is a sale of an item of property to a charitable organization at a price that is less than the fair market value of the property; the amount equal to the fair market value of the property, less the amount that is the sales price, is regarded as a contribution to the charitable organization.[515]

A court upheld a bargain sale transaction in which persons sold stock to a city for less than the fair market value of the securities. The city wanted the property represented by the stock for use as part of a sewage treatment program. The stock had a value of $7.9 million and was sold for $4 million.[516] In another case, two individuals sold to a charitable organization a custom flybridge steel fishing trawler for $25,000, to be used to teach delinquent youths individual responsibility by going on sea cruises. The vessel was custom-made for the sellers; it had a fair market value of $160,000.[517] Likewise, the sale of residential parcels of real estate to a state environmental restoration agency by a partnership was held to be a bargain sale.[518]

Disputes can arise as to whether a transaction is a bargain sale or a regular sale of property at fair market value. In one of these instances, a court held that the conveyance to a county of an easement restricting the development of land gave rise to a bargain sale and thus a charitable contribution deduction, despite the IRS's contention that the amount paid by the county for the transfer was its fair market value.[519] The county acquired the easement pursuant to an agricultural land preservation program. The donors were paid $309,000 (in money and promise of installment payments). The court found the value of the easement to be $518,000, resulting in a charitable deduction in the amount of $209,000. The IRS contended that the easement was worth only the $309,000 the government paid for it, that sum being in line with amounts the county generally paid for development rights under the program.

(b) Allocation of Basis

The charitable deduction arising from the making of a bargain sale may be an amount equal to the value of the gift portion of the property transferred. The charitable deduction may be less, however, inasmuch as a deduction reduction rule[520] potentially applies to the contribution element in a bargain sale. (The deduction reduction rule requires that, under certain circumstances, the amount that is equal to the fair market value of the property be reduced by the ordinary income or capital gain element in the property.)

---

[514] Reg. § 1.170A-4(c)(2)(ii). When the charitable organization is involved in the financing of the purchase component of a bargain sale, a result may be unrelated debt-financed income. See *Tax-Exempt Organizations* § 24.12. E.g., Tech. Adv. Mem. 9431001 (real property donated to charitable organization may have been debt-financed, absent statutory exception).

[515] E.g., *Stark v. Commissioner*, 86 T.C. 243 (1986); *Knott v. Commissioner*, 67 T.C. 681 (1977).

[516] *Waranch v. Commissioner*, 58 T.C.M. (CCH) 584 (1989).

[517] *Fair v. Commissioner*, 66 T.C.M. (CCH) 460 (1993).

[518] *Hay v. Commissioner*, 64 T.C.M. (CCH) 228 (1992).

[519] *Browning v. Commissioner*, 109 T.C. 303 (1997).

[520] See § 4.4(b).

There must be allocated to the contribution portion of the property that element of the adjusted basis of the entire property that bears the same ratio to the total adjusted basis as the fair market value of the contributed portion of the property bears to the fair market value of the entire property. Further, for these purposes, there must be allocated to the contributed portion of the property the amount of gain that is not recognized on the bargain sale, but that would have been recognized if the contributed portion of the property had been sold by the donor at its fair market value at the time of its contribution to the charitable organization.[521]

The amount of long-term capital gain or ordinary income that would have been recognized if the contributed portion of the property had been sold by the donor at its fair market value at the time of its contribution is the amount that bears (1) the same ratio to the ordinary income (or long-term capital gain) that would have been recognized if the entire property had been sold by the donor at its fair market value at the time of its contribution (2) as the fair market value of the contributed portion of the property at that time bears to the fair market value of the entire property at that time.[522] The fair market value of the contributed portion of the property is the amount determined by subtracting from the fair market value of the entire property the amount realized on the sale.[523]

The donee must use the adjusted basis of the contributed portion of the property in applying to the contributed portion of the property such rules of law as[524]

- Determining the adjusted basis of debt-financed property[525]
- Determining the basis of property acquired by gift[526]
- Determining capital gains and losses in the calculation of the net investment income of private foundations[527]
- Determining net short-term capital gain in calculating the tax on failure to distribute income imposed on private foundations[528]

The donee may not use the fair market value of the contributed portion of the property, at the time of the contribution, as the basis of the contributed portion.[529]

The contribution element arising from a bargain sale is subject to the percentage limitations.[530] The gain generated as the consequence of a bargain sale transaction must be recognized in the year of the sale.[531]

These rules as applied to a bargain sale are illustrated by the following example:

---

[521] IRC § 1011(b); Reg. § 1.1011-2(a)(1).
[522] Reg. § 1.170A-4(c)(3).
[523] *Id.*
[524] Reg. § 1.170A-4(c)(4).
[525] IRC § 514(a)(1). See § 3.5.
[526] IRC § 1015(a).
[527] IRC § 4940(c)(4).
[528] IRC § 4942(f)(2)(B).
[529] Reg. § 1.170A-4(c)(4), last sentence.
[530] See ch. 7.
[531] Reg. § 1.1011-2(a)(2). Also Reg. § 1.1011-2(c), Example (2).

EXAMPLE 9.14

H has long-term capital gain property that has a fair market value of $20,000. H's basis in the property is $8,000. H sold the property to a tax-exempt, charitable hospital for $8,000. Consequently, H made a charitable contribution to the hospital of $12,000 ($20,000 – $8,000). The transaction was thus partially a contribution ($12,000) and partially a sale ($8,000).

H thus received a gain of $8,000. To determine the net gain, H had to reduce the gain by the amount of the basis allocable to it. The basis allocated to the sale portion of the transaction was $3,200 ($8,000/$20,000 × $8,000). The basis allocated to the gift element of the transaction was $4,800 ($12,000/$20,000 × $8,000).

A bargain sale will also arise when the property transferred to a charitable organization is subject to a debt, even though the donor does not receive any payment for the transfer of the property.[532]

In one case, a court held that a charitable contribution of property, subject to a nonrecourse indebtedness, constituted a bargain sale that gave rise to taxable gain.[533] A dissent observed that the holding is erroneous because the donors were not relieved of any personal liability by the transfer of the land.

(c) Interplay with Deduction Reduction Rule

A court ruled that the federal tax regulations accompanying the appreciation reduction rule[534] were invalid to the extent that they required reduction of a donor's charitable deduction, arising by reason of a bargain sale, by the amount of the unrealized appreciation of the sale portion of the property.[535] Under the facts of the case, the donors sold appreciated long-term capital gain property to a charitable organization in a bargain sale. The regulations accompanying these rules[536] provided that, in the case of a bargain sale to which the deduction reduction rule applies, no deduction is allowable unless the gift exceeds the appreciation reduction amount for all of the property. Because this interpretation of the rules would have eliminated any charitable contribution deduction, the donors contended that the deduction reduction rule only causes a reduction in their charitable deduction of the inherent gain in the donated portion of the property. In agreeing with the donors, the court parsed the language of the deduction reduction rule, which speaks of the "property contributed," and concluded that Congress referenced, in connection with bargain sales, only the property donated and not the property sold as well. Therefore, the court pronounced the regulations "unreasonable" and thus invalid.[537] The regulations were subsequently revised to reflect this opinion.

(d) Interplay with Carryover Rules

In a case, a donor made a bargain sale of capital gain property to a charitable organization. Earlier in the same year, the same donor made another gift of

[532] See § 9.20.
[533] *Ebben v. Commissioner*, 783 F.2d 906 (9th Cir. 1986).
[534] IRC § 170(e)(1). See § 4.4.
[535] *Estate of Bullard v. Commissioner*, 87 T.C. 261 (1986).
[536] Reg. §§ 1.170A-4(c), 1.1011-2.
[537] *Estate of Bullard v. Commissioner*, 87 T.C. 261 (1986).

different capital gain property to another charitable recipient, resulting in a charitable deduction (prior to application of the percentage limitations).[538] This deduction exceeded the amount allowable for the donor for gifts of capital gain property for the year, thus forcing all of the deduction attributable to the bargain sale to be carried forward.

The tax regulations state that a charitable deduction arising from a bargain sale of property is an ''allowable'' deduction, even if part or all of the contribution must be carried forward, irrespective of whether the portion carried over is ever used as a deduction.[539] In this case, the donors challenged the regulation, claiming that the deduction resulting from the first gift must be made in its entirety before any part of the contribution for the second gift can be deducted. If that were true, it would have worked out that the entire allowable deduction relating to capital gain property in the year of the gift and in the subsequent year would have been charged against the first contribution, leaving nothing to be deductible attributable to the second contribution. But the court held that there is no basis in law for the ''first-in first out'' rule as the donors suggested.[540]

The court construed the term *allowable* in the context of the five-year carryover rule. That is, the deductibility of a gift may not be known until the expiration of six years—long after the expiration of the period of limitations for assessment of a deficiency in respect to the year of contribution. Wrote the court:

> We think it unlikely that Congress intended the substantive rights of taxpayers and the Government to be imperiled by a rule providing that no deduction was ''allowable'' for [these] purposes . . . unless it eventually turned out, long after the taxable year, that the contribution actually reduced the taxpayer's taxable income in any of the 5 succeeding taxable years.[541]

The court continued:

> We think that if the statute is read in the context of all relevant provisions, the word ''allowable'' must be interpreted as referring to a contribution available for deduction even though the contribution does not ultimately result in a deduction by reason of future events entirely unrelated to the nature of the charitable contribution.[542]

This interpretation of the law, concluded the court, ''strongly supports'' the regulation.[543]

§ 9.20 PROPERTY SUBJECT TO DEBT

Property may be the subject of charitable gifts.[544] When, however, the property is subject to a debt, unique tax consequences are likely to arise.

---

[538] See ch. 7.
[539] Reg. § 1.1011-2(a)(2).
[540] *Hodgdon v. Commissioner*, 98 T.C. 424 (1992).
[541] *Id*. at 434.
[542] *Id*.
[543] *Id*. A court case involving carryovers of a charitable contribution deduction arising out of a bargain sale is *Fair v. Commissioner*, 66 T.C.M. (CCH) 460 (1993). In general, Kaplan & Lederman, ''Bargain Sales Can Benefit Charities and Donor Limited Partnerships,'' 6 *J. Tax. Exempt Orgs*. (no. 2) 58 (Sep./Oct. 1994).
[544] See, e.g., ch. 4.

One of these consequences is that the transaction is likely to be a bargain sale.[545] This is because the transfer of property that was subject to a debt relieved the donor of that obligation, which is a form of consideration, so the donor received something in return for the gift (namely, relief from the debt).[546] This topic has been the subject of litigation.

The federal tax law is clear that "gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis."[547] The general rule is that the "adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis" for federal tax law purposes, as "adjusted."[548] The phrase *other disposition of property* includes a gift of property. Thus, a "disposition of property includes a gift of the property or a transfer of the property in satisfaction of the liabilities to which it is subject."[549] The bargain sale rules, however, entail a somewhat different definition of the term *basis*, which is that, if a deduction is allowed for a federal income tax charitable contribution deduction "by reason of a sale, then the adjusted basis for determining the gain from such sale shall be that portion of the adjusted basis which bears the same ratio to the adjusted basis as the amount realized bears to the fair market value of the property."[550] Thus, the general rule uses the phrase *sale or other disposition*, while the bargain sale rule only uses the term *sale*. This led to the contention that a sale occurs in this setting only when the transferor receives a direct benefit from the transaction, such as cash upon mortgaging the property or a depreciation deduction with respect to the property prior to transferring it to the charity.[551] This argument leads to the collateral argument that the general rule for determining basis applies, rather than the bargain sale rule.

A U.S. Supreme Court opinion made it clear, however, that taxation on relief from debt is not dependent on any theory of economic benefit; rather, it applies to situations such as those not involving the taking of any depreciation deductions.[552] The court stated:

> This, however, does not erase the fact that the mortgagor received the loan proceeds taxfree and included them in his basis on the understanding that he had an obligation to repay the full amount . . . When the obligation is cancelled, the mortgagor is relieved of his responsibility to repay the sum he originally received and thus realizes value to that extent within the meaning of . . . [the tax law defining *amount received*[553]]. From the mortgagor's point of view, when his obligation is assumed by a third party who purchases the encumbered property, it is as if the mortgagor first had been paid with cash borrowed by the third party from the mortgagee on a nonrecourse basis, and then had used the cash to satisfy his obligation to the mortgagee.[554]

---

[545] See § 9.19.
[546] Reg § 1.1011-2(a)(3). E.g., Rev. Rul. 81-163, 1981-1 C.B. 433.
[547] IRC § 1001(a).
[548] IRC § 1011(a). The rules concerning adjusted basis are the subject of IRC § 1016.
[549] Reg. § 1.1001-2(a)(4)(iii).
[550] IRC § 1011(b).
[551] This was the taxpayers' contention in *Ebben v. Commissioner*, 783 F.2d 906, 911–12 (9th Cir. 1986). There was a basis for this argument. E.g., *Crane v. Commissioner*, 331 U.S. 1 (1947).
[552] *Commissioner v. Tufts*, 461 U.S. 300 (1983).
[553] IRC § 1001(b).
[554] *Commissioner v. Tufts*, 461 U.S. 300, 312 (1983) (citation omitted).

The Supreme Court put the matter this way (as a contrast):

> When a taxpayer receives a loan, he incurs an obligation to repay that loan at some future date. Because of this obligation, the loan proceeds do not qualify as income to the taxpayer. When he fulfills the obligation, the repayment of the loan likewise has no effect on this tax liability.[555]

Another court subsequently completed this argument:

> But when someone else relieves him of his obligation to pay the loan, it is as though the taxpayer had received cash and the transfer of the encumbered property to the charity is the equivalent of a sale without regard to any tax benefit theory.[556]

In the case, the taxpayers contributed mortgaged property to a college, which took the property subject to the debt. The court wrote that ''it was as if the taxpayers had been paid with cash borrowed by . . . [the college] from the mortgagee on a nonrecourse basis, and then had used the cash to satisfy their obligation to the mortgagee.''[557]

The IRS consistently interprets the term *sale* in the bargain sale context to include gifts of mortgaged property to a charity. Thus,

> [i]f property is transferred subject to an indebtedness, the amount of indebtedness must be treated as an amount realized for purposes of determining whether there is a sale or exchange . . . , even though the transferee does not agree to assume or pay the indebtedness.[558]

This approach was upheld by a court as being reasonable.[559]

This doctrine of law causes the transaction to be partially a purchase and partially a gift. The tax basis of the property must, as noted, be allocated to both the purchase and gift portions of the transaction in determining the capital gain to be reported.[560]

Example 9.15

M contributed an item of capital gain property to PC, a public charitable organization. At the time of the gift, the property had a fair market value of $35,000. M's basis in the property was $15,000. The property was the subject of a $10,000 mortgage.

M's charitable contribution deduction for the year was $20,000 ($35,000 − $15,000). M also is treated as having received $10,000 as a form of consideration (relief from the mortgage obligation).

Of the $15,000 basis in the property, $4,286 was allocated to the purchase element of the transaction (10/35 × $15,000) and $10,714 was allocated to the gift element of the transaction (25/35 × $15,000). Thus, M had long-term capital gain of $5,714 as the result of this transaction.

For these purposes, it is immaterial whether the donee organization pays the debt or agrees to assume it. The relief from the obligation is regarded as an item

[555] *Id*. at 307.

[556] *Ebben v. Commissioner*, 783 F.2d 906, 912 (9th Cir. 1986). Also *Commissioner v. Peterman*, 118 F.2d 973 (9th Cir. 1941); *Guest v. Commissioner*, 77 T.C. 9 (1981); *Freeland v. Commissioner*, 74 T.C. 970 (1980).

[557] *Ebben v. Commissioner*, 783 F.2d 906, 912 (9th Cir. 1986).

[558] Reg. § 1.1011-2(a)(3).

[559] *Ebben v. Commissioner*, 783 F.2d 906, 913–15 (9th Cir. 1986).

[560] IRC § 1011(b). See § 9.19(b).

of consideration in either event.[561] This principle of law also applies in the planned giving context.[562] Thus, the contribution to a charitable organization, by means of a pooled income fund, of an item of property that is subject to a debt causes the donor to be treated as though he or she had received income in an amount equal to the amount of the debt.[563] The taxable gain is determined using the bargain sale rules, which require allocation of the basis in the property to the purchase and gift elements (see above).

It appears that these same rules apply in the context of charitable giving by means of charitable remainder trusts.[564] In the setting of charitable remainder trusts, the consequences of transferring property encumbered with debt can be more severe than is the case with pooled income funds. As discussed, a form of unrelated business income is unrelated debt-financed income.[565] A gift of mortgaged property to a charitable remainder trust can cause unrelated debt-financed income to be received by the trust.[566] When a charitable remainder trust receives unrelated business taxable income in a year, it loses its tax exemption for the year.[567] If an individual transfers mortgaged property to a charitable remainder trust, and the individual is personally liable on the mortgage, the trust may become disqualified on the ground that discharge of the obligation causes the donor to become the owner of the trust. The IRS has so held.[568]

§ 9.21 FUTURE INTERESTS IN TANGIBLE PERSONAL PROPERTY

A charitable contribution consisting of a transfer of a future interest in tangible personal property is treated as made only when all intervening interests in, and rights to the actual possession or enjoyment of, the property have expired, or are held by persons other than the donor or those related to the donor.[569]

The term *future interest* includes:

- reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time,[570] and
- situations in which a donor purports to give tangible personal property to a charitable organization but has an understanding, arrangement, agreement, or the like, whether written or oral, with the charitable organization which has the effect of reserving to, or retaining in, the donor a right to the use, possession, or enjoyment of the property.[571]

---

[561] *Ebben v. Commissioner*, 783 F.2d 906 (9th Cir. 1986).
[562] In general, see Part Three.
[563] Reg. § 1.642(c)-5(a)(3).
[564] Rev. Rul. 81-163, 1981-1 C.B. 433; Priv. Ltr. Rul. 8526015.
[565] See § 3.5.
[566] IRC § 514(c)(2)(A), (B).
[567] See § 12.7.
[568] Priv. Ltr. Rul. 9015049.
[569] IRC § 170(a)(3); Reg. § 1.170A-5(a)(1). The rules of IRC § 267(b) (relating to losses, expenses, and interest with respect to transactions between related taxpayers) are used to measure the requisite relationships.
[570] Reg. § 25.2503-3(b).
[571] Reg. § 1.170A-5(a)(4).

These rules do not apply with respect to a transfer of an undivided present interest in tangible personal property. For example, a contribution of an undivided one-quarter interest in a painting with respect to which the charitable donee is entitled to possession during three months of each year is treated as made upon receipt by the donee of a formally executed and acknowledged deed of gift. The period of initial possession by the donee may not, however, be deferred in time for more than one year.[572]

Thus, these rules do not apply with respect to a transfer of a future interest in intangible personal property or of a transfer of a future interest in real property.[573] A fixture that is intended to be severed from real property is, however, treated as tangible personal property.[574] For example, a contribution of a future interest in a chandelier attached to a building is considered to consist of a future interest in tangible personal property if the transferor intends that it be detached from the building at or prior to the time when the charitable organization's right to possession or enjoyment of the chandelier is to commence.[575]

In the case of a charitable contribution of a future interest, the other rules of the law of charitable giving are inapplicable to the contribution until the time the contribution is treated as made under these rules.[576]

These rules may be illustrated by the following examples:

EXAMPLE 9.16

On December 31, 2008, A, an individual who reports his income on the calendar year basis, conveyed title to a painting by deed of gift to a museum, but reserved to himself the right to use, possess, and enjoy the painting during his lifetime. There was no intention on A's part to avoid application of the partial interest gift rules[a] by the conveyance. At the time of the gift, the value of the painting was $200,000. Because the contribution consisted of a future interest in tangible personal property in which the donor retained an intervening interest, A did not make a deductible charitable contribution to the museum in 2008.[b]

[a] IRC § 170(f)(a)(A). See § 9.23.
[b] Reg. § 1.170A-5(b), Example (1).

EXAMPLE 9.17

The facts are the same as in Example 9.11, except that on December 31, 2009, A relinquished all of his right to the use, possession, and enjoyment of the painting, and delivered the painting to the museum. The value of the painting had increased to $220,000. A is treated as having made a charitable contribution of $220,000 in 2009 for which a deduction is allowable (without regard to the partial interest gift rules).[a]

[a] Reg. § 1.170A-5(b), Example (2).

---

[572] Reg. § 1.170A-5(a)(2). See, however, § 15.3(b).
[573] Reg. § 1.170A-5(a)(3).
[574] IRC § 170(a)(3), last sentence; Reg. § 1.170A-5(a)(3).
[575] Reg. § 1.170A-5(a)(3).
[576] Reg. § 1.170A-5(a)(5).

Example 9.18

The facts are the same as in Example 9.11, except that A died without relinquishing his right to the use, possession, and enjoyment of the painting. Because A did not relinquish his right to the use, possession, and enjoyment of the property during his life, A is treated as not having made a charitable contribution of the painting for income tax purposes.[a]

[a] Reg. § 1.170A-5(b), Example (3).

Example 9.19

The facts are the same as in Example 9.11, except that A, on December 31, 2009, transferred his interest in the painting to his daughter, B. Because A and B are related, no contribution of the remainder interest in the painting is considered to have been made in 2009.[a]

[a] Reg. § 1.170A-5(b), Example (4).

Example 9.20

The facts are the same as in Example 9.14. On December 31, 2010, B conveys to the museum the interest measured by A's life. B thus makes a charitable contribution of the present interest in the painting conveyed to the museum. In addition, because all intervening interests in, and rights to the actual possession or enjoyment of, the property have expired, a charitable contribution of the remainder interest is treated as having been made by A in 2010, for which a charitable contribution deduction is allowable (without regard to the partial interest gift rules). The value of the remainder interest is determined by subtracting the value of B's interest measured by A's life expectancy in 2010, and B receives a charitable contribution deduction in 2010 for the life interest measured by A's life expectancy.[a]

[a] Reg. § 1.170A-5(b), Example (5).

Example 9.21

On December 31, 2009, C, an individual, transfers a valuable painting to a qualified pooled income fund[a] maintained by a university. C retains for himself, for life, an income interest in the painting and contributes the remainder interest in the painting to the university. Because the contribution consists of a future interest in tangible personal property in which the donor has retained an intervening interest, no charitable deduction is considered to have been made in 2009.[b]

[a] See ch. 13.
[b] Reg. § 1.170A-5(b), Example (1).

Example 9.22

On January 15, 2009, D, an individual transfers a painting (a long-term capital asset) to a pooled income fund maintained by a university, and creates an income interest in the painting for E, for her life. D and E are not related individuals. D contributes the remainder interest in the property to the university. The trustee of the pooled income fund puts the painting to an unrelated use.[a] Accordingly, D is allowed a charitable deduction in 2009 for the present value of the remainder interest in the painting (after reducing the amount as required).[b] This reduction in the amount of the contribution is required because the pooled income fund's use of the painting would have been an unrelated use if it had been made by the university.[c]

[a] See § 3.5.
[b] *Id.*
[c] Reg. § 1.170A-5(b), Example (7).

§ 9.22 CONTRIBUTIONS BY TRUSTS

Contributions to charitable organizations may be made by trusts. The federal tax law differentiates between simple trusts[577] and complex trusts.[578] A trust may qualify as a simple trust in one year and be a complex trust in another year.[579]

(a) General Rules

The terms of a simple trust provide that all of the trust income is to be distributed currently and do not provide that any amounts are to be paid, permanently set aside, or used for charitable purposes.[580] A simple trust is not considered to be a trust that may pay, permanently set aside, or use any amount for charitable purposes for any tax year in which the trust is not allowed a charitable deduction.[581]

A complex trust is allowed a deduction, in computing its taxable income, for an amount of gross income, without limitation, that pursuant to the terms of the governing instrument is, during the tax year, paid for a charitable purpose.[582]

A trust is allowed a deduction for distributions to beneficiaries up to the amount of *distributable net income* of the trust for the tax year. A complex trust may deduct, up to its distributable net income ceiling for the year, the sum of any income for the tax year required to be distributed currently and any other amounts, whether income or principal, properly paid or credited or required to be distributed for that tax year.[583]

A trust beneficiary must include in income the amount distributed to the beneficiary, as well as any amount credited or required to be distributed by the trust to the beneficiary.[584] Any amount paid or permanently set aside or otherwise qualifying for the charitable deduction is not encompassed by these rules.

Amounts paid, permanently set aside, or to be used for charitable purposes are deductible by trusts only to the extent provided by the applicable charitable deduction rules.[585] Thus, a trust is not entitled to a charitable contribution deduction (or a distribution deduction) for a contribution to a charitable organization when the gift is of some or all of the trust principal. For example, the IRS ruled that a trust cannot claim a charitable contribution deduction for gifts of trust principal that satisfy the requirements of a qualified conservation contribution.[586]

For a trust to claim a charitable deduction for an amount of gross income that it contributes for charitable purposes, the governing instrument of the trust must accord the trustee(s) the authority to make charitable contributions. In the case of an investment by a trust in a partnership, the partnership may make a charitable contribution from the partnership's gross income. Although that income is never

---

[577] This category of trust is a trust subject to IRC §§ 651, 652.
[578] This category of trust is a trust that is not a simple trust and is subject to IRC §§ 661–663.
[579] Reg. § 1.651(a)-1.
[580] IRC § 651(a).
[581] Reg. § 1.651(a)-4. This charitable deduction is the subject of IRC § 642(c).
[582] IRC § 642(c)(1). This charitable deduction is in lieu of the more conventional charitable deduction allowed by IRC § 170. See § 2.5(b), text accompanied by note 18.
[583] IRC § 661(a).
[584] IRC § 662(a).
[585] Reg. § 1.663(a)-2. Again, this charitable deduction is that referenced in *supra* note 581.
[586] Rev. Rul. 2003-123, 2003-2 C.B. 1200. See § 9.7.

available to the trust, for federal tax purposes, the trust must take into account its distributive share of the partnership's income, gain, loss, deductions (including charitable contributions), and credits.[587] Under these circumstances, a trust's deduction for its distributive share of a charitable contribution made by a partnership will not be disallowed merely because the trust's governing instrument does not authorize the trustee to make charitable contributions.[588]

(b) Gifts of Interests in Properties

A charitable deduction is not allowed for the fair market value of a contribution of any interest in property that is less than the donor's entire interest in the property and that is transferred in trust, unless the transfer meets certain requirements.[589] If a donor's entire interest in the property is transferred in trust and contributed to a charitable organization, however, a charitable deduction is allowed.[590] For example, if an item of property is transferred in trust, with the requirement that the income of the trust be paid for a term of 20 years to a church and thereafter the remainder is to be paid to an educational institution, a deduction is allowed for the value of the property.[591]

These rules do not apply with respect to a contribution of a partial interest in property if the interest is the donor's entire interest in the property (an income interest or remainder interest). If the property in which a partial interest exists was divided in order to create the interest and thus avoid these rules, however, the deduction is not allowable.[592]

EXAMPLE 9.23

X, an individual, desires to contribute to a charitable organization the reversionary interest in certain securities that she owns. X transfers the securities in trust with the requirement that the income of the trust be paid to her son for life and that the reversionary interest be paid to herself. Immediately after creating the trust, X contributes the reversionary interest to the charitable organization. X is not allowed to take a charitable contribution deduction for the gift of her entire interest, namely, the reversionary interest in the trust.[a]

[a] *Id.*

As the example illustrates, the charitable contribution deduction is precluded when the ineligible partial interests are created on or about the same time. This ban is not necessarily permanent, however; when there is a substantial time gap between the creation of a trust and the contribution in question, the charitable deduction may be available. One instance in which this occurred involved the contribution of a fraction of an income interest in a charitable remainder trust to a charitable organization that was the remainder interest beneficiary (leading to a partial termination of the trust). The IRS was persuaded that the six-year gap

[587] See § 6.14.
[588] Rev. Rul. 2004-5, 2004-1 C.B. 295.
[589] IRC § 170(f)(2); Reg. § 1.170A-6(a)(1).
[590] IRC § 170(f)(2)(D).
[591] Reg. § 1.170A-6(a)(1).
[592] Reg. § 1.170A-6(a)(2).

spanning creation of the trust and the fractional interest gift demonstrated that the donors did not inappropriately divide their interest in the trust.[593]

A charitable contribution deduction is not allowed for the fair market value of a gift, to a charitable organization, of a remainder interest in property that is less than the donor's entire interest in the property and that the donor transfers in trust, unless the trust is

- a pooled income fund,[594]
- a charitable remainder annuity trust,[595] or
- a charitable remainder unitrust.[596]

A charitable contribution deduction is not allowed for the fair market value of a gift, to a charitable organization, of an income interest in property that is less than the donor's entire interest in the property and that the donor transfers in trust, unless the income interest is a guaranteed annuity interest or a unitrust interest, and the grantor is treated as the owner of the interest.[597]

(c) Guaranteed Annuity Interests

An income interest is a *guaranteed annuity interest* only if it is an irrevocable right, pursuant to the governing instrument of the trust, to receive a guaranteed annuity. A guaranteed annuity is an arrangement under which a determinable amount is paid periodically (but not less than annually), for a specified term and/or for the life or lives of an individual or individuals, each of whom must be living at the date of transfer and can be ascertained at that date. For example, the annuity may be paid for the life of A plus a term of years. An amount is determinable if the exact amount that must be paid under the conditions specified in the governing instrument of the trust can be ascertained as of the date of transfer. For example, the amount to be paid may be a stated sum for a term, or for the life of an individual, at the expiration of which it may be changed by a specified amount but may not be redetermined by reference to a fluctuating index, such as the cost of living index. The amount to be paid may be expressed in terms of a fraction or percentage of the cost of living index on the date of transfer.[598]

An income interest is a guaranteed annuity interest only if it is a guaranteed annuity interest in every respect. For example, if the income interest is the right to receive from a trust each year a payment equal to the lesser of a sum certain or a fixed percentage of the net fair market value of the trust assets, determined annually, the interest is not a guaranteed annuity interest.[599]

When a charitable interest is in the form of a guaranteed annuity interest, the governing instrument of the trust may provide that income of the trust, which is in excess of the amount required to pay the guaranteed annuity interest, may be paid to or for the use of a charitable organization. Nevertheless, the amount of the

---

[593] Priv. Ltr. Rul. 9550026.
[594] See ch. 13.
[595] See § 12.2.
[596] See § 12.3.
[597] IRC § 170(f)(2)(B); Reg. § 1.170A-6(c)(1).
[598] Reg. § 1.170A-6(c)(2)(i)(A).
[599] Reg. § 1.170A-6(c)(2)(i)(B).

charitable deduction is limited to the fair market value of the guaranteed annuity interest.[600]

If the present value on the date of transfer of all the income interests for a charitable purpose exceeds 60 percent of the aggregate fair market value of all amounts in the trust (after the payment of liabilities), the income interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits both the acquisition and the retention of assets that would give rise to the private foundation tax on jeopardizing investments[601] if the trustee had acquired assets of that nature.[602]

An income interest consisting of an annuity transferred in trust is not a guaranteed annuity interest if any amount other than an amount in payment of a guaranteed annuity interest may be paid by the trust for a private purpose before the expiration of all the income interests for a charitable purpose, unless the amount for a private purpose is paid from a group of assets that, pursuant to the governing instrument of the trust, are devoted exclusively to private purposes and to which the split-interest trust rules[603] are inapplicable by reason of an exception to them.[604] This exception applies only if the obligation to pay the annuity for a charitable purpose begins as of the date of creation of the trust, and the obligation to pay the guaranteed annuity for a private purpose does not precede in time the obligation to pay the annuity for a charitable purpose, and only if the governing instrument of the trust does not provide for any preference or priority in respect of any payment of the guaranteed annuity for a private purpose as opposed to any payment for a charitable purpose. In this context, an amount is not paid for a private purpose if it is paid for an "adequate and full consideration" in money or money's worth.[605]

EXAMPLE 9.24

E transfers $75,000 in trust. The terms of the trust require that an annuity of $5,000 a year, payable annually at the end of each year, be paid to B, an individual, for 5 years and that thereafter an annuity of $5,000 a year, payable annually at the end of each year, be paid to M, a charitable organization, for 5 years. The remainder is to be paid to C, an individual. A charitable deduction is not allowed under these rules with respect to the charitable annuity, because it is not a guaranteed annuity interest.[a]

[a] *Id.*

(d) Unitrust Interests

An income interest is a *unitrust interest* only if it is an irrevocable right pursuant to the governing instrument of the charitable remainder unitrust to receive payment, not less often than annually, of a fixed percentage of the net fair market value of the trust assets, determined annually. In computing the net fair market value of the trust assets, all assets and liabilities must be taken into account

[600] Reg. § 1.170A-6(c)(2)(i)(C).
[601] IRC § 4944. See *Private Foundations* ch. 8.
[602] Reg. § 1.170A-6(c)(2)(i)(D).
[603] IRC § 4947(a)(2). See § 5.3; see also *Private Foundations* § 3.7.
[604] This exception is the subject of IRC § 4947(a)(2)(B).
[605] Reg. § 1.170A-6(c)(2)(i)(E).

without regard to whether particular items are taken into account in determining the income of the trust. The net fair market value of the trust assets may be determined on any one date during the year or by taking the average of valuations made on more than one date during the year, provided that the same valuation date or dates and valuation methods are used each year. When the governing instrument of the trust does not specify the valuation date or dates, the trustee is to select the date or dates and indicate the selection on the first return that the trust is required to file with the IRS.[606] Payments under a unitrust interest may be paid for a specified term or for the life or lives of an individual or individuals, each of whom must be living at the date of transfer and can be ascertained at that date. For example, a unitrust interest may be paid for the life of A plus a term of years.[607]

An income interest is a unitrust interest only if it is a unitrust interest in every respect. For example, if the income interest is the right to receive from a trust each year a payment equal to the lesser of a sum certain or a fixed percentage of the net fair market value of the trust assets, determined annually, the interest is not a unitrust interest.[608]

When a charitable interest is in the form of a unitrust interest, the governing instrument of the trust may provide that income of the trust in excess of the amount required to pay the unitrust interest is to be paid to or for the use of a charitable organization. Nevertheless, the amount of the deduction under these rules must be limited to the fair market value of the unitrust interest.[609]

An income interest in the form of a unitrust interest is not a unitrust interest if any amount other than an amount in payment of a unitrust interest may be paid by the trust for a private purpose before the expiration of all the income interests for a charitable purpose, unless the amount for a private purpose is paid from a group of assets that, pursuant to the governing instrument of the trust, are devoted exclusively to private purposes and to which the split-interest trust rules are inapplicable by reason of an exception.[610] This exception applies only if the obligation to pay the unitrust interest for a charitable purpose begins as of the date of creation of the trust, and the obligation to pay the unitrust interest for a private purpose does not precede in time the obligation to pay the unitrust interest for a charitable purpose, and only if the governing instrument of the trust does not provide for any preference or priority in respect of any payment of the unitrust interest for a private purpose as opposed to any payment for a charitable purpose. In this context, an amount is not paid for a private purpose if it is paid for an ''adequate and full consideration'' in money or money's worth.[611]

(e) Valuation

The charitable contribution deduction allowed for a gift of a guaranteed annuity interest is limited to the fair market value of the interest on the date of the

---

[606] See § 24.13.
[607] Reg. § 1.170A-6(c)(2)(ii)(A).
[608] Reg. § 1.170A-6(c)(2)(ii)(B).
[609] Reg. § 1.170A-6(c)(2)(ii)(C).
[610] See § 9.22(c), text accompanied by *supra* notes 603, 604.
[611] Reg. § 1.170A-6(c)(2)(ii)(D).

contribution.[612] The same is true with respect to the gift of a unitrust interest.[613] The fair market value of a unitrust interest is determined by subtracting the present value of all interests in the transferred property, other than the unitrust interest, from the fair market value of the transferred property.[614] If, by reason of all the conditions and circumstances surrounding a transfer of an income interest in property in trust, it appears that the charitable organization may not receive the beneficial enjoyment of the interest, a charitable deduction is allowed under these rules only for the minimum amount it is evident the charity will receive.[615]

(f) Recapture

If the donor of an income interest in property, at any time before termination of the interest, ceases to be treated as the owner of the interest (such as by reason of death), the donor must be considered as having received, on the date of cessation of the ownership, an amount of income equal to (1) the amount of any charitable deduction to the donor that was allowed for the contribution of the interest, reduced by (2) the discounted value of all amounts that were required to be, and actually were, paid with respect to the interest under the terms of the trust to the charitable organization before the time at which the donor ceased to be treated as the owner of the interest.

The discounted value of these amounts is computed by treating each amount as a contribution of a remainder interest after a term of years and valuing each amount as of the date of contribution of the income interest by the donor, consistent with the manner in which the fair market value of the income interest was determined. This rule is not to be construed to disallow a deduction to the trust for amounts paid by the trust to the charitable organization after the time at which the donor ceased to be treated as the owner of the trust.[616]

(g) Denial of Deduction for Certain Contributions

If a charitable contribution deduction is allowed for the fair market value of an income interest transferred in trust, neither the grantor of the income interest, the trust, nor any other person may be allowed a charitable or any other type of deduction for the amount of any charitable contribution made by the trust with respect to, or in fulfillment of, the income interest.[617] This rule is not to be construed, however, to:

- disallow a deduction to the trust[618] for amounts paid by the trust after the grantor ceased to be treated as the owner of the income interest[619] that are not taken into account in determining the amount of recapture,[620] or

[612] Reg. § 1.170A-6(c)(3)(i).
[613] Reg. § 1.170A-6(c)(3)(ii).
[614] *Id.*
[615] Reg. § 1.170A-6(c)(3)(iii).
[616] IRC § 170(f)(2)(B); Reg. § 1.170A-6(c)(4).
[617] IRC § 170(f)(2)(C); Reg. § 1.170A-6(d)(1).
[618] IRC § 642(c)(1).
[619] IRC § 671.
[620] See § 9.22(f).

- disallow a deduction to the grantor[621] for a charitable contribution made to the trust in excess of the contribution required to be made by the trust under the terms of the trust instrument with respect to, or in fulfillment of, the income interest.[622]

§ 9.23 PARTIAL INTERESTS

As a general rule, there is no federal income tax deduction for a contribution of a partial interest in property to a charitable organization.[623] This rule is, however, largely engulfed by exceptions.[624] The principal exception is for qualified transfers made in trust form.[625] Additional exceptions cover certain gifts for conservation purposes,[626] contributions of a remainder interest in a personal residence or farm,[627] and contributions of an undivided portion of the donor's entire interest in property.[628]

A charitable deduction is, however, allowed for a contribution of a partial interest in property, without regard to this rule, when the interest is less than the entire interest in the property, if the interest is the donor's entire interest in the property.[629] Nonetheless, if the property in which the partial interest exists was divided to create this type of partial interest and thus avoid the general rule, the charitable deduction will not be allowed.[630]

The purpose of this general rule is to preclude a claimed charitable contribution deduction in an amount greater than the value of the interest contributed. Illustrations of partial interests include

- The contribution of voting stock to a charitable organization, with the donor retaining the right to vote that stock.[631] (Subsequently, however, the IRS considered a similar set of facts and reasoned that, because the voting rights were transferred to an unrelated individual for a valid business purpose, the contribution of stock subject to a voting agreement was eligible for the charitable contribution deduction, because the donor's interest in the stock was not divided to avoid the partial interest rule.[632] An irrevocable assignment to a charity of the cash surrender value of life insurance, with the donor retaining the right to designate the beneficiary and to assign the balance of the policy subject to the charity's right to the cash surrender value.[633]

---

[621] IRC § 671.
[622] Reg. § 1.170A-6(d)(2).
[623] IRC § 170(f)(3)(A); Reg. § 1.170A-7(a)(1).
[624] A court stated the general rule without qualification (which, if literally accurate, would undo nearly the entirety of the law underlying planned giving): "The Internal Revenue Code does not allow charitable deductions for donations of partial interests in property." *Greene v. United States*, 864 F. Supp. 407, 412 (S.D.N.Y. 1994).
[625] See § 9.22.
[626] See § 9.7.
[627] See § 15.2.
[628] See § 15.3.
[629] *Id.*
[630] Reg. § 1.170A-7(a)(2)(i).
[631] Rev. Rul. 81-282, 1981-2 C.B. 78.
[632] Priv. Ltr. Rul. 200108012.
[633] Rev. Rul. 76-143, 1976-1 C.B. 63.

As an illustration, a contribution of the right to use property that the donor owns, such as a contribution of a rent-free lease, is treated as a contribution of less than the person's entire interest in the property.[634] Likewise, if a person contributes an interest in motion picture films, but retains the right to make reproductions of the films and exploit the reproductions commercially, the contribution is regarded as one that is less than the person's entire interest in the property.[635] In both instances, the contribution is not deductible.

Another example involved the contribution to a tax-exempt university of a license to use a patent, with the donor retaining the right to license the patent to others. The IRS analogized this arrangement to the rent-free lease and the partial interest in motion picture films referenced above, in that the license did not constitute the donor's entire interest in the patent. This gift was ruled to be one of a nondeductible partial interest, with the IRS observing that the result would have been the same had the donor retained any other substantial right in the patent, such as a gift whereby the patent (or license to use the patent) was contributed solely for use in a particular geographic area while the donor retained the right to use the patent (or license) in other geographic areas.[636]

If, as of the date of a gift, a transfer of property for charitable purposes may be defeated by the performance of some act or the happening of some event, a charitable deduction is not allowable unless the possibility that the act or event will occur is so remote as to be negligible.[637] In application of this rule, the IRS held that a deduction was not allowable for a contribution of a patent to a tax-exempt university on the condition that an individual, a faculty member of the institution and an expert in the technology covered by the patent, continue to be a member of the faculty of the university during the remaining life of the patent.[638] If the individual ceased to be a member of the university's faculty before the patent expired, the patent was to revert to the donor. The patent was to expire 15 years after the date of the contribution. On the date of the gift, the likelihood that the individual would cease to be a member of the faculty of the university before the patent expired was not so remote as to be negligible.

In one case, a gift was made of the long-term capital gains portions of commodities futures contracts to a charitable organization. The donors retained a right to the income from the contracts representing short-term capital gain.[639] The IRS asserted that this was a nondeductible gift of a partial interest. The court, however, did not view these portions of gains as substantial interests or rights owned by the donors[640] that could not be divided in donating a portion of a futures contract. The charitable deduction was allowed, inasmuch as the donors did not retain any interest in the portion of the futures contracts that they donated to the charitable organization. The contribution was held to be of an undivided

---

[634] Reg. § 1.170A-7(a)(1). See § 9.18.
[635] Reg. § 1.170A-7(b)(1)(i). See § 15.3.
[636] Rev. Rul. 2003-28, 2003-1 C.B. 594.
[637] Reg. § 1.170A-7(a)(3).
[638] Rev. Rul. 2003-28, 2003-1 C.B. 594.
[639] *Greene v. United States*, 79 F.3d 1348 (2d Cir. 1996). The facts of this case are detailed in § 4.8, text accompanied by notes 74–81.
[640] Reg. § 1.170A-7(b)(1)(i).

portion of the donors' entire interest in the futures contracts, namely, the segment of the contracts representing long-term capital gain.[641]

In one of the more unusual applications of the partial interests rules, the IRS pondered the tax consequences of conveyances by railroads to a charitable organization of their interests in certain railroad rights-of-way for interim trail use pursuant to the Rails to Trails Act. This law causes this use of these rights-of-way (easements) to not be treated as a permanent abandonment of the right-of-way for railroad purposes, thus preserving the railroad right-of-way in case of future need. The railroads were seeking charitable contribution deductions for these conveyances. The IRS's lawyers concluded that the railroads gave only a partial interest in the property, retaining the right to use the easement in the case of reactivation of rail service. An aspect of this matter was left open, however; this concerned whether the value of the retained interests was insubstantial, on the ground that the possibility of reverter is so remote as to be negligible.[642]

The IRS wrote that, in enacting this rule, Congress ''was concerned with situations in which taxpayers might obtain a double benefit by taking a deduction for the present value of a contributed interest while also excluding from income subsequent receipts from the donated interest.'' Also, the agency wrote that Congress ''was concerned with situations in which, because the charity does not obtain all or an undivided portion of significant rights in the property, the amount of a charitable contribution deduction might not correspond to the value of the benefit ultimately received by the charity.'' The legislative solution, said the IRS, ''was to guard against the possibility that such problems might arise by denying a deduction in situations involving partial interests, unless the contribution is cast in certain prescribed forms.'' The scope of this rule ''thus extends beyond situations in which there is actual or probable manipulation of the non-charitable interest to the detriment of the charitable interest, or situations in which the donor has merely assigned the right to future income.''[643]

§ 9.24 TAXIDERMY

In instances of contributions made after July 25, 2006, the amount allowed as a deduction for charitable contributions of taxidermy property that is contributed by the person who prepared, stuffed, or mounted the property (or by any person who paid or incurred the cost of such preparation, stuffing, or mounting) is the lesser of the person's basis in the property or the fair market value of the property. Specifically, a person who makes such a charitable contribution of taxidermy property for a use related to the donee's exempt purpose must, in determining the amount of the charitable deduction, reduce the fair market value of the property by the amount of gain that would have been long-term capital gain if the property contributed had been sold by the person at its fair market value (determined at the time of the contribution).[644] *Taxidermy property* is any work of art that is the reproduction or preservation of an animal, in whole or in

[641] See § 15.3.
[642] Tech. Adv. Mem. 200610017.
[643] Rev. Rul. 2003-28, 2003-1 C.B. 594; Rev. Rul. 88-37, 1988-1 C.B. 97.
[644] IRC § 170(e)(1)(B)(iv).

part; is prepared, stuffed, or mounted for purposes of re-creating one or more characteristics of such animal; and contains a part of the body of the dead animal.[645]

For purposes of determining a person's basis in taxidermy property that is contributed by the person who prepared, stuffed, or mounted the property (or by any person who paid or incurred the cost of such preparation, stuffing, or mounting), the basis amount may include only the cost of the preparing, stuffing, or mounting. Only the direct costs of the preparing, stuffing, or mounting may be included in this basis.[646] Indirect costs, and thus costs that may not be included in basis, include the costs of transportation relating to any aspect of the taxidermy or the hunting of the animal, and the direct or indirect costs relating to the hunting or killing of an animal (including the cost of equipment and the costs of preparing an animal carcass for taxidermy).[647]

§ 9.25 CLOTHING AND HOUSEHOLD ITEMS

As to contributions made after August 17, 2006, a federal income tax deduction is not allowed for a charitable contribution of clothing or a household item unless the clothing or household item is in good used condition or better.[648] The IRS is authorized to deny by regulation a deduction for any contribution of clothing or a household item that has minimal monetary value, such as used socks and used undergarments.[649] The term *household items* includes furniture, furnishings, electronics, appliances, and linens; the term does not embrace food, paintings, antiques, other objects of art, jewelry, gems, and collections.[650]

A deduction may be allowed for a charitable contribution of an item of clothing or a household item not in good used condition or better if the amount claimed for the item is more than $500 and the donor includes with the donor's return a qualified appraisal with respect to the property.[651]

§ 9.26 CHARITABLE FAMILY LIMITED PARTNERSHIPS

The IRS is concerned about the growing use of a charitable giving technique involving what is known as *charitable family limited partnerships*. The agency wrote that the charitable family limited partnership is a ''planned giving scheme'' that ''may be this year's [2000's] favorite charity scam, superseding the charitable split-dollar transaction.''[652]

With this approach, a donor having substantially appreciated assets, which often are not readily marketable (such as real estate or a proprietary interest in a closely held business), establishes a family limited partnership. The donor

---

645 IRC § 170(f)(15)(B).
646 IRC § 170(f)(15)(A).
647 Joint Committee on Taxation, *General Explanation of the Pension Act of 2006*, 297 (109th Cong., 2d Sess. 2006).
648 IRC § 170(f)(16)(A).
649 IRC § 170(f)(16)(B).
650 IRC § 170(f)(16)(D). Prop. Reg. § 1.170A-18(c).
651 IRC § 170(f)(16)(C).
652 *IRS Exempt Organizations Continuing Professional Education Program* textbook for fiscal year 2001, at 128. The charitable split-dollar insurance transaction is the subject of § 17.6.

transfers the appreciated assets to the partnership in exchange for a general and limited partnership interest. The general partnership interest constitutes 1 or 2 percent of the total partnership interests. The partnership agreement usually provides for a term of 40 to 50 years.

The donor contributes a large percentage (e.g., 95 to 98 percent) of the partnership interest to a charity, in the form of a limited partnership interest. The donor usually retains the general partnership interest. The donor may also retain a modest limited partnership interest or transfer such an interest to his or her children. An independent appraisal of the value of the partnership interests is done to establish fair market value for purposes of the income tax charitable contribution deduction. The charity receives whatever assets are held by the partnership at the end of the partnership term, assuming that the partnership interest is not sold prior to the expiration of the term.

The donor claims an income tax charitable deduction based on the value of the gift of the partnership interest to the charity. The value likely has been discounted to take into account: (1) the lack of the charity's control and management of partnership operations, and (2) lack of marketability of the limited partnership interest in the context of a closely held business.

The IRS wrote that the "key point is control."[653] Here, control remains with the donor as the general partner. The charity, a limited partner, lacks any voice in the day-to-day management or operations of the partnership. (This is ironic, by the way, in that, when public charities first began functioning as general partners in limited partnerships, the IRS tried to insist that the charities *not* have any day-to-day involvement in the operations of the partnerships.)

If the partnership sells the appreciated property it holds, most of the gain escapes taxation because of the charity's tax-exempt status. Only the modest limited or general partnership interests held by the donor and the donor's family are subject to capital gain taxation. The donor generally receives a management fee as compensation for operating and managing the partnership.

The charity holds an interest that may produce current income (although the IRS notes that many of these limited partnerships produce little or no income). The charity also holds an interest in an asset (hopefully an appreciating asset) that will be sold or exchanged no later than the expiration of the partnership term, usually 40 to 50 years.

Often the partnership agreement gives the partnership the right to sell the property to the donor or the donor's family at a price specified in the partnership agreement. The IRS observes that, while this type of an option "may serve to benefit" the charity, the "option is often viewed by critics of this technique as working more for the benefit of" the donor or the donor's family.[654]

This technique, the IRS notes in an understatement, "raises a number of tax issues." One is that the "operation of the partnership may cross over into the area of clear tax abuse."[655] Other problematic areas are the extent of the charitable deduction (if any), private inurement, private benefit, unrelated business income,

[653] *IRS Exempt Organizations Continuing Professional Education Program Text for Fiscal Year 2001*, at 129.
[654] *Id.*
[655] *Id.*

and intermediate sanctions. If the charity involved is a private foundation (a bad idea), there may be issues of self-dealing and excess business holdings.

In one instance, a court upheld the basic validity of this type of partnership, sustaining the claim for federal gift tax charitable contribution deductions (although not in the amounts sought by the donors).[656] The court concluded that all that had been assigned were the economic rights with respect to the partnership, and thus that the assignment did not cause the assignees to be admitted as substitute limited partners.[657] One of the dissenters in this case (indeed, the trial judge) faulted the majority's analysis of the transaction, writing (somewhat reflecting the IRS's view of these transactions) that, ''[u]ndaunted by the facts, well-established legal precedent, and [the agency's] failure to present sufficient evidence to establish [its] determinations, the majority allow their olfaction to displace sound legal reasoning and adherence to the rule of law.''[658] Another dissenter was of the view that the public policy doctrine, or step transaction doctrine, would preclude the gift tax charitable deduction.[659]

§ 9.27 MOTOR AND OTHER VEHICLES

Contributions of motor vehicles, boats, airplanes, and the like to charitable organizations have vexed Congress and the IRS for many years. Although the principal concern has been and continues to be the matter of valuation, this aspect of charitable giving also potentially involves issues pertaining to private inurement, private benefit, intermediate sanctions, and the unrelated business rules.

(a) Background

Although this subject considerably predates 2000, it is notable that in that year the IRS, analogizing to *A Tale of Two Cities* and the *Star Wars* epic, observed that ''there is a dark side in the Exempt Organization Universe.''[660] Indeed, the agency on that occasion reflected its view that it is under siege because of evildoing in the realm of charitable giving: The IRS ''in recent years has been confronted with a number of aggressive tax avoidance schemes.''[661] The schemes with which the IRS has had to cope in recent years include abuses of charitable remainder trusts,[662] abuses of charitable lead trusts,[663] the explosive use of donor-advised funds,[664] inappropriate uses of supporting organizations,[665] gifts of

---

[656] *McCord v. Commissioner*, 120 T.C. 358 (2003).

[657] This distinction led the judge in a concurring opinion to take the position that the charitable gift involved was a gift of a partial interest that was subject to the gift tax disallowance provision (IRC § 2522(c)(2)). See § 9.22. See *McCord* v. *Commissioner*, 120 T.C. 358 (2003).

[658] *McCord* v. *Commissioner*, 120 T.C. 358, 416 (2003). He concluded: ''We are not responsible for protecting the fisc. Rather, our role and duty are to interpret and adhere to the rule of law—even if uncomfortable with the result.'' *Id*. at 425.

[659] *Id*. at 425–430. See §§ 9.27 and 4.8, respectively.

[660] *IRS Exempt Organization Continuing Professional Education Text for Fiscal Year 2000*, Topic P.

[661] *Id*.

[662] See, e.g., § 12.5(e).

[663] See, e.g., § 16.8.

[664] See *Private Foundations*, ch. 16.

[665] *Id*. § 15.7.

interests in charitable family limited partnerships,[666] and questionable split-interest charitable insurance programs.[667] None of these sometimes abusive giving arrangements, however, has irked the IRS more than the matter of solicitation of contributions to charitable organizations of automobiles and other vehicles. This matter festered over the ensuing years, with Congress legislating on the subject in 2004.[668]

The IRS was of the view that vehicle donation programs constituted a "growing area of noncompliance."[669] The agency was not concerned with charities that occasionally receive vehicles by gift and sell them, use them in their programs, or refurbish them for the benefit of the needy. The IRS was principally troubled with the use of "third party entrepreneurs" who receive the vehicles directly, dispose of them (such as by auction or sale to scrap dealers), and pay the charity a flat fee or set percentage per vehicle. The latter arrangements were dubbed by the agency as "suspect vehicle donation plans or programs."[670] Policymakers also became concerned about overvaluations of vehicles for contribution deduction purposes.

Continuing abuses concerning contributions of vehicles to charity led to congressional inquiries and an investigation by the General Accounting Office. According to the GAO, in 2000, about 733,000 taxpayers reported charitable gifts of used vehicles totaling $2.5 billion in value and a tax savings of $654 million. Late in 2001, the IRS and the National Association of State Charity Officials issued an "alert" to prospective donors of used vehicles, summarizing the federal and state law involved.[671] Thereafter, in 2003, the IRS issued a news release urging prospective donors to inquire as to the amount of proceeds the charity would receive as a consequence of such a gift, and reminding donors of the valuation and recordkeeping requirements.[672] Congress, in 2004, enacted legislation concerning charitable contributions of vehicles.[673]

(b) Statutory Regime

The rules entail deductibility and substantiation requirements in connection with contributions to charity of motor vehicles, boats, and airplanes—collectively termed *qualified vehicles*.[674] These requirements supplant the general gift substantiation rules[675] where the claimed value of the gifted property contributed exceeds $500.[676]

---

[666] See § 9.24.
[667] See § 17.6.
[668] See § 9.25(b).
[669] *IRS Exempt Organization Continuing Professional Education Text for Fiscal Year 2000*, Topic T.
[670] *Id.*
[671] IR-2001-112.
[672] IR-2003-129. A "consumer alert" on this subject was issued in 2004 (IR-2004-142) and in 2005 (IR-2005-145).
[673] American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004) § 884.
[674] IRC § 170(f)(12)(E), which refers to motor vehicles "manufactured primarily for use on public streets, roads, and highways." This rule does not apply to contributions of property from the donor's inventory (as defined in IRC § 1221(a)(1)) (see § 9.3).
[675] See § 21.3(b).
[676] IRC § 170(f)(12)(A).

Pursuant to these rules, a federal income tax charitable contribution deduction is not allowed unless the donor substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization and includes the acknowledgment with the donor's income tax return reflecting the deduction.[677] This acknowledgment must contain the name and taxpayer identification number of the donor and the vehicle identification number or similar number.[678] If the gift is of a qualified vehicle that was sold by the donee charitable organization without any ''significant intervening use or material improvement,'' the acknowledgment must also contain a certification that the vehicle was sold in an arm's-length transaction between unrelated parties, a statement as to the gross proceeds derived from the sale, and a statement that the deductible amount may not exceed the amount of the gross proceeds.[679] If there is such use or improvement, the acknowledgment must include a certification as to the intended use or material improvement of the vehicle and the intended duration of the use and a certification that the vehicle will not be transferred in exchange for money, other property, or services before completion of the use or improvement.[680] An acknowledgment is *contemporaneous* if the donee organization provides it within 30 days of the sale of the qualified vehicle or, in an instance of an acknowledgment including the foregoing certifications, of the contribution of the vehicle.[681]

The amount of the charitable deduction for a gift of a qualified vehicle is dependent on the nature of the use of the vehicle by the donee organization. If the charitable organization sells the vehicle without any significant intervening use or material improvement of the vehicle by the organization, the amount of the charitable deduction may not exceed the gross proceeds received from the sale.[682] Where there is such a use or improvement, the charitable deduction is based on the fair market value of the vehicle.

The legislative history accompanying this law states that these two exceptions are to be strictly construed.[683] To meet this *significant use* test, the organization must actually use the vehicle to substantially further the organization's regularly conducted activities and the use must be significant. The test is not satisfied if the use is incidental or not intended at the time of the contribution. Whether a use is *significant* also depends on the frequency and duration of use.[684]

The legislative history of this legislation provided an example of a charitable organization that, as part of its regularly conducted activities, delivers meals to

---

[677] IRC § 170(f)(12)(A)(i).
[678] IRC § 170(f)(12)(B)(i), (ii).
[679] IRC § 170(f)(12)(B)(iii). Neither the statute nor its legislative history defines the terms *arm's-length* or *unrelated party*. In general, the term *arm's-length* means a distance between persons under circumstances where authentic bargaining can take place. Congress obviously wants the sale to occur under these circumstances so that the value of the vehicle can be objectively ascertained. An *unrelated party* essentially is a person who is not related to another person by reason of a family or business relationship. Another way to state this is that an *unrelated party* is a person who is not in a conflict-of-interest position with respect to the other person. The statute is somewhat redundant in using both terms, although it is theoretically possible to have an arm's-length transaction between related parties.
[680] IRC § 170(f)(12)(B)(iv).
[681] IRC § 170(f)(12)(C).
[682] IRC § 170(f)(12)(A)(ii).
[683] H. Rep. No. 108-755, 108th Cong., 2d Sess. 737 (2004).
[684] *Id*.

needy individuals. The use requirement would be satisfied if the organization used a donated vehicle to deliver food to the needy. Use of the vehicle to deliver meals substantially furthers a regularly conducted activity of the organization. The use also must be significant, which depends on the nature, extent, and frequency of the use. If the organization used the vehicle ''only once or a few times'' to deliver meals, the use would not be considered significant. If the organization used the vehicle to deliver meals every day for one year, the use would be considered significant. If the organization drove the vehicle 10,000 miles while delivering meals, such use likely would be considered significant. Use of a vehicle in such an activity for one week or for several hundreds of miles generally would not be considered a significant use.[685]

This legislative history provides a second example concerning use by a charitable organization of a donated vehicle to transport its volunteers. The use would not be significant merely because a volunteer used the vehicle over a ''brief period of time'' to drive to or from the organization's premises. Conversely, if at the time the organization accepts the contribution of a qualified vehicle, the organization intends to use the vehicle as a ''regular and ongoing'' means of transport for volunteers of the organization, and the vehicle is so used, the significant use test would be met.[686]

The legislative history provides a third example, concerning an individual who makes a charitable contribution of a used automobile in good running condition and that needs no immediate repairs to a charitable organization that operates an elder care facility. The organization provides the donor with a written acknowledgment that includes a certification that the donee intends to retain the vehicle for a year or longer to transport the facility's residents to community and social events and to deliver meals to the needy. A few days after receiving the vehicle, the donee organization commences to use the vehicle three times a week to transport some of its residents to various community events and twice a week to deliver food to needy individuals. The organization continues to regularly use the vehicle for these purposes for approximately one year and then sells the vehicle. The donee's use of this vehicle constitutes a significant intervening use prior to the sale by the organization.[687]

A *material improvement* includes major repairs to a vehicle or other improvements to the vehicle that improve its condition in a manner that significantly increases the vehicle's value. Cleaning the vehicle, minor repairs, and routine maintenance do not constitute a material improvement.[688] This legislative history does not provide any examples pertaining to this exception. Presumably this exception is available only when the donee charitable organization expresses its intent at the outset (at least in part by means of the certification) that the donee plans to materially improve the vehicle.

A donee organization that is required to provide an acknowledgment under these rules must also provide that information to the IRS.[689] A penalty is imposed

---

[685] *Id*.
[686] *Id*.
[687] *Id*. at 737–738.
[688] *Id*. at 737.
[689] IRC § 170(f)(12)(D).

for the furnishing of a false or fraudulent acknowledgment, or an untimely or incomplete acknowledgment, by a charitable organization to a donor of a qualified vehicle.[690]

(c) Regulatory Gloss

The IRS issued interim guidance concerning these rules for deductible charitable contributions of qualified vehicles.[691] This guidance added a third exception to these rules, which is for circumstances where the charity gives or sells the vehicle at a significantly below-market price to a needy individual, as long as the transfer furthers the charitable purpose of helping a poor or distressed individual who is in need of a means of transportation.[692] The guidance also explains how the fair market value of a vehicle is determined.[693]

The IRS issued a form (Form 1098-C) to be used by donee charitable organizations to report to the IRS contributions of qualified vehicles and to provide the donor with a contemporaneous written acknowledgment of the contribution.[694]

The items on this form include:

- *Box 4a.* This is checked by the charitable donee to certify that the donated vehicle was sold to an unrelated party in an arm's-length transaction.
- *Box 4c.* Here the charity enters the gross proceeds it received from the sale of the donated vehicle. If box 4a is checked, the donor generally may take a deduction in an amount equal to the lesser of the amount in box 4c or the vehicle's fair market value on the date of the contribution.
- *Box 5a.* This is checked by the charity to certify that the donated vehicle will not be sold before completion of a significant intervening use or material improvement by the charity. If this box is checked, the donor generally may take a deduction equal to the vehicle's fair market value.
- *Box 5b.* This box is checked by the charity to certify that the donated vehicle is to be transferred to a needy individual in direct furtherance of the donee's charitable purpose of relieving the poor or distressed or underprivileged who are in need of a means of transportation. If this box is checked, the donor generally may take a deduction equal to the vehicle's fair market value.

A donor of a qualified vehicle must attach Copy B of this form to the donor's income tax return in order to take a deduction for the contribution of the vehicle where the claimed value is in excess of $500. Generally, the donee must furnish Copies B and C of the form to the donor no later than 30 days after the date of sale if box 4a is checked or 30 days after the date of the contribution if box 5a or 5b is checked.

---

[690] See § 10.14, text accompanied by notes 275 and 276.
[691] Notice 2005-44, 2005-1 C.B. 1287.
[692] This example is based on language in the legislative history. H. Rep. No. 108-755, 108th Cong., 2d Sess. 750 (2004).
[693] See § 10.1(c).
[694] Ann. 2005-66, 2005-39 I.R.B. 613. This form, which is reproduced in Appendix I-1, filed after December 31, 2007, must be filed with the Internal Revenue Service Center in Kansas City, MO, or Austin, TX; returns filed before that date should have been filed with the Internal Revenue Service Center in Ogden, UT (Notice 2007-70, 2007-2 C.B. 735).

Copy A of this form is to be filed with the IRS, Copy C is for the donor's records, and Copy D is retained by the charitable donee.

(d) Other Issues

Appraisal. If the value of the contributed vehicle is in excess of $5,000, the donor is obligated to obtain an independent appraisal of the value of the vehicle.[695]

Penalties. Both parties are potentially liable for penalties for aiding and abetting understatements of tax liability, for preparation of false tax returns, and for promoting abusive tax shelters.[696] Indeed, the IRS imposed these penalties in the context of a charitable organization's used vehicle contribution program when the organization had a practice of providing donors with documentation supporting the full fair market value of contributed vehicles in each instance, even when some of the vehicles were in poor condition and could only be sold for salvage or scrap.[697]

Unrelated business considerations. When vehicles are contributed to a charitable organization and the organization disposes of them, the charity may be perceived as being in the business of acquiring and selling the vehicles. Nonetheless, this activity is not considered an unrelated business, because of the *donated goods exception*.[698] The IRS has ruled on this point.[699] In some instances, payments to a charitable organization in the context of these programs may be characterized as tax-excludable royalties.[700]

Contributions ''to'' charity. To be deductible, a contribution must be to (or for the use of) a qualified charitable organization.[701] To be *to* a charity, the gift must be made under circumstances where the donee has full control of the donated money or other property and full discretion as to its use. When a charitable organization utilizes the services of a for-profit company to receive and process donated vehicles, the gift may be deemed to be to the company, rather than the charity, in which case there is no charitable contribution deduction. This situation can be resolved, however, by denominating the company as the agent of the charity for this purpose. The IRS has approved this approach.[702]

Private benefit doctrine. The IRS raised the issue of applicability of the private benefit doctrine.[703] The agency posits situations in which an automobile dealer or some other third party is the true beneficiary of a transaction. If the private benefit is more than insubstantial, the charitable organization's tax-exempt status could be jeopardized.

---

[695] See § 21.5.
[696] See § 10.10.
[697] Tech. Adv. Mem. 200243057.
[698] See § 3.5(f), text accompanied by note 503.
[699] E.g., Priv. Ltr. Rul. 200230005.
[700] See § 3.5(g).
[701] See § 3.1(a).
[702] Rev. Rul. 2002-67, 2002-1 C.B. 873; Priv. Ltr. Rul. 200230005.
[703] See § 3.3(b).

Private inurement doctrine. The IRS has also raised the possibility of application, in this setting, of the private inurement doctrine.[704] When such a third party is an insider with respect to the charitable organization, that doctrine could be implicated, thereby endangering the organization's exempt status.

Intermediate sanctions. The intermediate sanctions rules[705] are applicable when a transaction constitutes an *excess benefit transaction* and the charitable organization's dealings are with a *disqualified person* with respect to it. The IRS has applied the intermediate sanctions rules in connection with used vehicle donation programs.[706] The IRS may also assess a penalty for willful and flagrant violation of these standards.[707]

§ 9.28 INTELLECTUAL PROPERTY

(a) Background

A person may contribute intellectual property, by means of transfer of a patent, a license to use a patent, or otherwise, to a charitable organization. The tax consequences of such a contribution are numerous.

A contribution to a charitable organization of a patent can result in a charitable deduction. The same is true as to a contribution to a charitable organization of a license to use a patent. When, however, a person contributes to a charity a license to use a patent but retains a substantial right in the patent (such as the right to license the patent to others or the right to use the patent or license in certain geographical areas), the transaction constitutes a nondeductible transfer of a partial interest.[708]

A person may transfer to a charitable organization a patent subject to a conditional reversion. If, on the date of the contribution, the transfer may be defeated by the performance of an act or the happening of an event, a charitable contribution deduction is not allowed, unless the possibility that the act or event will occur is so remote as to be negligible. This rule applies in the context of transfers of patents.[709]

A person may transfer to a charitable organization a patent subject to a license or transfer restriction. Such a restriction reduces what would otherwise be the fair market value of the patent at the time of the contribution and therefore reduces the amount of the charitable contribution deduction.[710]

The IRS has become aware that some taxpayers have transferred or are transferring patents or other intellectual property to charitable organizations and are or will be claiming charitable contribution deductions in excess of the amounts to which they are entitled. The agency identified purported charitable contributions of intellectual property in which one or more of the following issues were

---

[704] *Id.*
[705] See Hopkins, *The Law of Intermediate Sanctions: A Guide for Nonprofits* (Hoboken, NJ: John Wiley & Sons, Inc., 2003).
[706] Tech. Adv. Mem. 200243057.
[707] IRC § 6684.
[708] See § 9.23, text accompanied by *supra* note 634; § 15.3, text accompanied by note 55.
[709] See § 10.4(a), text accompanied by note 156.
[710] See § 10.1(a), text accompanied by note 115.

present: there was a transfer of a nondeductible partial interest in the property, the person transferring the property expected or received a benefit in exchange for the transfer,[711] there was inadequate substantiation of the contribution,[712] and/or there was overvaluation of the intellectual property transferred.[713]

As to the second of these elements, the IRS stated that, as an example, if a donation agreement provides that the donee assumes the transferor's liability for a lease of a research facility, this assumption of liability is consideration provided by the donee. Likewise, a donee's promise to make available to the transferor the results of the donee's research, such as laboratory notebooks, data, and research files, is consideration from the donee. Similarly, a charitable organization's promise to hold a patent and maintain it for a period of time is consideration to the transferor if the transferor is benefited because others are prevented from purchasing or licensing the patent. The amount of the charitable contribution deduction is the amount of the fair market value of the property reduced by the consideration provided by the donee.[714]

The IRS announced that it intends to disallow charitable deductions based on transfers of intellectual property when the deduction is "improper."[715] The agency also announced that it may impose penalties on those claiming these inappropriate charitable deductions.[716] It further announced that the agency is reviewing promotions of transactions involving these improper deductions, and that the promoters and appraisers of the intellectual property may also be subject to penalties.[717]

The value of certain intellectual property contributed to charity can be speculative. An item of contributed intellectual property may prove to be worthless or the initial promise of worth may be diminished by subsequent inventions, marketplace competition, or other factors. Even if intellectual property has the potential for significant monetary benefit, this will not be the outcome if the charitable donee does not make the appropriate investment, have the necessary personnel and equipment, and/or have sufficient sustained interest to exploit the intellectual property. Valuation is made yet more difficult in the charitable contribution context because the transferee does not provide full, if any, consideration in exchange for the transferred property pursuant to arm's-length negotiations and there may not be a comparable sales market for the property to use as a benchmark for valuations.

Policymakers have been concerned that persons with intellectual property are taking advantage of the inherent difficulties in valuing the property and are preparing or obtaining inflated valuations. In some instances, a charity receives property of questionable value, while the donor receives a significant tax benefit. Nonetheless, there is recognition that some contributions of intellectual property may prove to be of economic benefit to the charitable donee and that donors may need an economic incentive to make this type of charitable contribution.

---

[711] See § 3.1(b).
[712] See § 21.3.
[713] Notice 2004-7, 2004-1 C.B. 310.
[714] E.g., Rev. Rul. 2003-28, 2001-1 C.B. 594.
[715] Notice 2004-7, 2004-1 C.B. 310.
[716] See § 10.14, text accompanied by notes 239–265.
[717] *Id.*, text accompanied by notes 276–288.

Congress, in 2004, enacted legislation concerning charitable contributions of intellectual property.[718] This legislation is predicated on the view that excessive charitable contribution deductions enabled by inflated valuations in this context are best addressed by confining the amount of the deduction for gifts of intellectual property to the donor's basis in the property, while allowing for additional charitable contribution deductions thereafter if the contributed property generates income for the charitable organization.[719]

(b) Statutory Regime

Contributions of certain types of intellectual property have been added to the list of gifts that give rise to a charitable contribution deduction that is confined to the donor's basis in the property,[720] although, as discussed later, in instances of gifts of intellectual property, there may be one or more subsequent charitable deductions. This property consists of patents, copyrights (with exceptions[721]), trademarks, trade names, trade secrets, know-how, software (with exceptions[722]), or similar property, or applications or registrations of such property. Collectively, these properties are termed *qualified intellectual property* (except in instances when contributed to standard private foundations[723]).[724]

A person who makes this type of gift, denominated a *qualified intellectual property contribution*,[725] is provided a charitable contribution deduction (subject to the annual percentage limitations[726]) equal to the donor's basis in the property in the year of the gift and, in that year and/or subsequent years, a charitable deduction equal to a percentage of net income that flows to the charitable donee as the consequence of the gift of the property.[727] For a contribution to be a qualified intellectual property contribution, the donor must notify the donee at the time of the contribution that the donor intends to treat the contribution as a qualified intellectual property contribution for deduction and reporting purposes.[728] The net income involved is termed *qualified donee income*.[729]

Thus, a portion of qualified donee income is allocated to a tax year of the donor,[730] although this income allocation process is inapplicable to income received by or accrued to the donee after 10 years from the date of the gift;[731] the process is also inapplicable to donee income received by or accrued to the donee after the expiration of the legal life of the property.[732]

The amount of qualified donee income that materializes into a charitable deduction, for one or more years, is ascertained by the *applicable percentage*, which is

---

[718] American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004) § 882.
[719] H. Rep. No. 108–755, 108th Cong., 2d Sess. 730 (2004).
[720] IRC § 170(e)(1)(B)(iii). The other contributions on this list are those described in §§ 4.5(a) and 4.6(a).
[721] This definition does not encompass a copyright described in IRC § 1221(a)(3) or 1231(b)(1)(C).
[722] This definition does not encompass software described in IRC § 197(e)(3)(A)(i).
[723] That is, a transaction referred to in IRC § 170(e)(1)(B)(ii) (see § 4.5(a)).
[724] IRC § 170(m)(9).
[725] IRC § 170(m)(8).
[726] See ch. 7.
[727] IRC § 170(m)(1).
[728] IRC § 170(m)(8)(B).
[729] IRC § 170(m)(3).
[730] IRC § 170(m)(4).
[731] IRC § 170(m)(5).
[732] IRC § 170(m)(6).

a sliding-scale percentage determined by this table, which appears in the Internal Revenue Code:[733]

Donor's Tax Year	Applicable Percentage
1st	100
2nd	100
3rd	90
4th	80
5th	70
6th	60
7th	50
8th	40
9th	30
10th	20
11th	10
12th	10

Thus, if, following a qualified intellectual property contribution, the charitable donee receives qualified donee income in the year of the gift, and/or in the subsequent tax year of the donor, that amount becomes, in full, a charitable contribution deduction for the donor (subject to the general limitations). If such income is received by the charitable donee eight years after the gift, for example, the donor receives a charitable deduction equal to 40 percent of the qualified donee income. As this table indicates, the opportunity for a qualified intellectual property deduction arising out of a qualified intellectual property contribution terminates after the 12th year of the donor ending after the date of the gift.[734]

The reporting requirements rules, concerning certain dispositions of contributed property, were amended in 2004 to encompass qualified intellectual property contributions.[735]

(c) Notification Requirement

A donor satisfies the notification requirement[736] if the donor delivers or mails to the donee, at the time of the contribution, a statement containing:

- The donor's name, address, and taxpayer identification number
- A description of the intellectual property in sufficient detail to identify it
- The date of the contribution
- A statement that the donor intends to treat the contribution as a qualified intellectual property contribution[737]

---

[733] IRC § 170(m)(7).
[734] IRC § 170(m)(10)(C).
[735] See § 24.9. In general, Shortill, "New Rules for Charities Receiving Certain Contributions of Intellectual Property," 49 *Exempt Org. Tax Rev.* (no. 1) 89 (July 2005).
[736] See text accompanied by *supra* note 728.
[737] IRC § 6050L(b). A copy of this return must be timely furnished to the donor (IRC § 6050L(c)). The IRS, on April 4, 2008, issued final regulations (Reg § 1.6050L-2) providing guidance for filing information returns (Form 8899) by donees relating to qualified intellectual property contributions (T.D. 9392); these regulations affect donees receiving net income from such contributed property in the case of contributions made after June 3, 2004.

§ 9.29 FOREIGN TAX CREDIT

The IRS, in 2005, issued final regulations[738] that permit U.S. donors to allocate and apportion all of their deductible charitable contributions to U.S.-source income for purposes of calculating the foreign tax credit.[739] These regulations[740] change the method of allocating and apportioning these deductions from ratable apportionment on the basis of gross income to apportionment on the basis of income from sources within the United States.

These regulations provide that the deduction for charitable contributions is definitely related and allocable to all of the donor's gross income and is apportioned between the statutory grouping (or among the statutory groupings) of gross income and residual grouping on the basis of the relative amounts of gross income from sources in the United States in each grouping. For example, where a deduction for charitable contributions is allocated and apportioned for purposes of the foreign tax credit limitation, the charitable deducation is allocated to all of the donor's gross income and apportioned solely to the residual grouping consisting of U.S.−source gross income.

This revision of the regulations is intended to ensure that multinational corporations are not discouraged from making charitable contributions, which are deductible for federal income tax purposes, simply because the allocation and apportionment rules would reduce the donor's foreign source income and, as a result, the donor's foreign tax credit limitation.

The regulations also provide that, where a charitable contribution is made by a member of an affiliated group, the deduction for the charitable contribution is related to and allocated to the income of all of the members of the afficliated group and not to any subset of the group.

The regulations, which are effective for charitable contributions made on or after July 28, 2004, replace controversial rules proposed in 1991 that would requried allocation based on where the contribution would be used, so that some of the expenses would be allocated to foreign income and, thus, not be deductible.

§ 9.30 SUBSISTENCE WHALING EXPENSES

An individual recognized by the Alaska Eskimo Whaling Commission (AEWC) as a whaling captain, who is responsible for maintaining and carrying out sanctioned whaling activities and engages in these activities during a tax year, may claim a charitable contribution deduction not to exceed $10,000 per year for the reasonable and necessary whaling expenses paid in carrying out these whaling activities.[741]

The AEWC represents the Alaskan whaling communities in efforts to preserve the Eskimo subsistence hunting of bowhead whales. Its purpose is to protect the bowhead whale and its habitat; preserve Eskimo subsistence bowhead whaling and associated Eskimo culture, traditions, and activities; and conduct

[738] T.D. 9211.

[739] The foreign tax credit rules are the subject of § 2.21.

[740] Reg § 1. 861-8(e)(12).

[741] IRC § 170(n). This body of law was introduced by the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004) § 335.

research and educational activities related to these whales. The AEWC recognizes certain individuals as whaling captains and provides rules for the conduct of sanctioned whaling activities. It requires these captains to file reports detailing their whaling activities.

The term *whaling expenses* includes amounts paid for the acquisition and maintenance of whaling boats, weapons, and gear used in sanctioned whaling activities; and the storage and distribution of the catch from the activities.[742] The phrase *sanctioned whaling activities* means subsistence bowhead whale hunting activities conducted pursuant to the management plan of the AEWC.[743]

Congress directed the IRS to issue guidance requiring taxpayers claiming this charitable deduction to substantiate their whaling expenses by maintaining appropriate written records of the time, place, date, amount, and nature of the expenses and of the taxpayer's eligibility for the deduction.[744] The IRS responded to this directive by promulgating procedures pursuant to which the whaling expenses of a recognized whaling captain are substantiated for these federal tax purposes.[745]

§ 9.31 PUBLIC POLICY CONSIDERATIONS

There is a doctrine in the law of tax-exempt organizations that states that a nonprofit organization cannot be tax-exempt as a charitable entity[746] if it engages in one or more activities that are contrary to public policy.[747] This rule is infrequently applied in the charitable giving setting.

In one case, however, an individual contributed certain Native American artifacts to a museum; a portion of the collection consisted of elements protected by the Eagle Protection Act and the Migratory Bird Treaty Act. The IRS contended that there should not be any charitable deduction for this portion of the gift, on the ground that acquisition of them was contrary to public policy. Nonetheless, a court held that the donors had a sufficient ownership interest in these elements to contribute them to the museum, even though the donors may have violated federal law when they purchased the items.[748]

There are other aspects of the public policy doctrine; one concerns the efficacy of the imposition of certain conditions subsequent on the terms and conditions of a gift. In the principal case, an individual transferred certain property interests to a trust benefiting his children. The instrument making the gift provided that, should there be a final determination that any part of the transfer was subject to gift tax, all the parties agreed that the excess property decreed to be subject to the tax would automatically be deemed not included in the conveyance and be the sole property of the individual, free of trust.

---

[742] IRC § 170(n)(2)(B).
[743] RC § 170(n)(3).
[744] IRC § 170(n)(4).
[745] Rev. Proc. 2006-50, 2006-2 C.B. 944.
[746] That is, an organization that is tax-exempt under IRC § 501(a) as an entity described in IRC § 501(c)(3).
[747] See *Tax-Exempt Organizations* § 6.2.
[748] *Sammons v. Commissioner*, 51 T.C. 1968 (1986).

The court held that this provision was a condition subsequent that was void because it was contrary to public policy.[749] It wrote that ''[w]e do not think that the gift tax can be avoided by any such device as this.''[750]

A contrary holding, wrote the court, would mean that, ''upon a decision that the gift was subject to tax, the court making such decision must hold it not a gift and therefore not subject to tax.''[751] This holding would be made in the context of litigation to which the donees of the property were not parties, so the decision would not be binding on them and they would be able to enforce the gift notwithstanding the court's decision. Wrote the court: ''It is manifest that a condition which involves this sort of trifling with the judicial process cannot be sustained.''[752]

This condition subsequently was found to be contrary to public policy for three reasons. First, ''it has a tendency to discourage the collection of the [gift] tax by the public officials charged with its collection, since the only effect of an attempt to enforce the tax would be to defeat the gift.''[753]

Second, the ''effect of the condition would be to obstruct the administration of justice by requiring the courts to pass upon a moot case.''[754] That is, if the condition ''were valid and the gift were held subject to tax, the only effect of the holding would be to defeat the gift so that it would not be subject to tax.''[755] The consequence is that ''[t]he donor would thus secure the opinion of the court as to the taxability of the gift, when there would be before the court no controversy whatever with the taxing authorities which the court could decide, the only possible controversy being as to the validity of the gift and being between the donor and persons not before the court.''[756]

Third, the condition ''is to the effect that the final judgment of a court is to be held for naught because of the provision of an indenture necessarily before the court when the judgment is rendered.''[757] The court noted that gift tax liability cannot be the subject of a federal court declaratory judgment. The condition thus ''could not be given the effect of invalidating a judgment which had been rendered when the instrument containing the condition was before the court, since all matters are merged in the judgment.''[758] The court rephrased its distress with the voided condition: The condition ''is not to become operative until there has been a judgment; but after the judgment has been rendered it cannot become operative because the matter involved is concluded by the judgment.''[759]

In a similar case, a husband and wife transferred shares of stock to their three children. At the time of the gifts, these individuals executed a gift adjustment agreement that was intended to ensure that the parents' gift tax liability for the stock transfers would not exceed the unified credit against tax to which they

---

[749] *Commissioner v. Proctor*, 142 F.2d 824 (4th Cir. 1944), *cert. den*., 323 U.S. 756 (1944).
[750] *Id*., 142 F.2d at 827.
[751] *Id*.
[752] *Id*.
[753] *Id*.
[754] *Id*.
[755] *Id*.
[756] *Id*.
[757] *Id*
[758] *Id*. at 828.
[759] *Id*.

were entitled at the time. This agreement stated that, if it should be finally determined for federal gift tax purposes that the fair market value of the transferred stock either was less than or greater than $2,000 per share, an adjustment would be made to the number of shares conveyed, so that each donor would have transferred $50,000 worth of stock to each donee.

The court in this case declined to give effect to the gift adjustment agreement, inasmuch as honoring the agreement would run counter to public policy concerns.[760] It wrote that a ''condition that causes a part of a gift to lapse if it is determined for Federal gift tax purposes that the value of the gift exceeds a given amount, so as to avoid a gift tax deficiency,'' involves a ''trifling with the judicial process.''[761] If valid, this type of condition would ''compel'' the court to ''issue, in effect, a declaratory judgment as to the stock's value, while rendering the case moot as a consequence.''[762] Yet there was ''no assurance that the [parents] will actually reclaim a portion of the stock previously conveyed to their sons, and our decision on the question of valuation in a gift tax suit is not binding upon the sons, who are not parties to this action.''[763] The sons, the court added, ''may yet enforce the gifts.''[764]

There is another line of law, captured by this quotation: ''The purpose of Congress in providing deductions for charitable gifts was to encourage gifts for charitable purposes; and in order to make such purposes effective, there must be a reasonable probability that the charity actually will receive the use and benefit of the gift, for which the deduction is claimed.''[765] A dissenting opinion in a Tax Court case stitched these aspects of the case law together in an attempt to defeat charitable contributions that the dissenter viewed as caused by an increase in value of property facilitated by the court majority. The dissent concluded that the ''possibility of an increased charitable deduction serves to discourage [the IRS] from collecting tax on the transaction because any attempt to enforce the tax due on the transaction is of no advantage to the fisc.''[766] It argued that the charity involved would never be able to benefit from the gifts, and characterized the charitable deductions as ''against public policy'' and ''plainly wrong.''[767]

---

[760] *Ward v. Commissioner*, 87 T.C. 78 (1986).
[761] *Id*. at 114, quoting from *Commissioner v. Proctor*, 142 F.2d 824, 827 (4th Cir. 1944).
[762] *Ward v. Commissioner*, 87 T.C. 78, 114 (1986).
[763] *Id*.
[764] *Id*.
[765] *Hamm v. Commissioner*, 20 T.C.M. (CCH) 1814, 1838 (1961), *aff'd*, 325 F.2d 934 (8th Cir. 1963). Years later, the court wrote: ''Public policy encourages gifts to charity, and Congress allows charitable deductions to encourage charitable giving'' (*Estate of Christiansen v. Commissioner*, 130 T.C. No. 1 (2008)).
[766] *McCord v. Commissioner*, 120 T.C. 358, 429 (2003).
[767] *Id*. at 427.

CHAPTER TEN

Other Aspects of Deductible Giving

§ 10.1 Valuation of Property **383**
- (a) General Principles 384
- (b) Valuation of Works of Art 393
- (c) Valuation of Other Property 396

§ 10.2 Contributions by Means of an Agent **402**

§ 10.3 Gifts for the *Use* of Charity **403**

§ 10.4 Conditional Gifts **405**
- (a) Material Conditions—Nondeductibility 405
- (b) Negligible Conditions 407
- (c) Material Conditions—Deductibility 408

§ 10.5 Earmarking of Gifts for Individuals **408**

§ 10.6 Alternative Minimum Tax Considerations **411**

§ 10.7 Interrelationship with Business Expense Deduction **412**

§ 10.8 Denial of Deduction for Lobbying Activities **412**

§ 10.9 Deductible Gifts to Noncharitable Organizations **413**

§ 10.10 Reallocation of Deductions **416**

§ 10.11 Charitable Giving and Funding of Terrorism **416**

§ 10.12 Statute of Limitations **417**

§ 10.13 Concept of Trust Income **417**
- (a) Basic Principles 417
- (b) Definition of *Income* 419
- (c) Capital Gains and Losses 420

§ 10.14 Penalties **420**

§ 10.15 Transactions of Interest **427**
- (a) Successor Member Interests 427
- (b) Asset Dispositions 430

The complexities of the law of charitable giving are manifold. They are limited only by the intricacies of the federal tax law and the imaginations of gift planners, regulators, and litigants. These other aspects of deductible charitable giving are treated in this chapter.

§ 10.1 VALUATION OF PROPERTY

Charitable gifts are frequently made of property. A gift to charity may be an outright contribution of property or of a partial interest in an item of property. The

gift may entail a reduction of the otherwise deductible amount[1] or may implicate one or more of the percentage limitations.[2] The income tax rules and/or the gift and estate tax rules[3] may be involved. The property may be personal property or real property, tangible property or intangible property.

Whatever the circumstances, the determination of a federal income tax charitable contribution deduction for a gift of property to charity is likely to require valuation of the property. Appraisal requirements apply in connection with larger charitable contributions;[4] the value of gift property is an integral part of the substantiation requirements,[5] the *quid pro quo* contribution rules,[6] other disclosure rules,[7] and the reporting rules.[8]

(a) General Principles

Frequently, the valuation of property is not confine to good faith estimates by charitable organizations or the work of appraisers. Controversy in this area can arise between contributors and the IRS, with the matter forced into court for resolution. This is because "[v]aluation is not a precise science."[9]

In litigation, the court may be called on to decide the value of an item of gift property. This issue is one of fact, not law.[10] In this type of litigation, it is common for one or both sides to use one or more expert witnesses in an attempt to convince the court of the merits of a particular value. The court may rely on the expertise of one or more of these witnesses or may disregard all of them and set a value on the basis of its own belief as to value.[11] As with any witness, the credibility of the expert witness (and of the donor) in the eyes of a court is critical in formulating the outcome.[12] Where experts offer competing estimates of fair market value, the court decides how to weigh those estimates by examining the factors they considered in reaching their conclusions.[13] A finding by a trial court of a value for an item of property will be set aside on appeal only if the finding of the value is clearly erroneous.[14]

---

[1] See ch. 4.
[2] See ch. 7.
[3] See ch. 8.
[4] See § 21.5.
[5] See § 21.3.
[6] See § 22.2.
[7] See ch. 22.
[8] See ch. 24.
[9] *Kiva Dunes Conservation, LLC v. Commissioner*, 97 T.C.M. (CCH) 1818, 1821 (2009).
[10] E.g., *Goldstein v. Commissioner*, 89 T.C. 535 (1987); *Skripak v. Commissioner*, 84 T.C. 285 (1985); *Zmuda v. Commissioner*, 79 T.C. 714 (1982), *aff'd*, 731 F.2d 1417 (9th Cir. 1984); *Kaplan v. Commissioner*, 43 T.C. 663 (1965); *Arbini v. Commissioner*, 81 T.C.M. (CCH) 1753 (2001).
[11] E.g., *Helvering v. National Grocery Co.*, 304 U.S. 282 (1938); *Silverman v. Commissioner*, 538 F.2d 927 (2nd Cir. 1976); *Estate of Newhouse v. Commissioner*, 94 T.C. 193 (1990); *Parker v. Commissioner*, 86 T.C. 547 (1986); *Johnson v. Commissioner*, 85 T.C. 469 (1985); *Buffalo Tool & Die Mfg. Co. v. Commissioner*, 74 T.C. 441 (1980).
[12] In one case, the court ruled that the donors of mining claims were not entitled to any charitable deduction because the claims lacked any value. In rejecting the testimony of the donors' expert witness, the court noted that his values were "financial fantasies." *Snyder v. Commissioner*, 86 T.C. 567, 585 (1986).
[13] E.g., *Casey v. Commissioner*, 38 T.C. 357 (1962).
[14] *Anselmo v. Commissioner*, 757 F.2d 1208 (11th Cir. 1985).

The pertinent value in this context is the fair market value of the property at the time it contribute.[15] As a general rule, the *fair market value* of an item of property 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.[16] The valuation standard for charitable contribution deduction purposes generally is the same as that used for estate and gift tax purposes.[17]

The IRS amplified this rule, holding that the ''most probative evidence of fair market [value] is the prices at which similar quantities of . . . [the property] are sold in arms'-length transactions.''[18] In a ruling concerning the deductibility of bibles initially purchased at a ''discount,'' the IRS also stated that the fair market value of gift property is determined by reference to the ''most active and comparable market place at the time of the donor's contribution.''[19]

In deciding the fair market value of property, a court must take into account not only the current use of the property but also its highest and best use.[20] A property's highest and best use is the highest and most profitable use for which it is adaptable and needed or likely to be needed in the reasonably near future.[21] The highest and best use can be any realistic, objective potential use of the property.[22]

The fair market value of an item of property is to be determined in the market in which the item is ''most commonly sold to the public.''[23] Normally, a sale ''to the public'' refers to a sale to the ''retail customer who is the ultimate consumer of the property.''[24] The ''ultimate consumer'' is deemed to be a customer who does not hold the item for subsequent resale.[25] In this context, the word *retail* does not mean that the most expensive source is the only source for determining fair market value.[26] The determination of the appropriate market for valuation purposes is a question of fact.[27] In one instance, a court, in valuing a contributed newspaper collection, concluded that the wholesale market, not the retail market, was the appropriate market to use, because the ultimate consumers are newspaper collectors, newspaper dealers, and others interested in obtaining a newspaper

[15] Reg. § 1.170A-1(a), (c)(1).

[16] Reg. § 1.170A-1(c)(2).

[17] E.g., *United States v. Parker*, 376 F.2d 402 (5th Cir. 1967); *Lio v. Commissioner*, 85 T.C. 56 (1985), *aff'd sub nom. Orth v. Commissioner*, 813 F.2d 837 (7th Cir. 1987); *Anselmo v. Commissioner*, 757 F.2d 1208 (11th Cir. 1985).

[18] Rev. Rul. 80-69, 1980-1 C.B. 55.

[19] Rev. Rul. 80-233, 1980-2 C.B. 69. The fair market value of a publicly traded security is not necessarily equal to its market quotation, its average trading price, or its face value. Reg. § 1.170A-13(c)(7)(xi)(D). A court wrote that, "[n]evertheless, we assume that Congress believed that the existence of readily available market quotations would substantially assist in, if not determine, fair market valuation (and discourage overvaluation)." *Todd v. Commissioner*, 118 T.C. 334, 345 (2002). This court then rejected valuation of stock on the basis of a price suggested by a brokerage firm on the basis of the net asset value of the underlying enterprise, inasmuch as the share price did not necessarily reflect a price that any willing buyer or seller had accepted or would accept.

[20] Reg. § 1.170A-14(h)(3)(i), (ii); *Stanley Works & Subsidiaries v. Commissioner*, 87 T.C. 389 (1986).

[21] E.g., *Olson v. United States*, 292 U.S. 246 (1934).

[22] E.g., *Symington v. Commissioner*, 87 T.C. 892 (1986).

[23] Reg. §§ 20.2031-1(b), 25.2512-1.

[24] *Anselmo v. Commissioner*, 80 T.C. 872, 882 (1983), *aff'd*, 757 F.2d 1208 (11th Cir. 1985).

[25] E.g., *Goldman v. Commissioner*, 388 F.2d 476 (6th Cir. 1967), *aff'g* 46 T.C. 136 (1966).

[26] *Lio v. Commissioner*, 85 T.C. 56, 70 (1985).

[27] E.g., *Chou v. Commissioner*, 58 T.C.M. (CCH) 1497 (1990).

collection, rather than individual purchasers (members of the general public).[28] Once the appropriate market is identified, the fair market value of the property involved is determined by the amount that consumers would pay, in that market, for the property on the date of its contribution.[29]

In recent years, the courts have had to decide a substantial number of charitable gift ''tax shelter'' cases, in which property was sold to putative donors with the expectation that the donors would hold the property long enough for it to become long-term capital gain property and then donate the property to charity, at a time when the value of the property had appreciated in relation to the original purchase price. These tax shelter cases frequently involve gifts of gems[30] or works of art.[31] The courts have not looked favorably on these transactions.[32]

Some examples of court opinions that have addressed the question of the valuation of property follow.

- A case concerned contribution of a partial interest in property for conservation purposes.[33]
- A case concerned the valuation of land and improvements contributed to a college.[34]
- A case concerned the valuation of a mineral interest contributed to a governmental agency.[35]
- Two donors contributed wastewater treatment equipment to a university. The donors claimed a deduction of $201,000. The IRS asserted that the value of the property was $20,500. The court that heard the case settled, without explanation, on a deduction value of $75,000. On appeal, this decision was reversed and remanded. The appellate court wrote:

> Unlike the original judgment of Solomon, the true rationale of which has been readily apparent to generations of disinterested observers . . . the judgment appealed from here has no discernable logic. We are not prepared to permit the . . . [court below], whenever it disagrees with the valuations offered by both sides, simply to shut its eyes and pick at random any number that happens to lie somewhere between the Commissioner's valuation and the taxpayer's. Only by happenstance will such a blind choice avoid a valuation that is either unacceptably low or unacceptably high. The random walk approach, which leaves no trail for the appellate court to follow, may be a sensible way to pick stocks, but it is not an appropriate way to determine the value of a charitable donation.[36]

- A donor contributed 30 gravesites to a church. The donor claimed a deduction of $15,000. The IRS contested that valuation. The court concluded that the sites had a value of $4,000.[37]

---

[28] *Arbini v. Commissioner*, 81 T.C.M. (CCH) 1753 (2001).
[29] E.g., *Goldstein v. Commissioner*, 89 T.C. 535, 544 (1987).
[30] See § 9.2.
[31] See § 9.1.
[32] See, e.g., *Anselmo v. Commissioner*, 757 F.2d 1208 (11th Cir. 1985).
[33] *Hilborn v. Commissioner*, 85 T.C. 677 (1985).
[34] *Palmer Estate v. Commissioner*, 86 T.C. 66 (1985), *rev'd & remanded*, 839 F.2d 420 (8th Cir. 1988).
[35] *Stark v. Commissioner*, 86 T.C. 243 (1985).
[36] *Stark v. Commissioner*, 1986 T.C.M. (P-H) ¶ 61,000 (5th Cir. 1986).
[37] *Sandler v. Commissioner*, 52 T.C.M. (CCH) 563 (1986).

- A court determined the fair market value of a donated scenic easement by using the basis of the property as a single parcel, rather than on the basis of its potential for subdivision into 24 lots.[38] The court wrote that, in ascer taining the value of land, the ''appropriate question is what a hypothetical Malcolm Forbes would have paid for it as one tract, rather than what two dozen hypothetical yuppies would have paid for it'' as 24 lots.[39]
- Two donors contributed gravesites to charitable organizations. They claimed a charitable deduction of $300 per site. The IRS contested that valuation. The court found the value to be $60 per site.[40]
- A charitable deduction was allowed for the installation and transfer of drainage facilities and easements to a city. The IRS denied the deduction. The court found the value to be about twice that asserted by the IRS.[41]
- A court held that there was no deduction for a contribution, by the spouse of a deceased psychoanalyst, of the decedent's correspondence and manuscripts because the material lacked any value.[42]
- A donor contributed bandages to an international relief organization. The donor claimed a value of $45,600. The IRS contested the valuation. The court found the property to have a value of $4,211.[43]
- A number of individuals contributed an easement to a natural wildlife habitat. The value of the easement was litigated. The IRS asserted a pregift value of $475,000 and a postgift value of $47,500. The court found that the property was valued at $1,165,000 prior to contribution of the easement and $100,000 after the contribution.[44]
- A donor contributed a conservation easement to a historic preservation organization. The donor claimed a value of $350,000. The IRS asserted that the value was $70,000. The court found the value to be $130,000.[45]
- A donor contributed a ''façade servitude'' to a charitable organization. The donor claimed a value of $350,000. The IRS contended that the value was $86,000. The court found the value to be $168,700.[46]
- A donor contributed interests in a collection of antique stereoscopic negative glass plates and related items to a university. The donor claimed a deduction for the gift of $1,427,253. The IRS originally asserted that the property did not have any value; during the court proceedings, it tried to compromise at $450,000. The court allowed a deduction of $1,250,000.[47]

---

[38] *Akers v. Commissioner*, 799 F.2d 243 (6th Cir. 1986), *aff'g* 48 T.C.M. (CCH) 1113 (1984).

[39] *Id.*, 799 F.2d at 245. The appellate court termed the difference between the two valuations as being ''rather like the difference between the worth of a gravid or potentially gravid sow and the postpartum worth of sow-cum-shoats.'' *Id.*

[40] *Broad v. Commissioner*, 52 T.C.M. (CCH) 12 (1986).

[41] *Osborne v. Commissioner*, 87 T.C. 575 (1986).

[42] *Strasser v. Commissioner*, 52 T.C.M. (CCH) 1130 (1986).

[43] *Tallal v. Commissioner*, 52 T.C.M. (CCH) 1017 (1986).

[44] *Stotler v. Commissioner*, 53 T.C.M. (CCH) 973 (1987).

[45] *Losch v. Commissioner*, 55 T.C.M. (CCH) 909 (1988).

[46] *Nicoladis v. Commissioner*, 55 T.C.M. (CCH) 624 (1988).

[47] *Mast v. Commissioner*, 56 T.C.M. (CCH) 1522 (1989).

- Two donors contributed certain equipment and spare parts to a university, claiming the value of these items to be $201,000. The court found the value to be $157,500.[48] This finding came after the court had previously found the value to be $75,000[49] but was directed by an appellate court to revalue the property.[50]
- A business corporation contributed a news film library to a university. The donor claimed a tax deduction of $62 million; the IRS asserted a value of $1.84 million. At trial, the corporation that asserted the value of the library was $35 million (or, alternately, $22.9 million) and the IRS contended that the value was $1.35 million (and later $2.02 million). The court upheld the deduction at $1.84 million.[51] The court nicely summarized the valuation process:

> Charitable contribution tax cases characteristically present a battle of experts on the issue of the fair market value of the donated property. As is typical in litigation that involves battles by experts in analysis of complex matters, the information provided by the valuation witnesses of both parties was skewed to advance the objectives of their respective clients. Plaintiff's expert witnesses resolved valuation issues so as to maximize the dollar value of the contribution: defendant's witnesses, on the other hand, attempted to satisfy IRS and Department of Justice interests to minimize the allowable deduction. These recognized but seldom articulated characteristics are manifest in the record of this case.[52]

- Participants in a gravesite exchange and contribution program contributed 450 gravesites to a church. The court found the value of the property given to be no more than the donor's costs in acquiring the gravesites.[53]
- Other participants in a gravesite exchange and contribution program had their charitable contribution deduction confined to basis as well.[54]
- Two donors engaged in a bargain sale transaction[55] involving a boat with a charitable organization. They claimed a value of $169,000; the court, from the bench, ruled that the value was $160,000.[56]
- A donor contributed several wild game trophy mounts and rugs to a museum, claiming a value of $126,500. The IRS contended that the items lacked any value whatsoever; the court placed a value of $75,000 on them.[57]
- In a case involving charitable gifts of interests in oil and gas leases, the donors claimed charitable contribution deductions totalling $667,420; the IRS asserted a value of $138,000; the court found the value (and thus the deduction) to be $534,144.[58]

---

[48] *Akers v. Commissioner*, 64 T.C.M. (CCH) 546 (1992).
[49] *Akers v. Commissioner*, 47 T.C.M. (CCH) 1621 (1984).
[50] *Akers v. Commissioner*, 798 F.2d 894 (6th Cir. 1986).
[51] *Hearst Corp. v. United States*, 93-1 U.S.T.C. ¶ 50,303 (Fed. Cl. 1993).
[52] *Id.* at 88,187.
[53] *Weiss v. Commissioner*, 65 T.C.M. (CCH) 2768 (1993).
[54] *Klavan v. Commissioner*, 66 T.C.M. (CCH) 68 (1993).
[55] See § 9.19.
[56] *Fair v. Commissioner*, 66 T.C.M. (CCH) 460 (1993). Subsequently, the donors attempted to obtain an award of litigation costs (under IRC § 7430) but failed, on the ground that the IRS's position was not unreasonable because it was based on the testimony of an expert. *Fair v. Commissioner*, 68 T.C.M. (CCH) 1371 (1994).
[57] *Engel v. Commissioner*, 66 T.C.M. (CCH) 378 (1993).
[58] *Haught v. Commissioner*, 65 T.C.M. (CCH) 1921 (1993).

- The fair market value of an open-space easement, contributed to a charitable organization, was calculated using the difference in value of the property before and after the easement was granted.[59]
- The fair market value of a water tower donated to a city was determined.[60]
- The fair market value of a minority interest in common stock of a closely held corporation was determined, with an appellate court holding that the lower court relied on the wrong postgift transaction in valuing the stock.[61]
- The fair market value of shares of closely held stock, contributed by means of remainder interests in trust, was determined.[62]
- The fair market value of a yacht hull contributed to a charitable organization was determined; the claimed deduction was $145,000, whereas the allowed deduction was $45,000.[63]
- The fair market value of a painting donated to a museum was determined.[64]
- The fair market value of a sailboat donated to a charitable organization was determined.[65]
- The fair market value of 180,000 Christmas cards with gold medallions donated to a religious organization was ascertained; the donors used the fair market value of $1.89 million (based on value selected by the U.S. Customs Service for import duty purposes), whereas the court held that the fair market value was $67,500.[66]
- In the absence of evidence presented by the donors as to the value of conference materials they donated to a charitable organization, the charitable contribution deduction was determined to be $10,000, rather than the claimed $39,130.[67]
- An open-space conservation easement was valued on the basis of its most profitable use (a duck hunting club), using the ''before and after'' method.[68]
- The fair market value of silver coins, a silver bar, and a copper ingot contributed to a museum was determined.[69]
- The fair market value of a collection of sheet music, contributed to a charitable organization over a three-year period, was determined not to be in excess of the amount represented by the donor's claimed deductions for those years ($96,616); thus, the claimed charitable deductions (total of

---

[59] *Dennis v. United States*, 92-2 U.S.T.C. ¶ 50,498 (E.D. Va. 1992).
[60] *Brigham v. Commissioner*, 64 T.C.M. (CCH) 244 (1992).
[61] *Krapf v. United States*, 977 F.2d 1454 (Fed. Cir. 1992).
[62] *O'Reilly v. Commissioner*, 95 T.C. 646 (1990), *rev'd & remanded*, 973 F.2d 1403 (8th Cir. 1992), on remand, 67 T.C.M. (CCH) 2176 (1994).
[63] *Bragg v. Commissioner*, 66 T.C.M. (CCH) 1047 (1993).
[64] *Doherty v. Commissioner*, 63 T.C.M. (CCH) 2112 (1992), *aff'd*, 16 F.3d 338 (9th Cir. 1994).
[65] *Parks v. Commissioner*, 67 T.C.M. (CCH) 1911 (1994).
[66] *Pasqualini v. Commissioner*, 103 T.C. 1 (1994).
[67] *Osborne v. Commissioner*, 68 T.C.M. (CCH) 273 (1994).
[68] *Schwab v. Commissioner*, 67 T.C.M. (CCH) 3004 (1994).
[69] *Ferman v. Commissioner*, 68 T.C.M. (CCH) 1063 (1994).

$340,000) for amounts carried forward into the three subsequent years were disallowed.[70]

- The fair market value of an interest in an oil and gas partnership (a burned-out tax shelter) was held not to be in excess of the amount represented by the donors' claimed deductions for a period of years ($61,955), so carryover deductions were disallowed (total claimed deduction was $108,000). The donors were faulted for not offering any comparative or actual selling prices for the partnership interests; the court wrote that it was unwilling to rely on a ''purely theoretical'' estimate of value.[71]
- A court refused to allow valuation of charitable gift property beyond that claimed over four years; hence, carryover deductions were disallowed.[72]
- A court concluded that an individual was entitled to a charitable contribution deduction of $500 for a gift of a flight helmet to a museum.[73]
- In a case involving valuation of stock in a closely held corporation donated to a university, a court applied the adjusted net worth method. The claimed deduction was $260,000; the fair market value of the property found by the court was $63,885.[74]
- An owner donated unproductive mining property to the federal government and claimed a charitable contribution deduction in the amount of $2.75 million; a court concluded that the actual value was $38,000. The donor was an expert with respect to the property; the court was of the view that he ''had to have known that . . . [his appraiser's] estimate was hooey, the sort of number ginned up to put one over on the revenooers.''[75]
- A payment made in settlement of a claim for tortious interference with an inheritance was held not to qualify as a charitable contribution because no value was added for the benefit of the charity; that is, the charity would have had to pay the amount in settlement over to noncharitable beneficiaries.[76]
- A court determined the value of wild game animal trophy mounts contributed to various charitable organizations.[77]
- An individual donated a boat to a charitable organization, claiming a charitable deduction based on a fair market value of $75,100; a court upheld the IRS's determination that the value of the boat was $22,125.[78]

[70] *Rimmer v. Commissioner*, 69 T.C.M. (CCH) 2620 (1995).
[71] *Harding v. Commissioner*, 69 T.C.M. (CCH) 2625, 2629 (1995).
[72] *Manning v. Commissioner*, 70 T.C.M. (CCH) 490 (1995).
[73] *Droz v. Commissioner*, 71 T.C.M. (CCH) 2204 (1996).
[74] *Krapf, Jr. v. United States*, 96-1 U.S.T.C. ¶ 50,249 (Fed. Cl. 1996). In an earlier opinion, the court placed the value at $112,840. *Krapf, Jr. v. United States*, 89-2 U.S.T.C. ¶ 9448 (1989), *rev'd & remanded*, 977 F.2d 1454 (Fed. Cir. 1992).
[75] *Van Zelst v. Commissioner*, 100 F.3d 1259 (7th Cir. 1996), *aff'g* 70 T.C.M. (CCH) 435 (1995), *cert. den.*, 522 U.S. 807 (1997).
[76] *Lindberg v. United States*, 927 F. Supp. 1401 (D. Colo. 1996), *aff'd*, 99-1 U.S.T.C. ¶ 60,334 (10th Cir. 1999).
[77] *Robson v. Commissioner*, 73 T.C.M. (CCH) 2574 (1997).
[78] *Sergeant v. Commissioner*, 76 T.C.M. (CCH) 133 (1998).

- A court upheld the disallowance of a $1.6 million charitable deduction claimed by a partnership that sold its interest in real property to a university. The purchase price was $9 million; the deduction, however, was based on a $12.2 million value, determined using the value-in-use method, which the court rejected because it did not reflect the property's fair market value.[79]
- An individual contributed stamp collectibles and religious articles to a charity, claiming a fair market value for this property of $949,030; a court sustained the IRS's conclusion that the property's value was $12,973. The donor's testimony as to value was rejected in part because he treated the property as though it had little value, storing it in a warehouse that "had a rodent problem and was very hot during the summer."[80]
- A court concluded that the fair market value of a conservation easement granted by an individual in 1993 to a charitable organization was $800,000 and that the value of an amendment to the easement granted to the charity in 1994 was $290,000.[81]
- A court, for federal gift tax purposes, valued interests in a limited partnership that were assigned as gifts to individuals and to charitable organizations. The court found them to be merely economic rights with respect to the partnership, rather than conferring partner status on the assignees; the court applied discounts for lack of control and lack of marketability of the interests.[82]
- A court was called on to decide the fair market value of land, improved with a chapel, monastery, and dormitory, to be a retreat center, for purposes of a charitable contribution deduction. The claimed deduction was $475,000; the IRS asserted that the value was $76,000. The court relied on the value of the donor's purchase of the property 17 months before the gift. The expert witness for the IRS set the value of this property at $90,000; the donor's expert's valuation was found to be "problematic," with the court "troubled" by his "methodology and omissions."[83]
- A court considered the fair market value of a parcel of mining real estate for purposes of calculating a charitable contribution deduction. The donor asserted that the value of this property on the date of gift was $1.8 million; the IRS was of the view that the value was $301,000. The court, in finding the property's value to be $1.3 million, wrote that the "answer we reach (as to valuation), not surprising in a valuation case, is somewhere between what both of them [the parties' experts] proposed."[84]
- The IRS initially decided that the value of stock contributed to a charity was zero. Then, on the basis of its expert's analysis, it agreed that each share of stock had a value of about $37/share. The donors claimed the

[79] *Arbor Towers Assocs. v. Commissioner*, 77 T.C.M. (CCH) 2348 (1999).
[80] *Jacobson v. Commissioner*, 78 T.C.M. (CCH) 930, 931 (1999).
[81] *Strasburg v. Commissioner*, 79 T.C.M. (CCH) 1697 (2000).
[82] *McCord v. Commissioner*, 120 T.C. 358 (2003).
[83] *Wortmann v. Commissioner*, 90 T.C.M. (CCH) 336, 342 (2005).
[84] *Terrene Investments, Ltd., Deerbrook Construction, Inc. v. Commissioner*, 94 T.C.M. (CCH) 136 (2007).

stock had a value of approximately $402/share. A court agreed with the $37/share value, rejecting application of the income and market approach to valuation (because the underlying company was not a going concern) and applying the asset-based approach to valuation.[85]

- A donor placed a perpetual conservation easement on a golf course and contributed it to a qualified public charity. The donor claimed a charitable deduction in the amount of $30,588,235 for this gift. The IRS initially took the position that no charitable deduction was available (a position it changed following trial). A court concluded that the fair market value of this easement was $28,656,004.[86]

An issue that can arise is the value of property purchased out of the estate of a bankrupt person and subsequently contributed to a charitable organization. An individual, for example, may purchase property from a bankruptcy court and then donate the property to charity. The bankruptcy sale price may be the amount appropriately used to establish the property value. This happened, as an illustration, when the donee, a hospital, frequently purchased equipment at bankruptcy sales.[87] That outcome can also occur when the donor is a participant in a tax shelter scheme.

The bankruptcy sale price, however, may not be the equivalent of the property's fair market value. This aspect of the matter is grounded on the basic definition of the term *fair market value*, which is the hypothetical sales price that would be negotiated between a knowledgeable and willing buyer and a knowledgeable and willing seller, neither of whom are compelled to buy or sell.[88]

In one instance, a court expressed disagreement with the proposition that a bankruptcy court "was a willing seller not compelled to sell."[89] In that case, concerning a subsequent contribution of hospital equipment, the court wrote that the "sale of equipment was made in haste, without objection from the creditors, and . . . there was no hearing on valuation."[90] As part of a plan to establish a hospital in a community, the donors and others purchased the equipment from a bankruptcy court that was presiding over the liquidation of the assets of a bankrupt hospital. The donors purchased the property for $40,000, then donated it for the new hospital; on the basis of an appraisal, they claimed charitable contribution deductions totaling $1,002,380. The court rejected the IRS's attempt to confine the charitable deductions to $40,000 and allowed the full claimed deductions, writing: "While it is true that these apparently altruistic efforts resulted in an income tax windfall for the . . . [donors], this does not mean that they acted with an intent to defraud or that they are not entitled to the benefit of this windfall."[91]

If the value of an item of property is determined by a trial court and the case is appealed, the appellate court will likely expect some explanation from the

---

[85] *Bergquist v. Commissioner*, 131 T.C. 8 (2008).
[86] *Kiva Dunes Conservation, LLC v. Commissioner*, 97 T.C.M. (CCH) 1818 (2009).
[87] *Weitz v. Commissioner*, 56 T.C.M. (CCH) 1422 (1989).
[88] See text accompanying *supra* note 16.
[89] *Herman v. United States*, 99-2 U.S.T.C. ¶ 50,899, at 89,984 (E.D. Tenn. 2000).
[90] *Id*. at 89,984.
[91] *Id*. at 89,985. Indeed, the court added that the "facts of this case suggest that the debtor-hospital's Trustee grossly undervalued the equipment in question to the detriment of the hospital's creditors." *Id*.

lower court as to the basis for its conclusions. The court of appeals will not want to have to speculate as to how the lower court arrived at its view of the value. Certainly, finding a valuation figure that has as its only virtue the fact that it is within the ranges suggested by the litigants' expert witnesses will not suffice. As one appellate court stated, it is not sufficient for the lower court to provide the ''pieces of the puzzle''; the court of appeals undoubtedly will want the lower court to divulge ''how it put them together.''[92]

The foregoing rules apply to outright gifts of property. Other rules apply in the case of a charitable contribution of a partial interest in property.[93] The general rule in this context is that the amount of the deduction for the gift of a partial interest is the fair market value of the interest at the time of the gift.[94] Other rules apply with respect to contributions of qualified conservation easements,[95] charitable contributions of a remainder interest in real property not transferred in trust,[96] charitable contributions of remainder interests in pooled income funds,[97] and charitable contributions of remainder interests in charitable remainder trusts.[98]

(b) Valuation of Works of Art

In an effort to reduce litigation in this area, Congress in 1993 directed the Department of the Treasury to report on the development of a procedure under which prospective donors could elect to seek an advance valuation of tangible personal property from the IRS before making a charitable contribution of it. This directive was contained in the conference report accompanying the Omnibus Budget Reconciliation Act of that year. The conferees included this statement in the conference report:

> The report should address the advisability of establishing threshold amounts for claimed value and imposing user fees as prerequisites for seeking an agreement under the procedure, possible limitations on applying the procedure only to items with significant artistic or cultural value, and recommendations for legislative action needed to implement the procedure.[99]

---

[92] *Estate of Magnin v. Commissioner*, 184 F.3d 1074, 1081 (9th Cir. 1999). This court of appeals stated its standard of review in this regard in *Leonard Pipeline Contractors v. Commissioner*, 142 F.3d 1133 (9th Cir. 1998). See also *Estate of Trompeter v. Commissioner*, 279 F.3d 767 (9th Cir. 2002), *vacating & remanding* 75 T.C.M. (CCH) 1653 (1998); *Estate of Mitchell v. Commissioner*, 250 F.3d 696 (9th Cir. 2001), *aff'g in part & rev'g in part* 74 T.C.M. (CCH) 872 (1997). A court, in a case involving the valuation of contributed real estate, ''found credible the testimony of both [of the litigants'] experts'' and therefore concluded that the ''value of the donated parcel at the time of its conveyance is most accurately reflected by a figure between those advocated by plaintiff and the government'' (*Frazee v. United States*, 2004-1 U.S.T.C. ¶ 50,253 (D. Md. 2004)). Observing that the property appraisal process is ''more an art than a science,'' the court wrote that it is ''thus compelled to apply its own artistic brush to establish a reasonable value for the land that accurately reflects all of the evidence presented in this proceeding.''

[93] See § 9.23.

[94] Reg. § 1.170A-7(c). The fair market value of such a partial interest must be determined in accordance with Reg. § 20.2031-7. See, e.g., Priv. Ltr. Rul. 200205008.

[95] Reg. § 1.170A-14. See §§ 9.7, 10.1(c).

[96] IRC § 170(f)(4); Reg. § 1.170A-12.

[97] Reg. § 1.170A-6(b)(2). See § 13.11.

[98] Reg. § 1.170A-6(b)(2). See § 12.10.

[99] H. Rep. No. 213, 103d Cong., 1st Sess. 561 (1993).

The final response to this directive came late in 1995, when the IRS issued procedures by which individual and corporate donors and other transferors can obtain from the IRS a statement of value to be used to substantiate the fair market value of art for income, estate, or gift tax purposes, including charitable giving.[100]

These procedures generally apply to an item of art that has been appraised at $50,000 or more and has been transferred as a charitable contribution for income tax purposes, by reason of a decedent's death, or by *inter vivos* (lifetime) gift. The IRS may, however, issue a statement of value for items appraised at less than $50,000 if (1) the request for the statement includes a request for appraisal review for at least one item appraised at $50,000 or more, and (2) the IRS determines that issuance of this type of statement would be in the best interest of efficient tax administration.

For this purpose, *art* includes paintings, sculpture, watercolors, prints, drawings, ceramics, antique furniture, decorative arts, textiles, carpets, silver, rare manuscripts, and historical memorabilia.

A request for such a statement of value, for income tax purposes, must be made prior to filing of the income tax return that first reports the charitable contribution. This request must include a copy of the appraisal of the item of art; a check or money order payable to the IRS in the amount of $2,500, as a user fee for a request for a statement of value for up to three items of art, plus $250 for each additional item of art; a completed appraisal summary;[101] and the location of the IRS district office that has or will have examination jurisdiction over the tax return.

A request for a statement of value may be withdrawn at any time prior to its issuance. When this happens, however, the IRS will retain the user fee and notify the appropriate IRS district director.

The appraisal must meet the requirements for a qualified appraisal[102] and also include (1) a complete description of the item of art, including the name of the artist or culture, the title or subject matter, the medium (such as oil on canvas), the date created, the size, any signatures or labels (or marks) on the item of art (or on its back or frame), the history of the item (including any proof of authenticity), a record of any exhibitions at which the item was displayed, any reference source citing the item, and the physical condition of the item; (2) a professional-quality photograph of a size and quality fully showing the item, preferably an 8 × 10-inch color photograph or a color transparency not smaller than 4 × 5 inches; and (3) the specific basis for the valuation.

The appraisal must be made no earlier than 60 days prior to the date of the contribution of the item of art. Contributors and their representatives are encouraged to include in the request any additional information that may affect the determination of the fair market value of the art.

Similar requirements apply when a person is seeking a statement of value from the IRS for an item of art transferred as part of an estate or as an *inter vivos* noncharitable gift. In this context, the procedures also state criteria for the

[100] Rev. Proc. 96-15, 1996-1 C.B. 185.
[101] See § 21.5.
[102] See § 21.5(a).

appraisal and the appraiser. This is not done in the setting of charitable gifts for income tax purposes because the criteria are already in the tax regulations.

For a completed request for a statement of value received by the IRS after July 15, but on or before January 15, the IRS will ordinarily issue the statement by the following June 30. As to a completed request for the statement received after January 15, but on or before July 15, the IRS will ordinarily issue the statement by the following December 31. It is the responsibility of the persons involved to obtain any necessary extensions of time to file tax returns.

If the IRS agrees with the value reported on an appraisal, it will issue a statement of value approving it. If the IRS disagrees, it will issue a statement of value with its determination of the value, as well as the basis for its disagreement with the appraisal.

Regardless of whether the person involved agrees with it, a copy of the statement of value must be attached to and filed with the appropriate income, estate, or gift tax return. If a person files a tax return reporting the transfer of an art item for which a statement of value was requested before the statement is received, the person must indicate on the return that a statement has been requested and attach a copy of the request. Upon receipt of the statement, an amended or supplemental return must be filed with the statement of value attached. If a person disagrees with a statement of value issued by the IRS, the person may submit with the tax return additional information in support of a different value.

A person may rely on a statement of value received from the IRS for an item of art. A person may not, however, rely on a statement of value issued to another person. Further, a person may not rely on a statement of value if the representations on which it was based are not accurate statements of the material facts.

In general, a work of art may be valued using the cost or selling price of the donated property, sale of comparable properties, replacement cost, or the opinion of an expert. A charitable deduction for a contribution of a work of art must, unless the deduction is not in excess of $5,000, be supported by a written appraisal prepared by a qualified appraiser.[103] Important elements in the valuation of art, including antiques, are the property's physical condition and extent of restoration.

More weight is usually accorded an appraisal prepared by an individual specializing in the type and price range of the art being appraised. Certain art dealers or appraisers specialize, for example, in old masters, modern art, or bronze sculpture. Their opinions as to the authenticity and desirability of art are usually given more credence than opinions of more generalized art dealers or appraisers.

If a charitable deduction for a gift of art is claimed, where the deduction is $20,000 or more, the donor must attach a complete copy of the signed appraisal to the donor's tax return reflecting the deduction.[104] For individual objects with that claimed value, a photograph of a size and quality fully showing the object, preferably an 8- × -10-inch color photograph or a color transparency no smaller than 4 × 5 inches, must be provided to the IRS on request.

[103] See § 21.5.
[104] *Id.*

(c) Valuation of Other Property

The increased emphasis on detailed reporting of noncash contributions[105] has brought renewed attention to rules for valuation of these properties for charitable deduction purposes. Formal and informal rules exist for valuation of eight types of properties in the charitable deduction context.

1. Publications. Review of comparable sales and adjustment of the prices according to the differences between these sales and the item being evaluated is the usual way to determine the value of books. This undertaking is frequently the task of a specialized appraiser, such as a dealer who concentrates on certain areas (Americana, foreign imports, scientific books, and the like).

Some book collections may be of modest value (that is, not requiring a written appraisal). In determining fair market value for this type of collection, it is necessary to remember that a book (or books) that is very old or very rare is not necessarily valuable. The condition of a book may have great influence as to its value; collectors are interested in items that are in fine, or at least good, condition (that is, not torn, stained, or missing pages). Other factors affecting the value of a book are the type of its binding (leather, cloth, paper), page edges, and illustrations (drawings and photographs). Although collectors generally want first editions of books, other editions—because of changes or additions—may be worth as much as, or more than, the first edition.

As to manuscripts, autographs, diaries, and similar items, because they are (or can be) handwritten, or at least signed by famous individuals, they are often in demand and are valuable. The writings of unknown individuals also may be of value if they are of unusual historical or literary importance. Determining the value of this type of material is difficult. The appraiser determines a value in these cases by applying knowledge and judgment to factors such as comparable sales and conditions.

2. Clothing and Household Goods. The fair market value of used clothing and household goods is usually much lower than the price paid for the goods when they were new. This type of property may have little or no market value because of its worn condition. Also, property of this nature may be out of style or no longer useful. The price that buyers of used items actually pay in consignment stores or thrift shops is a good indication of their value.

3. Vehicles. Various commercial firms and trade organizations publish monthly or seasonal guides as to vehicles for different regions of the nation, containing complete dealer sale prices or dealer average prices for recent model years. Prices are reported for each make, model, and year. These guides also provide estimates for adjusting for unusual equipment, unusual mileage, and physical condition. Although these prices are not "official" and these publications do not rise to the level of an appraisal of any specific property, they provide clues for making an appraisal and suggest relative prices for comparison with current sales and offerings in particular geographical areas.

---

[105] See § 24.7.

An acceptable measure of the fair market value of an automobile, boat, or airplane is an amount not in excess of the price listed in a used-vehicle pricing guide for a private-party sale, rather than the dealer retail value, of a similar vehicle. The fair market value may be less than that amount, however, if the vehicle has engine trouble, body damage, high mileage, or excessive wear. The fair market value of a vehicle is the same as the price listed in a used-vehicle pricing guide for a private-party sale only if the guide lists a sales price for a vehicle that is the same make, model, and year, sold in the same geographic area, in the same condition, with the same or similar options or accessories, and with the same or similar warranties.

Except for inexpensive boats, the valuation of these vehicles should be based on an appraisal by a marine surveyor because the physical condition of the boat is critical in ascertaining its value.

The IRS published guidance as to valuation of used vehicles contributed to charitable organizations, for purposes of determining the charitable deduction, including when it is permissible to rely on a pricing guide.[106] The agency, following a recitation of the general rules,[107] stated that there ''is no single correct way to determine the fair market value of a car [or other vehicle]; any reasonable method may be used.''

One method of determining the fair market value of a donated car or other vehicle, said the IRS, is by reference to an established used-car or other vehicle pricing guide. This guide, however, ''establishes fair market value only if the guide lists the sales price for a car that is the same make, model, and year, sold in the same area, and in the same condition, as the donated car.''

In this guidance, the IRS hypothesized two individuals, each of whom contributed a used car to a charitable organization. Donor A consulted an established used-car pricing guide, which listed $4,500 as the current sales price for a car of the same make, model, and year as A's car and sold in A's area, if the car is in excellent condition. The guide listed $3,000 as the current sales price for such a car if it is in average condition. The guide was silent as to the sales price for a car that is in poor condition.

This guide states that a car is in *excellent condition* if it has no defects. A vehicle is in *average condition* if it has some defects, yet remains safe to drive. A vehicle is in *poor condition* if it requires substantial mechanical or body repairs or is unsafe to drive.

Donor A's car was in average condition. The car of another donor, Donor B, was in poor condition. Thus, the fair market value of A's car, and the amount of the charitable contribution deduction (assuming that A itemized deductions), was $3,000. The IRS observed that Donor A also could have determined the value of the car by any other reasonable method. Because the guide did not provide a value for a car in poor condition, Donor B had to establish the fair market value of that car using some other method that was reasonable under the circumstances.

This is not only a matter for donors; it can be important to donee charitable organizations if they participate in the valuation process. In one situation, a representative of a charitable organization, who administrated a program involving

[106] Rev. Rul. 2002-67, 2002-1 C.B. 873.
[107] See § 10.1(a).

contributions of used vehicles for the organization, overvalued gift property by providing donors with a pricing-guide value for vehicles in excellent condition, even though ''some of the vehicles were not able to be driven and were sold for scrap.''[108] This individual was subjected to the penalties for aiding and abetting understatements of tax liabilities.[109] The IRS observed that this individual ''made no attempt to provide donors with the more relevant, and much lower[,] . . . wholesale or salvage value of the donated automobile[s].''

The IRS subsequently stated that it intends to issue regulations clarifying that, for charitable deduction purposes, the dealer retail value listed in a used-vehicle pricing guide is not an acceptable measure of fair market value of a similar vehicle.[110] These regulations will make it clear that the fair market value of a vehicle is an amount not in excess of the price listed in a used-vehicle pricing guide for a private-party sale of a similar vehicle. The IRS will consider whether other values, such as the dealer trade-in value, are appropriate measures of the fair market value of a vehicle for these purposes.[111]

4. Intellectual Property. The value of certain intellectual property contributed to charity can be speculative. An item of contributed intellectual property may prove to be worthless or the initial promise of worth may be diminished by subsequent inventions, marketplace competition, or other factors. Even if intellectual property has the potential for significant monetary benefit, this will not be the outcome if the charitable donee does not make the appropriate investment, have the necessary personnel and equipment, and/or have sufficient sustained interest to exploit the intellectual property. Valuation is made yet more difficult in the charitable contribution context because the transferee does not provide full, if any, consideration in exchange for the transferred property pursuant to arm's-length negotiations and there may not be a comparable sales market for the property to use as a benchmark for valuations.

The fair market value of a patent is determined by taking into account factors such as whether the patented technology has been made obsolete by other technology; any restrictions on the holders' use of, or ability to transfer, the patented technology; and the length of time remaining before the patent expires.

5. Securities. The value of a stock or a bond is the fair market value of the security on the valuation date. If there is an active market for the stocks or bonds, such as on a stock exchange or in an over-the-counter market, the fair market value of each share or bond is the average price between the highest and lowest quoted selling prices on the valuation date.

If there were no sales of the security on the valuation date, but sales occurred within a reasonable period before and after the valuation date, the fair market value of a security is determined by taking the average price between the highest and lowest sales prices on the nearest date before and on the nearest date after the

[108] Tech. Adv. Mem. 200243057.
[109] See § 10.14, text accompanied by *infra* note 243.
[110] Notice 2005-44, 2005-1 C.B. 1287. See § 9.25.
[111] The IRS stated that any regulations limiting the fair market value of a vehicle to an amount less than the private-party sale will not apply to contributions made prior to the date that the regulations become effective.

valuation date. Then the averages are weighted in inverse order by the respective number of trading days between the selling dates and the valuation date.

Stocks or bonds listed on more than one stock exchange are valued on the basis of the prices of the exchange on which they are principally dealt. This applies if these prices are published in a generally available listing or publication of general circulation. If this is not applicable, and the stocks or bonds are reported on a composite listing of combined exchanges in a publication of general circulation, the composite list should be used to determine value.

If there were no sales within a reasonable period before and after the valuation date, the fair market value of a security is the average price between the bona fide bid and asked prices on the valuation date.

If there were no prices available on the valuation date, the fair market value of a security is determined by taking the average prices between the bona fide bid and asked prices on the closest trading date before and after the valuation date. Both dates must be within a reasonable period. Then these averages are weighted in inverse order by the respective number of trading days between the bid and asked dates and the valuation date.

If selling prices or bona fide bid and asked prices are not available on a date within a reasonable period before the valuation date, but are available on a date within a reasonable period after the valuation date, or if the reverse is the case, the average price between the highest and lowest of these available prices may be treated as the value.

When a large block of stock is put on the market, the selling price of the stock may be lowered if the supply exceeds the demand. Conversely, market forces may exist that will afford higher prices for large blocks of stock. Because of the many factors to consider, a determination of the value of large blocks of stock usually requires the assistance of experts specializing in underwriting large quantities of securities or in trading in the securities of the industry of which the particular issuing company is a part.

If selling prices or bid and asked prices are not available, or if securities of a closely held corporation are involved, the fair market value of the security is determined by consideration of these factors: (1) for bonds, the factors include the soundness of the security, the interest yield, and the date of maturity; (2) for shares of stock, the factors include the company's net worth, prospective earning power, and dividend-paying capacity.

Other relevant factors for assessing the value of a security include the nature and history of the business, particularly its recent history; the goodwill of the business; the economic outlook in the particular industry; the company's position in the industry, its competitors, and its management; and the value of securities issued by companies engaged in the same or similar business. For preferred stock, the most important factors are its yield, dividend coverage, and protection of its liquidation preference.

Some classes of stock cannot be publicly traded because of restrictions imposed by the Securities and Exchange Commission, by the corporate charter, or by a trust agreement. These *restricted securities* usually trade at a discount in relation to freely traded securities. Factors to be considered in ascertaining the fair market value of restricted securities include the resale provisions found in the restriction agreements, the relative negotiating strengths of the buyer and seller,

and the market experience of freely traded securities of the same class as the restricted securities.

6. Jewelry and Gems. Jewelry and gems are of such specialized nature that it is almost always necessary to obtain an appraisal by a knowledgeable appraiser. The appraisal should include a description of the style of the jewelry, the cut and setting of the gem, and whether the item is now in fashion. If it is not currently in fashion, the possibility of having the property redesigned, recut, or reset should be reported in the appraisal. The stone's coloring, weight, cut, brilliance, and flaws should be analyzed and reported. Sentimental value does not have an impact on the determination of the fair value of jewelry or gems. The fact that an item of jewelry was owned or worn by a famous individual may increase the value of the item. Contributions of jewelry and gems may be reported as gifts of works of art or as collectibles.

7. Collectibles. Valuation of a collection can be accomplished by use of catalogs, dealers' price lists, and specialized hobby periodicals. The most current edition of these types of reference materials, as of the contribution date, must be used. Nonetheless, these sources are not always reliable indicators as to fair market value (such as a dealer selling an item that has been unsold for some time at a discount or a rigged sale at an auction), and the value may need to be supported by other evidence.

For example, in the case of stamp collections, libraries have catalogs that report estimates of values (for postmarked and not postmarked stamps); stamp dealers generally are able to prepare satisfactory appraisals of valuable collections. Likewise, in connection with coin collections, many catalogs and other reference materials reflect opinion as to the value of coins on or near the date of the publication. Like many other collectors' items, the value of a coin depends on the demand for it, its age, its rarity, and its condition (mint or merely good).

8. Restricted Property. The amount of a charitable contribution, determined for deduction purposes, can be affected by a restriction placed by the donor on the use of the donated property.[112] In one instance, an agricultural college sought to acquire a parcel of land, consisting of 100 acres, to use in connection with its operations in farming research and development of new farming techniques. The owner of the property contributed 50 acres to the college under a deed of gift that carried a restrictive covenant providing that the land could be used only for agricultural purposes. Use of the land for agricultural purposes did not result in a special benefit to the donor. The "highest and best" use of the land was for a more valuable use, however.

The IRS said that the value of property contributed to a charitable organization is the "price that a reasonably knowledgeable willing buyer would pay a reasonably knowledgeable willing seller for the property subject to any restrictions imposed at the time of the contributions."[113] Added the IRS: "Property otherwise

[112] Rev. Rul. 85-99, 1985-2 C.B. 83.
[113] *Id*.

intrinsically more valuable[,] that is encumbered by some restriction or condition limiting its marketability or use, must be valued in light of such limitation.''[114]

In another instance, a person contributed to a tax-exempt university all of that person's interests in a patent. The transfer agreement provided that the university could not sell or license the patent for a period of three years after the transfer. This restriction did not result in any benefit to the donor, nor could the patent revert to this donor under any circumstances. The IRS ruled that the contribution was deductible, with the restriction reducing what would otherwise be the fair market value of the patent and therefore reducing the amount of the donor's charitable deduction.[115] The IRS added that, had the donor received a benefit in exchange for the contribution, the value of the benefit would have further reduced the amount of this charitable contribution.[116]

9. Conservation Easements. Where there is a substantial record of sales of perpetual conservation easements comparable to a contributed easement, the fair market value of the donated easement is based on the sales prices of those comparable easements.[117] If there is no established market for similar conservation easements and no record exists of sales of these easements, the fair market value of a perpetual conservation easement generally is equal to the difference between the fair market value of the property it encumbers before the granting of the restriction and the fair market value of the encumbered property after the granting of the restriction.[118] The U.S. Tax Court uses this *before-and-after* methodology in evaluating conservation easements.[119] Also, any enhancement in the value of a donor's other property resulting from the easement contribution, or of property owned by certain related persons, reduces the value of the charitable contribution deduction.[120]

In one instance, a court found that the fair market value of a perpetual conservation easement covering a golf course, owned by the contributor of the easement, was $28,656,004. The donor of the easement claimed a charitable deduction in the amount of $30,588,235; the IRS originally denied the charitable deduction in its entirety (but relented following trial). The parties asserted that the highest and best use of this golf course at the time of contribution of the easement would have been for development of a residential subdivision; after the gift, the highest and best use of the property was determined to be continued operation as a golf course. The court found the before-value amount to be $31,938,985 and the after-value amount to be $2,982,981; the court also concluded that the conservation easement enhanced the value of property owned by the donor by $300,000.[121]

An appraisal of a façade easement as a percentage of the value of the underlying fee before the granting of the easement, without reference to the actual

[114] *Id*. See also *Cooley v. Commissioner*, 33 T.C. 223 (1959), *aff'd*, 283 F.2d 945 (2d Cir. 1960).
[115] Rev. Rul. 2003-28, 2003-1 C.B. 594.
[116] See § 3.1(b).
[117] Reg. § 1.170A-14(h)(3)(i).
[118] *Id*.
[119] E.g., *Browning v. Commissioner*, 109 T.C. 303 (1997); *Hughes v. Commissioner*, 97 T.C.M. (CCH) 1488 (2009).
[120] Reg. § 1.170A-14(h)(3)(i).
[121] *Kiva Dunes Conservation, LLC v. Commissioner*, 97 T.C.M. (CCH) 1818 (2009).

value of the underlying fee after the granting of the easement, may not be used to substantiate the fair market value of the easement.[122]

§ 10.2 CONTRIBUTIONS BY MEANS OF AN AGENT

Deductible charitable contributions can be made *to*[123] or *for the use of*[124] the recipient organization. In connection with the former approach, a charitable organization may receive charitable contributions by means of an agent. The IRS wrote that it is ''well established'' that a charity can use an agent for this purpose.[125] In fact, however, there is little law on the point, although the matter has come to the fore in the context of charitable contributions of used vehicles.[126]

Agency is a fiduciary relationship resulting from the manifestation of consent by one person (the *principal*) to another (the *agent*) that the agent shall act on behalf of the principal and be subject to the principal's control, and consent by the agent to function in that capacity. The IRS observed that an agent's general fiduciary duties to the principal include the ''duty to account for profits arising out of the employment, the duty not to act as (or on account of) an adverse party without the principal's consent, the duty not to compete with the principal on his own account or for another in matters relating to the subject matter of the agency, and the duty to deal fairly with the principal in all transactions between them.''[127]

The tax regulations provide that if a taxpayer unconditionally delivers or mails a properly endorsed stock certificate to a charitable donee or the donee's agent, the gift is completed on the date of delivery; or, if the certificate is received in the ordinary course of the mail, on the date of mailing.[128] In the facts of a revenue ruling, a utility company was authorized by a charitable organization to act as its agent in receiving contributions from customers of the utility company.[129] In appropriate circumstances, a charitable organization may use an agent to perform functions other than receipt of contributions.[130] Although the contract terms setting forth the parties' rights and obligations are of major importance to the IRS, all of the facts and circumstances must be considered in determining the existence of a principal-agent relationship.[131]

In connection with a property donation program reviewed by the IRS, a charitable organization desired to appoint a company as its agent for the purpose of assisting the charity in the solicitation, acceptance, processing, and sale of personal property donated by the general public. The agency looked primarily to the terms of a proposed contract between the parties, which, the IRS observed, ''clearly purports'' to establish an agency relationship pursuant to state law. The agreement showed that the company would be acting on the charity's behalf and

---

[122] Chief Counsel Advice Memorandum 200738013. See § 9.7.
[123] See, e.g., ch. 4.
[124] See § 10.3.
[125] Priv. Ltr. Rul. 200230005.
[126] See § 9.25.
[127] Priv. Ltr. Rul. 200230005.
[128] Reg. § 1.170A-1(b). See § 6.5, text accompanied by note 31.
[129] Rev. Rul. 85-184, 1985-2 C.B. 84. See § 10.9, text accompanied by *infra* note 208.
[130] E.g., *Kaplan v. Commissioner*, 43 T.C. 663 (1965) (case describing property donation program operated by for-profit corporation on behalf of charitable entity; the issue of agency was not raised).
[131] E.g., *State Police Ass'n v. Commissioner*, 125 F.3d 1 (1st Cir. 1997).

subject to its control in the general performance of the activities. The amount of discretion that the company was to exercise was said not to be in conflict with an agency relationship. The charity was, and was to remain, the equitable owner of the property until an authorized sale occurred. The vehicle titling process was found to be in accord with agency treatment; upon the sale of an item of donated property, the proceeds were to become the property of the charity, net of the fee payable to the company. Until a sale occurred, the risk of accidental loss, damage, or destruction of the donated property was to be borne by the charity, subject to the company's obligation to pay the cost of insurance coverage. The company was to provide monthly accounting reports to, in a form and in detail satisfactory to, the charity. The company was to provide weekly advertising reports to the charity. The charity reserved the right to audit and inspect the company's property donation program financial statements at any time during normal business hours. The IRS held that if the actual course of dealing between the parties was in accord with their written agreement, there would be a valid agency relationship, so that contributions could be made to the charity by means of the company.[132]

§ 10.3 GIFTS FOR THE *USE* OF CHARITY

The federal tax law provisions concerning charitable giving frequently make reference, in addition to gifts *to* a charitable organization, to gifts *for the use of* a charitable organization. The definition of a *charitable contribution* for federal income tax law purposes states that it is "a contribution to or for the use of" qualified charitable organizations.[133]

There is little law on the point. One court had occasion to peruse the legislative history of the law that added this phrase to the Internal Revenue Code (in 1921) and concluded that the words mean "roughly the equivalent of" the words "in trust for."[134] In the previous year, the then Bureau of Internal Revenue had ruled that charitable deductions could not be taken for contributions to trusts, community chests, and other types of charitable foundations, on the ground that these organizations were not organized and operated for charitable purposes but merely served as a conduit for contributions to charitable organizations.[135] These organizations were common law trusts; legal title to the contributions remained vested in a trustee that invested the funds prior to disbursement to various charitable organizations.

The legislative history of this phrase indicates that Congress intended by this law change to make contributions in trust for the benefit of charitable organizations eligible for deduction as charitable gifts.[136] Over the intervening years, courts and the IRS have adhered to this interpretation of the words *for the use of*.[137]

---

[132] Priv. Ltr. Rul. 200230005.

[133] IRC § 170(c), opening clause.

[134] *Rockefeller v. Commissioner*, 676 F.2d 35, 40 (2d Cir. 1982).

[135] O.D. 669, 3 C.B. 187 (1920).

[136] E.g., H. Rep. No. 350, 67th Cong., 1st Sess. 12 (1921).

[137] E.g., *Danz v. Commissioner*, 18 T.C. 454 (1952), *aff'd on other grounds*, 231 F.2d 673 (9th Cir. 1955), *cert. den.*, 352 U.S. 828 (1956); *Bowman v. Commissioner*, 16 B.T.A. 1157 (1956); Rev. Rul. 53-194, 1953-2 C.B. 128; Rev. Rul. 55-275, 1955-1 C.B. 295.

The matter was taken to the U.S. Supreme Court, in connection with an issue as to whether funds transferred by parents to their children while the children served as full-time, unpaid missionaries for a church are deductible as charitable contributions. Inasmuch as the gifts were not to the church, the argument advanced by the parents turned on whether the gifts were for the use of the church. The Court, in reaffirming that the words mean ''in trust for,'' concluded that the payments were not deductible as charitable contributions.[138]

The Court observed that while this interpretation of the phrase ''does not require that the qualified [charitable] organization take actual possession of the contribution, it nevertheless reflects that the beneficiary must have significant legal rights with respect to the disposition of donated funds.''[139] The Court rejected the claim that a charitable deduction should be allowed merely because the charitable organization has ''a reasonable opportunity to supervise the use of contributed funds.''[140] The Court observed that the IRS ''would face virtually insurmountable administrative difficulties in verifying that any particular expenditure benefited a qualified donee,'' were a looser interpretation of the phrase utilized.[141] The larger interpretation would, wrote the Court, ''create an opportunity for tax evasion that others might be eager to exploit,'' although the Court was quick to note that ''there is no suggestion whatsoever in this case that the transferred funds were used for an improper purpose.''[142]

Under the facts, the Court found that the funds were not transferred ''in trust for'' the church. The money was transferred to the children's personal bank accounts on which they were the sole authorized signatories. No trust or ''similar legal arrangement''[143] was created. The children lacked any legal obligation to use the money in accordance with guidelines of the church, nor did the church have any legal entitlement to the money or a cause of action against missionaries who used their parents' money for purposes not approved by the church.

A charitable contribution deduction is not allowed for a gift of services.[144] However, unreimbursed expenses made incident to the rendition of services to charitable organizations can be deductible.[145] At the outset, the IRS's position was that expenses incurred for charitable purposes were gifts for the use of, and not to, charitable organizations. This position was reviewed in litigation and the government lost the cases.[146] The IRS thereafter abandoned this position and ruled that unreimbursed expenses incurred by an individual in rendering gratuitous services to a charitable organization are gifts to the charity.[147]

A contribution of an income interest in property, whether or not the contributed interest is transferred in trust, for which a charitable deduction is allowed,[148] must be construed as made for the use of, rather than to, a charitable

---

[138] *Davis v. United States*, 495 U.S. 472 (1990).
[139] *Id*. at 483.
[140] *Id*. at 484–85.
[141] *Id*. at 485.
[142] *Id*.
[143] *Id*.
[144] See § 9.14.
[145] See § 9.15.
[146] E.g., *Rockefeller v. Commissioner*, 676 F.2d 35, 40 (2d Cir. 1982).
[147] Rev. Rul. 84-61, 1984-1 C.B. 39.
[148] IRC § 170(f)(2)(B) or (3)(A).

organization.[149] A contribution of a remainder interest in property, whether or not the contributed interest is transferred in trust, for which a charitable deduction is allowed,[150] must generally be considered as made to the charitable organization.[151] If, however, a remainder interest is transferred in trust and, pursuant to the terms of the trust instrument, the interest contributed is, upon termination of the predecessor estate, to be held in trust for the benefit of the organization, the contribution must be considered as made for the use of the organization.[152]

Example 10.1 illustrates these points:

EXAMPLE 10.1

A transfers property to a charitable remainder annuity trust.[a] This arrangement includes the requirement to pay to B for life an annuity equal to 5 percent of the initial fair market value of the property transferred in trust. The trust instrument provides that after B's death the remainder interest in the trust is to be transferred to M, a church, or, in the event that M is not a charitable organization at the time the amount is to be irrevocably transferred to it, to another qualifying charitable organization. The contribution by A of the remainder interest is made to M. If, however, A had directed in the trust instrument that after B's death the remainder interest was to be held in trust for the benefit of M, the contribution would have to be considered as made for the use of M.

[a] See § 12.2.

§ 10.4 CONDITIONAL GIFTS

A donor may make a contribution to a charitable organization but place conditions on the gift. Depending on the type of condition, there may not be a charitable deduction for the transfer, at least not until the condition is satisfied. Conversely, a condition may not have any bearing on the deductibility of the charitable gift.

There are three types of conditions in this regard:

1. A condition (sometimes termed a *contingency*) that is material, so that the transfer is not considered complete until the condition is satisfied
2. A condition involving a possible occurrence, when the likelihood of the event occurring is so remote as to be negligible, in which case the condition is ignored for purposes of deductibility
3. A condition that is material but that is in furtherance of a charitable purpose, so that the condition is more in the nature of a *restriction*

(a) Material Conditions—Nondeductibility

As to the first two of the above categories, the standard is as follows: If, as of the date of a gift, a transfer for charitable purposes depends on 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

[149] Reg. § 1.170A-8(a)(2).
[150] IRC § 170(f)(2)(A) or (3)(A).
[151] *Id.*
[152] *Id.*

transfer will not become effective is so remote as to be negligible.[153] If the possibility is not negligible, if it occurs, and if the charitable transfer becomes effective, the charitable deduction arises at the time the condition is satisfied or eliminated.

As an illustration, a charitable organization wishes to construct a building to be used for its program purposes. It has developed a building fund that is sufficient to cover 90 percent of the construction costs of the building; the organization will seek the remaining funds from the general public. The organization represents to donors that if the contributions are not sufficient to meet the balance of the costs of construction, the contributions will be returned to the donors. If the contributions received exceed the necessary amount, the organization will retain the excess funds for general program purposes. Thus, as of the date of the gifts, the transfers for charitable purposes depend on the performance of an act or the happening of a precedent event to become effective. Furthermore, whether the contributions will be returned depends solely on whether the donors contribute an amount equal to the difference between the cost of constructing the building and the amount already in the building fund. Under these circumstances, the possibility that the charitable transfer will not become effective is not so remote as to be negligible. Consequently, the gifts are not deductible as of the time of the transfer, but will become deductible at the time the condition is satisfied or eliminated (that is, when the public gifts are transferred to the building fund, because the needed amount was raised, or are retained by the organization to be expended for general program purposes).[154]

As another example, a person contributed a patent to a tax-exempt university subject to the condition that a named faculty member of the institution (who was an expert on the technology covered by the patent) continue to be a member of the faculty of the university during the remaining life of the patent. Under the terms of this gift, if the individual ceased to be a faculty member of the university before the patent expired, the patent would revert to the donor. The patent was to expire 15 years after the date of the contribution. On the date of the contribution, the likelihood that the specified individual would cease to be a member of the faculty of the university before the patent expired was not so remote as to be negligible. The IRS ruled that a charitable contribution deduction was not allowable for this gift.[155]

In some instances, a condition may affect only a portion of the gift. For example, the Department of Parks, Recreation, and Tourism of a state obtained sponsors who agreed to pay any deficit that the department might incur in conducting an international steeplechase race to promote tourism. The department represented to the sponsors that any funds not used to meet the deficit would be returned to the sponsors on a pro rata basis. Thus, only the pro rata portion of any sponsorship advance that the department used for racing expenses was a payment to the state for exclusively public purposes. Therefore, only the portion of each advance actually used to meet the deficit was deductible by the sponsor as a charitable contribution. No portion of the advance was considered to be a

[153] Reg. § 1.170A-1(e).
[154] Rev. Rul. 79-249, 1979-2 C.B. 104.
[155] Rev. Rul. 2003-28, 2003-1 C.B. 594.

payment of a contribution until such time as the net amount actually going to the state was definitely determined by a final accounting.[156]

A condition or battery of conditions may be so extensive that the matter goes to the question of the donor's intent. In one instance, a gift of land was burdened with so many conditions, including sale of the land, that a court found that the "donor," at best, had an intent to make a gift of future sales proceeds rather than an intent to make a present gift of the land.[157]

(b) Negligible Conditions

As noted, a condition that is *so remote as to be negligible* is ignored for gift deductibility purposes. This phrase has been defined as "a chance which persons generally would disregard as so highly improbable that it might be ignored with reasonable safety in undertaking a serious business transaction."[158] It has also been defined as "a chance which every dictate of reason would justify an intelligent person in disregarding as so highly improbable and remote as to be lacking in reason and substance."[159]

In one case, a court found conditions that were not so remote as to be negligible. One condition was found to have a "good chance" of occurring.[160] Another condition was characterized as "certainly foreseeable" and "quite likely."[161] Still another condition was labeled as having a "high probability," "probable," and "quite possible."[162] Thus, a charitable gift was not deductible at the time originally made. In another case, a charitable deduction was not allowable because there was a "realistic possibility" that the condition involved would occur.[163] The IRS examined the terms and conditions of a trust established to advance charitable ends, and concluded that the possibility that trust assets would be used for noncharitable purposes was not so remote as to be considered negligible. Thus, it disallowed the claimed charitable contribution deductions.[164]

Further, if an interest has passed to, or is vested in, a charitable organization on the date of a gift, and if the interest would be defeated by the performance of some act or the happening of some event, the possibility of occurrence of which appeared on that date to be so remote as to be negligible, the charitable contribution deduction would be available.[165]

If it is determined that a condition is a negligible one, the amount of the gift for deduction purposes may still have to be discounted by the present value of the condition.[166]

---

[156] Rev. Rul. 72-194, 1972-1 C.B. 94.
[157] *Dayton v. Commissioner*, 32 T.C.M. (CCH) 782 (1973).
[158] *United States v. Dean*, 224 F.2d 26, 29 (1st Cir. 1955).
[159] *Briggs v. Commissioner*, 72 T.C. 646, 657 (1979), *aff'd without published opinion*, 665 F.2d 1051 (9th Cir. 1981), *citing Woodworth Estate v. Commissioner*, 47 T.C. 193 (1966), and *United States v. Provident Trust Co.*, 291 U.S. 272 (1934).
[160] *Briggs v. Commissioner*, 72 T.C. 646, 657 (1979).
[161] *Id.*
[162] *Id.* at 658.
[163] *885 Inv. Co. v. Commissioner*, 95 T.C. 156, 162 (1990).
[164] Priv. Ltr. Rul. 200142011.
[165] E.g., Priv. Ltr. Rul. 9303007.
[166] E.g., Tech. Adv. Mem. 9443004 (concerning discounting by the present value of the possibility of a reversion).

(c) Material Conditions—Deductibility

There is one type of material condition that will not defeat a charitable deduction and, indeed, must be satisfied if the deduction is to be allowed. This is a condition that the gift be used for one or more program purposes; as noted, this is frequently known as a *restricted* gift. The following are some examples of restricted gifts:

- A gift to a charitable organization restricted to use for scholarships
- A gift to a university restricted to a fund underlying a chair in a particular department
- A gift to a museum restricted to the museum's endowment fund
- A gift to a hospital restricted to the hospital's building fund

These types of conditions or restrictions will not cause a charitable contribution deduction to be disallowed.[167]

§ 10.5 EARMARKING OF GIFTS FOR INDIVIDUALS

A charitable contribution deduction is not allowed if the charitable organization involved is used merely as a conduit, so that a payment to the charity is *earmarked* or similarly designated for the benefit of one or more specified individuals, even if these recipients are members of the charitable class the charity is intended to benefit. This aspect of the law comprises other, related elements, such as the concept of a gift,[168] gifts for the use of a charity,[169] and conditional gifts.[170]

For example, an individual claimed charitable contribution deductions for payments made to a tax-exempt college. He had previously indicated to a prospective student at the college that he would like to aid the student financially; he wrote that he would try to arrange for a scholarship for this student. In a letter to the director of admissions of the college, accompanying the gifts, this individual wrote: ''I am aware that a donation to a [s]cholarship [f]und is only deductible if it is unspecified, however, if in your opinion and that of the authorities, it could be applied to the advantage of [the student], I think it would be constructive.'' A court found that these gifts were earmarked for the student, as evidenced by the fact that the college never awarded him a scholarship and simply applied the payments to his account at the college.[171]

Likewise, an individual made payments for the maintenance and education of a child who was a ward of a tax-exempt children's home. Rejecting the claim of a charitable deduction for the payments, a court, while conceding that the payments relieved the home of the financial obligation of furnishing the child with its services, wrote that the deduction could not be sustained because the payments were for a designated individual and ''for no other individuals or for no other

[167] Another illustration of this type of gift is a contribution of an art collection to a museum pursuant to an agreement mandating exhibition of the collection in adherence with a variety of conditions. E.g., Priv. Ltr. Rul. 200202032.

[168] See § 3.1(a).

[169] See § 10.3.

[170] See § 10.4. To some extent, this also involves the matter of the need for a charitable class. See § 3.3(b), text accompanied by notes 334–344.

[171] *Tripp v. Commissioner*, 337 F.2d 432 (7th Cir. 1964), *aff'g* 22 T.C.M. (CCH) 1225 (1963).

purpose'' of the home.[172] The court wrote that ''[c]harity begins where certainty in beneficiaries ends, for it is the uncertainty of the objects and not the mode of relieving them which forms the essential elements of charity.''[173]

The IRS has ruled in this context. In one instance, an individual contributed money to an exempt university, with the requirement that the funds be used to further the research project of a particular professor. Inasmuch as the university lacked discretion over the use of the funds, the IRS concluded that it was only a conduit, so that the true donee was the professor. The IRS ruled that the gift was not deductible.[174] Similarly, an individual made a contribution to a missionary fund that was intended to reimburse missionaries for approved expenses not covered by amounts received from the missionaries' parents, friends, relatives, or personal savings; the donor's son was one of the missionaries. The IRS ruled that contributions to the missionary fund that were earmarked for a particular individual would be treated as gifts to that individual and were not deductible.[175]

The pivotal test in this setting is whether the charitable organization receiving the contribution has full control of the donated funds and discretion as to their use, so as to ensure that the funds will be used to carry out the charity's functions and purposes. Contributions are deductible unless they are distinctly marked by the donor so that they may be used only for the benefit of a designated individual or are received by the charity pursuant to a commitment or understanding that they will be so used.[176]

For example, a corporation established a scholarship program, selecting the universities from which it drew a substantial number of its employees. The universities selected the recipients of the scholarship, although there was no employment commitment between the corporation and the scholarship recipients. The IRS observed that, for purposes of determining that a contribution is made to or for the use of a charitable organization rather than to a particular individual who ultimately benefits from the contribution, the organization must have full control of the use of the donated funds, and the contributor's intent in making the payment must be to benefit the organization, not the individual recipient.[177]

In another instance, students at a religious educational institution had their tuition paid by ''sponsors,'' which in many cases were the students' parents. The sponsors signed a commitment form that set the contribution amount and the payment schedule, and indicated the names of the sponsor and the student; space was provided on the payment envelopes for the student's name. The form provided that use of the contributions was ''solely at the discretion of'' the organization. The IRS denied a charitable contribution deduction because deductibility requires both full control of the gift funds by the charitable organization and an intent by the donor to benefit the charity and not a particular recipient. The agency concluded that the commitment form and envelopes indicated that

[172] *Thomason v. Commissioner*, 2 T.C. 441, 444 (1943).
[173] *Id*. at 443.
[174] Rev. Rul. 61-66, 1961-1 C.B. 19.
[175] Rev. Rul. 62-113, 1962-2 C.B. 10. See the discussion of *Davis v. United States* in § 3.1(a), text accompanied by notes 26–32; Priv. Ltr. Rul. 9247030 (holding that a gift to a charitable organization was earmarked for a noncharitable organization).
[176] Rev. Rul. 62-113, 1962-2 C.B. 10.
[177] Rev. Rul. 68-484, 1968-2 C.B. 105.

the payments were designated for the benefit of particular students. The control the school had over the use of the funds was no different from the control any school has over tuition payments.[178]

Another court opinion nicely illustrates the subtleties that can arise in making distinctions in this area. The charity involved was a tax-exempt charitable and religious mission. Donors sent many checks to the mission, on many of which were entered the names of particular missionaries; the receipts from the mission reflected ''support'' for missionaries identified by name. Sometimes the checks were accompanied by letters that identified missionaries by name, indicating that the contribution was for their support. The mission sent the donors a pamphlet stating that contributions were allocated equally for the missionaries, in terms of personal allowances and service support. The donors' contributions were placed in a common pool used for missionary support and were disbursed in accordance with the policy of the mission as described in the pamphlet.

The court concluded that the mission had exclusive control, pursuant to its policy, over the administration and distribution of the funds contributed. The donors' designation of the missionaries to be supported by their contributions was portrayed by the court as ''no more than a manifestation of [the donors'] desire to have their donations credited to the support allowance of those individuals.''[179] The court found that the donors ''knew and intended that their funds would go into a common pool to be distributed only as the [m]ission itself determined.''[180]

The court thus rejected the IRS's assertion that these contributions were not deductible because they were made for the support of certain designated individuals. That position was dismissed thus: ''It seems to us that [the IRS] has chosen the wrong case to be puristic in [its] effort to collect the sovereign's revenue.''[181] Indeed, the court concluded that the IRS was ''hoist with [its] own petard,''[182] in that a revenue ruling had reached a conclusion similar to the one in this case.[183]

The IRS considered a situation concerning a tax-exempt charitable and educational organization that provided support for the composition and performance of musical works. A married couple expressed interest in supporting the composition of a work by a particular composer; six months later, they made a contribution to the charity. At the time of the gift, the charity did not make any commitment to use the funds to commission a work by the composer. Five months later, however, the charity, the composer, and an orchestra entered into an agreement by which the charity paid the composer a fee to commission a work and to reimburse his expenses for appearing at the premiere of the work; the amount of the donors' gift was ''sufficient'' to enable the charity to pay these costs. The IRS ruled that the gift was not impermissibly earmarked for the benefit of the composer and thus was deductible.[184]

---

[178] Rev. Rul. 79-81, 1979-1 C.B. 107.
[179] *Peace v. Commissioner*, 43 T.C. 1, 7 (1964).
[180] *Id*. at 7.
[181] *Id*. at 8.
[182] *Id*.
[183] Rev. Rul. 62-113, 1962-2 C.B. 10.
[184] Priv. Ltr. Rul. 200250029.

§ 10.6 ALTERNATIVE MINIMUM TAX CONSIDERATIONS

The federal tax law includes an alternative minimum tax.[185] This tax is termed an *alternative* tax because it may be paid instead of the regular income tax. It is called a *minimum* tax because it is designed to force persons of wealth to pay some federal tax, notwithstanding the sophistication of their tax planning.

Some persons are able to avoid taxation, in whole or in part, through the use of deductions, credits, exemptions, and the like. These items are generally known as *items of tax preference* or *tax preference items*. A general summary of the alternative minimum tax is that it is a tax, albeit computed with some adjustments, on many of a person's tax preference items.

The charitable community and the alternative minimum tax have a precarious coexistence. This is because, as a general rule, the donor of an item of appreciated property contributed to a public charity escapes taxation on the capital gain inherent in the property.[186] This feature of the federal income tax law is a major incentive for charitable giving. There are those, however, who assert that—if only as a matter of pure tax policy—this capital gain should be subject to some taxation. One option in this regard is to subject this gain to the alternative minimum tax. Congress experimented with this approach. Thus, for a period of about six years, the appreciation element inherent in a charitable contribution of appreciated property was considered an item of tax preference for purposes of the alternative minimum tax.[187]

In 1986, a rule was adopted that, for purposes of computing alternative minimum taxable income, the deduction for charitable contributions of capital gain property (real, tangible personal, or intangible personal) is disallowed to the extent that the fair market value of the property exceeds its adjusted basis. This rule was a compromise in the face of an effort to subject this type of appreciation element to the regular capital gains tax. The charitable community that is highly dependent upon contributions of appreciated property (such as institutions of higher education and museums) thereafter experienced a substantial decline in giving of property and began to work to change, if not eliminate, the rule.

This effort was successful. First Congress created a partial and temporary exception in 1990. Then Congress attempted to permanently repeal the application of the alternative minimum tax to charitable giving in 1992, although this undertaking failed. Nonetheless, the legislative history of this potential law change offered the following explanation:

> The [Senate Finance] [C]ommittee believes that the temporary AMT [alternative minimum tax] exception for contributions of appreciated tangible personal property has induced additional charitable giving. Thus, by permanently extending this rule and expanding it to apply to all appreciated property gifts, taxpayers will be allowed the same charitable contribution deduction for both regular tax and alternative minimum tax purposes. This will provide an additional incentive for taxpayers to make contributions of appreciated property.[188]

---

[185] IRC §§ 55–59. See § 2.

[186] See § 4.3.

[187] Former IRC § 57(a)(6).

[188] *Technical Explanation of the Finance Committee Amendment*, at 579–580. The *Technical Explanation* was not formally printed; it was, however, reproduced in the *Congressional Record*. 138 Cong. Rec. (No. 112) S11246 (Aug 3, 1992).

Success in this regard arrived in 1993, which brought permanent repeal of this alternative minimum tax rule in relation to gifts of all categories of property.[189] Thus, an inducement for charitable giving, in the form of the appreciated property contribution rules, is firmly embedded in the Internal Revenue Code.

§ 10.7 INTERRELATIONSHIP WITH BUSINESS EXPENSE DEDUCTION

A charitable contribution deduction is not allowed for a gift of property for which the donor has claimed a business expense deduction.[190] For example, a retired athlete cannot claim a charitable contribution deduction for donating to a museum gifts of clothing and supplies used during his or her career, if he or she previously claimed a business expense deduction with respect to the items.[191] This limitation also applies to the deduction for depreciation.[192]

An individual or a corporation is not permitted a deduction for a contribution as a business expense if any part of it is deductible as a charitable contribution.[193] For example, if an individual made a contribution of $5,000 and only $4,000 was deductible as a charitable contribution (whether because of the percentage limitations,[194] the requirements as to time of payment,[195] or both), there cannot be a business expense deduction for the remaining $1,000.[196] For this rule to apply, the payment must in fact be a charitable contribution.[197] Thus, contributions to organizations other than charitable ones ''which bear a direct relationship to the taxpayer's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses.''[198]

§ 10.8 DENIAL OF DEDUCTION FOR LOBBYING ACTIVITIES

The business expense deduction is denied for amounts incurred in an attempt to influence federal or state (but not local) legislation through communication with members or employees of legislative bodies or other government officials who may participate in the formulation of legislation.[199] There is a flow-through rule, which disallows a business expense deduction for a portion of the membership dues paid to a trade, business, or professional association or other noncharitable

---

[189] Omnibus Budget Reconciliation Act of 1993, § 13171(a).

[190] This point of law is derived from the basic rule that ''[d]ouble [income tax] deductions are not permitted'' and ''[a]mounts deducted under one provision of the Internal Revenue Code . . . cannot again be deducted under any other provision thereof.'' Reg. § 1.161-1; *Ilfeld v. Hernandez*, 292 U.S. 62 (1943). The business expense deduction is the subject of IRC § 162. See § 2.5(a).

[191] Priv. Ltr. Rul. 9335017.

[192] IRC §§ 167, 168.

[193] Reg. § 1.162-15(a)(1).

[194] See ch. 7.

[195] See ch. 6.

[196] Reg. § 1.162-15(a)(1).

[197] Reg. § 1.162-15(a)(2).

[198] Reg. § 1.162-15(b). See § 3.1(a), text accompanied by note 6; § 3.1(b), note 111.

[199] IRC §§ 162(e)(1), (2).

organization that engages in lobbying (unless the organization elects to pay a proxy tax on its lobbying expenditures).[200]

An anti-avoidance rule is intended to prevent persons from using charitable organizations as a conduit to conduct lobbying activities, the costs of which would not be deductible if conducted directly by the donor. That is, a deduction is not allowed—either as a charitable contribution deduction or as a business expense deduction—for amounts contributed to a charitable organization that conducts lobbying activities, if (1) the charity's lobbying activities concern matters of direct financial interest to the donor's trade or business and (2) a principal purpose of the contribution is to avoid the general disallowance rule that would apply if the contributor directly had conducted the lobbying activities.[201]

The application of this anti-avoidance rule to a contributor does not adversely affect the tax-exempt status of the charitable organization as long as the activity qualified as nonpartisan analysis, study, or research or was not substantial under either the substantial part test or the expenditure test.[202] The determination regarding a principal purpose of the contribution is based on the facts and circumstances surrounding the contribution, including the existence of any formal or informal instructions relating to the charitable organization's use of the contribution for lobbying efforts (including nonpartisan analysis), the temporal nexus between the making of the contribution and the conduct of the lobbying activities, and any historical pattern of contributions by the donor to the charity.[203]

§ 10.9 DEDUCTIBLE GIFTS TO NONCHARITABLE ORGANIZATIONS

It is possible for a contribution to be treated as a deductible charitable contribution when the gift is made to a noncharitable (including for-profit) organization. This occurs when the recipient of the gift is a pass-through entity and a charitable organization is the ultimate donee. In some instances, the initial payee organization is regarded as the agent of the organization that is the ultimate recipient of the organization, and the payor is considered, for federal tax purposes, to have made the payment directly to the ultimate transferee, notwithstanding the flow of the payment through one or more intermediate (or conduit) entities.[204]

For example, contributions to a tax-exempt social club[205] were held to be deductible as charitable contributions, because the club functioned as an authorized agent for one or more charitable organizations, enabling the members of the club, when purchasing tickets for a social event: (1) to direct that the amount of their total payment in excess of the price of the tickets be transferred to charitable organizations; and (2) to deduct, as charitable gifts, that portion of the payment to the club that was paid over to the charitable organizations.[206] This is a common

[200] IRC § 162(e)(3), 6033(e)(2)(A)(i).
[201] IRC § 170(f)(9).
[202] H. Rep. No. 103–213, 103d Cong., 1st Sess. 610, n. 70 (1993). For a brief summary of these tests, see § 3.3 (b), text accompanied by note 282.
[203] H. Rep. No. 103–213, 103d Cong., 1st Sess. 610 (1993).
[204] See §§ 10.2, 10.9.
[205] These organizations are tax-exempt under IRC § 501(a) by reason of description in IRC § 501(c)(7). See *Tax-Exempt Organizations* ch. 15.
[206] Rev. Rul. 55-192, 1955-1 C.B. 294.

practice among trade, business, and professional associations that encourage members to make gifts to related charitable organizations at the same time they pay their annual membership dues. The payments to both entities are made as a single transaction because the gift element of the payments is flowed through the association to the charitable recipient.[207]

Charitable gift deductibility treatment was accorded to additional amounts paid by customers of a utility company, when paying their bills to the company, when the additional amounts were earmarked for a charitable organization that assisted individuals with emergency-related energy needs.[208] Again, the utility company was considered the agent of the charitable organization; the company did not exercise any control over the funds and segregated them from its own funds. In a similar situation, contributions paid to a title-holding company[209] for purposes of maintaining and operating a historic property were once ruled by the IRS to be deductible as charitable gifts, when the gifts were segregated from the company's funds and were otherwise clearly devoted to charitable ends.[210] In this instance, however, the ruling was subsequently withdrawn,[211] although the effect of the withdrawal was not made retroactive.[212]

Although not in the charitable giving context, a comparable set of rules offers some guidelines for this type of pass-through giving. The law is that amounts paid to a tax-exempt organization (such as a business league[213]) for transfer to a political action committee[214] do not, when promptly and directly transferred,

---

[207] See, e.g., Priv. Ltr. Rul. 7944054.

[208] Rev. Rul. 85-184, 1985-2 C.B. 84.

[209] These organizations are tax-exempt under IRC § 501(a) by reason of description in IRC §§ 501(c)(2) and (25). See *Tax-Exempt Organizations* § 19.2.

[210] Priv. Ltr. Rul. 8705041.

[211] Priv. Ltr. Rul. 8826012.

[212] Priv. Ltr. Rul. 8836040. The IRS did not provide any explanation for the withdrawal of this ruling, although it may be surmised that the IRS was concerned that this form of charitable giving (that is, giving to noncharitable organizations) could become prevalent and present difficulties in enforcing the rules.

There are other private letter rulings dealing with somewhat comparable settings. For example, the IRS held that charitable contributions can be made in the form of rebates on the purchase price of certain items and coupons redeemable at local supermarkets and retailers, when the rebate amounts are paid to charities. See § 3.1(h). In one ruling, the matter involved an individual credit or debit cardholder who purchases items at participating retailers that submit a percentage of the purchase price to the sponsor of the cards. The sponsor in turn transfers an amount in excess of its administrative and processing costs to a charitable organization of the cardholder's choice. The sponsor held these amounts on behalf of each cardholder in a custodial account. In ruling that the contributions were deductible as charitable gifts, the IRS focused on the cardholder's ability to decide whether to make payments to a charity (a voluntary act), along with his or her ability to designate the charitable organization to receive the payments. As to when the cardholder may take the deduction, the IRS concluded that the sponsor acted as agent of the cardholders, so the cardholder controlled the funds until they were actually paid to the charity. Priv. Ltr. Rul. 9623035. As emphasized in a subsequent ruling, therefore, a cardholder in this situation is entitled to a charitable deduction only upon transfer of the funds to the designated charitable organization. Priv. Ltr. Rul. 199939021.

A bank clearinghouse association made contributions on behalf of its member banks to various charitable organizations. The amounts of the contributions were included in the bills rendered to member banks on a monthly basis. A court held that the association acted as a disbursing agent for the banks in making the contributions, thus providing the banks with a charitable contribution deduction for the payments. *First Nat'l Bank v. Commissioner*, 17 B.T.A. 1358 (1929), *sustaining & vacating (on another issue)*, 49 F.2d 70 (8th Cir. 1931).

[213] These organizations are tax-exempt under IRC § 501(a) by reason of description in IRC § 501(c)(6). See *Tax-Exempt Organizations* ch. 14.

[214] These organizations are tax-exempt by reason of description in IRC § 527. See *Tax-Exempt Organizations* ch. 17.

constitute political campaign expenditures by the transferor exempt organization.[215] A transfer is considered ''promptly and directly'' made if: (1) the procedures followed by the organization satisfy the requirements of applicable federal and state campaign laws; (2) the organization maintains adequate records to demonstrate that the amounts transferred do in fact consist of political contributions or dues, rather than investment income; and (3) the political contributions or dues transferred were not used to earn investment income for the transferor organization. [216]

One of the issues reflected in the political action committee rules is the element of *promptness* of the transfer of the funds. Although this generally is a facts-and-circumstances test, in one instance the IRS imported the concept into the charitable field. The case involved facts similar to those in the utility company matter.[217] Although the IRS wrote that the payments were ''initially commingled'' with the utility's funds, it added that they were ''earmarked and transferred'' to the charity's account on a ''frequent and regular basis.''[218] In both of these instances, the transfers were made weekly.[219]

Based on the foregoing law (such as it is), it may be concluded that a payment made to a noncharitable entity can be deductible as a charitable gift under five sets of circumstances:

1. The amount that is the charitable gift is clearly so designated by the donor
2. The intermediate organization is clearly functioning as the agent of the charity
3. The gift component of the payment is promptly transferred to the charity

---

[215] E.g., Priv. Ltr. Rul. 7903079.

[216] Reg. § 1.527-6(e). In general, see *Tax-Exempt Organizations* § 28.5. A matter that is festering at present is the tax treatment of funding of educational activities (such as the availability and maintenance of study rooms and computers) within the chapter houses of college and university fraternities and sororities. The difficulty is that these entities are classified as social clubs (see § 10.9, note 183), although the individuals involved are members of a charitable class (viz., students). See § 3.2(b)(vi). Usually, funding of this nature comes from related foundations to which the donors have made deductible gifts. Some in the IRS, however, are of the view that the educational activities are inextricably interwoven with the social and recreational ones, and/or that this funding generates unwarranted private benefit. This issue is under active consideration by the IRS at this time, although it was once thought settled in favor of the recognition of targeted gifts and grants to chapter houses. In the meantime, the same (and sometimes more extensive) funding flowing to an educational institution is deductible, as illustrated by the IRS ruling that contributions to a university for the purpose of reconstructing and remodeling fraternity housing owned by it qualify for the charitable contribution deduction. Priv. Ltr. Rul. 9733015. Likewise, the IRS ruled that deductible contributions can be made to: (1) a university to finance construction of a building to provide a safe meeting area for students who are members of sororities on the campus (Priv. Ltr. Rul. 9829053); (2) a college, for the renovation, construction, and operation of facilities at fraternity chapter houses (Priv. Ltr. Rul. 199929050); (3) a public charity for the preservation of a fraternity's chapter house, on the condition that a perpetual conservation easement be granted (Priv. Ltr. Rul. 199933029); and (4) a college, when the college will use the funds to construct student housing and lease the houses to fraternities (Priv. Ltr. Rul. 200003013).

[217] See text accompanied by *supra* note 208.

[218] Priv. Ltr. Rul. 9335022.

[219] An earlier private letter ruling, Priv. Ltr. Rul. 8417019, is believed to be the precursor to Rev. Rul. 85-184, 1985-2 C.B. 84. In that earlier ruling, oddly, the IRS found that similar payments to a utility company were deductible as charitable gifts. The IRS noted that the funds would not be commingled with the utility company's money and would accrue interest while held by the company, although the interest was to be transferred to the charity. There, too, the transfers were to be made weekly.

4. The intermediate entity does not earn any investment income on the amounts destined for charity
5. The intermediate organization directly transfers the appropriate funds to the charitable organization

These factors, in summary, make it clear that the intermediate entity is functioning as a conduit on behalf of the charitable organization.

§ 10.10 REALLOCATION OF DEDUCTIONS

Congress has provided the IRS with broad authority to undo a taxpayer's ''creative'' tax planning by readjusting the facts to more correctly state the taxpayer's tax position. This authority empowers the IRS to closely scrutinize transactions between mutually controlled parties. This process is known as *reallocation* of items of income, deductions, and credits; it is done when necessary to prevent the evasion of taxes or to ensure the clear reflection of each taxpayer's income.[220] The IRS can use this authority to reallocate, in the charitable giving context, to adjust (reduce) a claimed charitable contribution deduction.

In one instance, two partners, who were an individual and a corporation wholly owned by him, caused their partnership to distribute to them a tract of land in the form of two tracts of approximately equal value but not equal size. The individual received a 76 percent interest in one tract and a 24 percent interest in the other. The individual held a 49 percent interest in the partnership. The land was donated to a city and the individual claimed a charitable contribution deduction based on a 76 percent interest in the real estate. (He also reported 24 percent of the gain from the sale of the other tract.) The IRS reallocated the amount of the charitable contribution deduction (and the capital gain) between the two partners on the basis of their respective percentage interests in the partnership. The IRS was successful in court in forcing this donor to confine his deduction to an amount equal to the 49 percent interest in the land.[221]

§ 10.11 CHARITABLE GIVING AND FUNDING OF TERRORISM

National security concerns, certainly those arising in the aftermath of the terrorist attacks on September 11, 2001, can add federal governmental regulatory constraints and prohibitions on charitable organizations that attract contributions for use in countries other than the United States. While the law in this area is emerging, a key element of it is an executive order signed by the president a few days after the attacks.[222] Actions by the Office of Foreign Assets Control (OFAC), within the Department of the Treasury, entail a variety of sanctions, including

[220] IRC § 482.
[221] *Dolese v. Commissioner*, 82 T.C. 830 (1984), *aff'd*, 811 F.2d 543 (10th Cir. 1987).
[222] Exec. Order No. 13,224 (Sept. 24, 2001), titled ''Blocking Property and Prohibiting Transactions with Persons Who Commit, Threaten to Commit, or Support Terrorism.'' A summary of this executive order is at Rambler, ''New Developments for International Charitable Giving: The War Against Terrorist Financing,'' 39 *Exempt Orgs. Tax Rev.* (No. 1) 33 (Jan. 2003).

denial of the deductibility of contributions to an organization. The broad authority of OFAC is being upheld by the courts.[223]

These developments also have led the Treasury Department to issue "voluntary" guidelines for charitable organizations to follow so as to avoid ties to terrorist organizations.[224] These sweeping guidelines have attracted considerable attention and criticism, in part because they embody precepts that are not required by the federal tax law or state corporate law.[225]

Moreover, the tax-exempt status of an organization that has been designated, pursuant to federal law, as supporting or engaging in terrorist activity or supporting terrorism is suspended. Contributions made to an organization during the period of suspension of exemption are not deductible for federal tax purposes.[226]

§ 10.12 STATUTE OF LIMITATIONS

The general rule is that the statute of limitations establishes a three-year period within which the IRS can assess or collect any deficiencies or additions to tax as determined by it.[227] In the case of a fraudulent return, however, the period of limitations is extended indefinitely.[228] On many occasions, the IRS has been allowed to assess and collect tax deficiencies and additions to tax after expiration of the general three-year period, because of fraud committed by abuse of the charitable contribution deduction.[229]

§ 10.13 CONCEPT OF TRUST INCOME

(a) Basic Principles

The definition of what constitutes *income* of a trust reverberates throughout the tax law of charitable giving as well as the federal tax law generally. This definition affects ordinary trusts, estates, charitable remainder trusts,[230] pooled income funds,[231] trusts that qualify for the gift and estate tax marital deduction,[232] and trusts that are subject to the generation-skipping transfer rules.[233] This aspect of the law is of concern to grantors, beneficiaries, and fiduciaries.

---

[223] E.g., *Holy Land Found. for Relief & Dev. v. Ashcroft*, 219 F. Supp. 2d 57 (D.D.C. 2002); *Global Relief Found., Inc. v. O'Neill*, 207 F. Supp. 2d 779 (N.D. Ill. 2002).

[224] U.S. Department of the Treasury, *Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities* (Nov. 7, 2002), at 39 *Exempt Orgs. Tax Rev.* (No. 1) 120 (Jan. 2003).

[225] E.g., Harris, "New Treasury Guidelines on Terrorist Funding Draw Criticism," 39 *Exempt Orgs. Tax Rev.* (No. 1) 23 (Jan. 2003); Rambler, "New Developments for International Charitable Giving: The War Against Terrorist Financing," 39 *Exempt Orgs. Tax Rev.* (No. 1) 33 (Jan. 2003).

[226] IRC § 501(p), created upon enactment of § 108 of the Military Family Tax Relief Act of 2003 (Pub. L. No. 108-121), effective as of November 11, 2003. See *Tax-Exempt Organizations* § 25.7.

[227] IRC § 6501(a).

[228] IRC § 6501(c).

[229] E.g., *Braswell v. Commissioner*, 66 T.C.M. (CCH) 627 (1993).

[230] See ch. 12.

[231] See ch. 13.

[232] See §§ 8.2(k)(i), 8.3(b)(ii).

[233] See 8.5.

The statutory law generally provides that, for these purposes, the term *income* means the ''amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law.''[234] This concept of income is used as the measure of the amount that must be distributed from a trust in order for the trust to qualify for certain federal tax treatments. Trusts that are classified as simple trusts, net income charitable remainder unitrusts,[235] pooled income funds, and qualified subchapter S trusts are required to make distributions measured, at least in part, by the amount of trust accounting income. A similar concept applies to trusts that qualify for the gift and estate tax marital deductions.

A trust instrument may provide for any amount to be distributed to beneficiaries currently. Trust provisions that measure the amount of the distribution by reference to income but define the term *income* differently from the state statutory definition of *income* generally are recognized for state law purposes. Various provisions of the Internal Revenue Code that require the current distribution of income to qualify the trust for certain federal tax treatment, however, are based on the assumption that the income beneficiary will receive what is traditionally considered to be income. In some situations, such as with qualified subchapter S trusts and marital deduction trusts for spouses who are U.S. citizens, the income beneficiary is also permitted to receive distributions of principal as long as all of the income is currently distributed. In other instances, such as with net income charitable remainder unitrusts and pooled income funds, only the income may be distributed. In all of these situations, the determination as to what is income is critical. Thus, a core concept in this context is this: The definition of *income* under the terms of the governing instrument and applicable local law must not depart fundamentally from traditional concepts of income and principal, if the desired federal tax treatment is to be secured.

In recent years, *applicable local law*—state law—has been dramatically changing on this point. These statutes are in the process of altering traditional concepts of income and principal in response to investment strategies that seek total positive return on trust assets. These statutes are designed to ensure that when a trust invests in assets that may generate little income in the traditional sense (such as dividends, interest, and rent), the income and remainder beneficiaries are allocated reasonable amounts of the total return of the trust (including traditional income and capital appreciation of trust assets), so that both classes of beneficiaries are treated impartially.

Some statutes permit the trustee to pay an income beneficiary a unitrust amount—a fixed percentage of the fair market value of the trust assets. Other statutes accord the trustee the discretion to make adjustments between income and principal so as to treat the beneficiaries impartially.

The Department of the Treasury and the IRS are of the view that an allocation to principal of traditional income items should be respected for federal tax law purposes only if applicable state law has specifically authorized the allocation, in circumstances such as when necessary to ensure impartiality regarding a trust investing for total return. Under the regulations, a state statute authorizing

[234] IRC § 643(b).
[235] See § 12.3(a)(ii), (iii).

certain unitrust payments in satisfaction of an income interest or certain powers to adjust satisfy that requirement, as does a decision by a state's highest court announcing a general principle or rule of law that would apply to all trusts administered under the laws of that state.

(b) Definition of *Income*

For federal tax law purposes, the term *income*, other than when modified, means the amount of income of an estate or trust for the year determined under the terms of the governing instrument and applicable local law. Trust provisions that depart fundamentally from traditional principles of income and principal generally will not be recognized. Thus, items such as dividends, interest, and rent generally are allocated to income, and proceeds from the sale or exchange of trust assets generally are allocated to principal.

Nonetheless, an allocation of amounts between income and principal pursuant to local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year, including ordinary and tax-exempt income, capital gains, and appreciation. For example, a state statute providing that income is a unitrust amount of no less than 3 percent and no more than 5 percent of the fair market value of the trust assets, determined annually or averaged on a multiple-year basis, is a reasonable apportionment of the total return of the trust.

Generally, these adjustments are permitted by state statutes when the trustee invests and manages the trust assets under the state's prudent investor standard; the trust describes the amount that may or must be distributed to a beneficiary by reference to the trust's income; and the trustee, after applying the state law rules regarding the allocation of receipts and disbursements, is unable to administer the trust impartially. Allocations pursuant to methods prescribed by such state statutes for apportioning the total return of a trust between income and principal will be respected regardless of whether the trust provides that the income must be distributed to one or more beneficiaries or may be accumulated in whole or in part, and regardless of which alternate permitted method is actually used, as long as the trust complies with all requirements of the state statute for switching methods.

A switch between methods of determining trust income authorized by state statute will not constitute a recognition event[236] and will not result in a taxable gift from the trust's grantor or any of the trust's beneficiaries. A switch to a method not specifically authorized by state statute, but valid under state law, may constitute a recognition event to the trust or its beneficiaries and may result in taxable gifts from the trust's grantor and beneficiaries, based on the relevant facts and circumstances.

An allocation to income of all or a part of the gains from the sale or exchange of trust assets will generally be respected if the allocation is made either pursuant to the terms of the governing instrument and local law, or pursuant to a reasonable and impartial exercise of a discretionary power granted to the fiduciary by local law or by the governing instrument, if not prohibited by local law.[237]

---

[236] IRC § 1001.

[237] Reg. § 1.643(b)-1 (revised), which is effective for tax years of trusts and estates ending after January 2, 2004.

(c) Capital Gains and Losses

Gains from the sale or exchange of capital assets generally are excluded from distributable net income to the extent that the gains are allocated to corpus. Capital gains allocated to corpus are, however, included in distributable net income if they are paid, credited, or required to be distributed to a beneficiary during the year, or paid, permanently set aside, or to be used for a charitable purpose.

Capital gains can be included in distributable net income if the terms of the governing instrument and local law permit it. That can also be the outcome pursuant to a reasonable and impartial exercise of discretion by the fiduciary, in accordance with a power granted to the fiduciary by applicable local law or by the governing instrument if not prohibited by local law.[238]

§ 10.14 PENALTIES

The federal tax law contains a variety of penalties that can be imposed for violation of various aspects of the law of charitable giving. These penalties are part of a broader range of *accuracy-related penalties*.[239]

The threshold accuracy-related penalty is determined as an amount to be added to the income tax equal to 20 percent of the portion of the underpayment of tax.[240] This body of law relates to the portion of any underpayment of tax that is attributable to one or more specified acts, including the following:

- Negligence[241]
- Disregard of rules or regulations[242]
- Any substantial understatement of income tax[243]
- Any substantial income tax valuation misstatement[244]
- Any substantial estate or gift tax valuation understatement[245]

The term *negligence* is defined for this purpose as including "any failure to make a reasonable attempt to comply with" the applicable law.[246] The term *disregard* includes "any careless, reckless, or intentional disregard."[247]

A *substantial understatement* occurs when the amount of the understatement of tax for the year exceeds the greater of 10 percent of the tax that is required or $5,000.[248] When the violation is by a regular corporation, the penalty is the greater

---

[238] Reg. § 1.643(a)-3 (revised), which is effective for tax years of trusts and estates ending after January 2, 2004. Reg. § 1.643(a)-3(f).
[239] IRC § 6662.
[240] IRC § 6662(a).
[241] IRC § 6662(b)(1).
[242] *Id*.
[243] IRC § 6662(b)(2).
[244] IRC § 6662(b)(3).
[245] IRC § 6662(b)(5).
[246] IRC § 6662(c). The tax regulations state that negligence is strongly indicated where a taxpayer "fails to make a reasonable attempt to ascertain the correctness of a deduction, credit or exclusion on a return which would seem to a reasonable and prudent person to be 'too good to be true' under the circumstances" (Reg. § 1.6662-3(b)(1)(ii)). An instance of imposition of this penalty in the charitable giving context appears in *Bergquist v. Commissioner*, 131 T.C. 8 (2008).
[247] *Id*.
[248] IRC § 6662(d)(1)(A).

of 10 percent of the required tax or $10,000.[249] The term *understatement* means the excess of: (1) the amount of tax required to be shown on the tax return for a taxable year over (2) the amount of tax imposed, which is shown on the tax return, less certain rebates.[250] These rules apply with respect to *tax shelters*; that term is defined to include any ''plan or arrangement'' (including a partnership) if the ''principal purpose'' of it ''is the avoidance or evasion of Federal income tax.''[251]

An *income tax substantial valuation misstatement* generally occurs if the value of any property (or the adjusted basis of any property) claimed on a tax return is 200 percent or more of the amount determined to be the correct amount of the valuation (or adjusted basis).[252] For this penalty to be imposed, the substantial misstatement must exceed $5,000 ($10,000 for most corporations).[253]

This penalty may be increased in the event of a *gross valuation misstatement*, which is an amount equal to 40 percent of the portion of the underpayment.[254] An income tax gross valuation misstatement generally occurs if the value of any property (or the adjusted basis of any property) claimed on a tax return is 400 percent or more of the amount determined to be the correct amount of the valuation (or adjusted basis).[255]

This increased penalty does not apply to any portion of an underpayment if the taxpayer establishes that there was reasonable cause for the portion and that the taxpayer acted in good faith.[256] This exception applies in the income tax charitable contribution context only if the claimed value of the property was based on a qualified appraisal[257] made by a qualified appraiser[258] and the taxpayer made a good-faith investigation of the value of the contributed property.[259] In one instance, a court found that a group of donors, all of whom are well educated, did not act in good faith and were imprudent in accepting an excessive valuation of donated stock; a request by a lawyer to withhold relevant information from their tax advisors was considered notice to the donors as to the inaccuracy of the claimed deductions.[260] The court wrote that a donor ''cannot blindly rely'' on advice or an appraisal to avoid the penalty[261] and will be faulted for not seeking advice from an advisor ''who is truly independent of the planned transaction.''[262]

---

[249] IRC § 6662(d)(1)(B).

[250] IRC § 6662(d)(2). In this context, a *rebate* is an abatement, credit, refund, or like payment made on the ground that the tax imposed was less than the tax deficiency initially determined. IRC § 6211(b)(2).

[251] IRC § 6662(d)(2)(C)(ii)(III).

[252] IRC § 6662(e)(1)(A).

[253] IRC § 6662(e)(2).

[254] IRC § 6662(h)(1).

[255] IRC § 6662(h)(2)(A)(i).

[256] IRC § 6664(c)(1).

[257] See § 21.5(a).

[258] See § 21.5(b).

[259] IRC § 6664(c)(2).

[260] *Bergquist v. Commissioner*, 131 T.C. 8 (2008).

[261] *Id*. citing *Kellahan v. Commissioner*, 77 T.C.M. 2329 (CCH) (1999), *Estate of Goldman v. Commissioner*, 71 T.C.M. (CCH) 1896 (1996).

[262] *Bergquist v. Commissioner*, 131 T.C. 8 (2008). If, however, there is a separate, independent ground for disallowing a deduction, an overvaluation penalty cannot be imposed (e.g., *Gainer v. Commissioner*, 893 F.2d 225 (9th Cir. 1990). An illustration of this point in the charitable giving context is in *Derby v. Commissioner*, 95 T.C.M. (CCH) 1177 (2008).

There is a *substantial estate or gift tax valuation understatement* if the value of any property claimed on a tax return is 50 percent or less of the amount determined to be the correct amount of the valuation.[263] This penalty applies when the underpayment exceeds $5,000.[264] A gross valuation misstatement in this context takes place if the value of any property claimed on a tax return is 25 percent or less of the amount determined to be the correct amount of the valuation.[265]

The foregoing rules have, however, been revised with respect to appraisals made and returns filed after August 17, 2006.[266]

There is a fraud penalty, which is an addition to the tax of an amount equal to 75 percent of the portion of the underpayment that is attributable to fraud.[267] If the IRS establishes that any portion of an underpayment is attributable to fraud, the entire underpayment is treated as attributable to fraud, except with respect to any portion of the underpayment that the taxpayer can prove, by a preponderance of the evidence, is not attributable to fraud.[268]

These penalties often hinge on the existence of an *underpayment*. This term is defined as the amount by which the tax imposed exceeds the excess of the sum of

- The amount shown as the tax by the taxpayer on his, her, or its tax return, plus
- Amounts not so shown, which were previously assessed (or collected without assessment), over
- The amount of rebates[269] made.[270]

---

[263] IRC § 6662(g)(1).

[264] IRC § 6662(e)(2). Thus, where a taxpayer is not liable for the 40-percent accuracy-related penalty because the underpayment did not exceed $5,000, the taxpayer is liable for the 20-percent penalty. E.g., *Bergquist v. Commissioner*, 131 T.C. 8 (2008).

[265] IRC § 6662(h)(2)(C).

[266] See § 21.5(c).

[267] IRC § 6663(a).

[268] IRC § 6663(b). Under prior statutory law, it was held that an underpayment of federal income tax is due to fraud if it results from a taxpayer's specific intent to evade a tax that the taxpayer believes he or she owes. *Bradford v. Commissioner*, 796 F.2d 303 (9th Cir. 1986), *aff'g* 49 T.C.M. (CCH) 105 (1984). Thus, to prove that an underpayment of tax is due to fraud, the IRS must show that the taxpayer intended to evade a tax known to be due by engaging in conduct designed to conceal, mislead, or otherwise prevent collection of the tax by the IRS. *Patton v. Commissioner*, 799 F.2d 166 (5th Cir. 1986), *aff'g* 49 T.C.M. (CCH) 1068 (1985); *Recklitis v. Commissioner*, 91 T.C. 874 (1988).

The existence of fraudulent intent is a factual question to be decided on the basis of the examination of the entire record. *Recklitis v. Commissioner*, 91 T.C., at 909; *Grosshandler v. Commissioner*, 75 T.C. 1 (1980). It may never be presumed but must be established by affirmative evidence. *Beaver v. Commissioner*, 55 T.C. 85 (1970). Because direct proof of a taxpayer's intent is rarely available, however, fraud may be established by circumstantial evidence. *Grosshandler v. Commissioner*, 75 T.C. at 19; *Gajewski v. Commissioner*, 67 T.C. 181 (1976), *aff'd*, 578 F.2d 1383 (8th Cir. 1978).

In the charitable giving context, courts will, in determining the existence of tax fraud, take into account the state of the law at the time, whether this law was "well established," the level of intelligence and professional training of the donor, the extent of relevant information readily accessible to the donor, and whether the donor consulted a lawyer or accountant on the point. E.g., *Braswell v. Commissioner*, 66 T.C.M. (CCH) 627 (1993); *Mobley v. Commissioner*, 65 T.C.M. (CCH) 1939 (1993). In one instance, a federal district court looked to state law to find fraud when a married couple joined the tax protest movement, created a personal church, conveyed their personal residence to the church, and stopped paying federal income taxes on the ground that one of the spouses was an ordained minister. The court found the conveyance to be intentionally fraudulent (and ordered the property sold to pay the taxes due). *United States v. Freeman*, 93-1 U.S.T.C. ¶ 50,296 (D.N. J. 1993).

[269] See *supra* note 250. See also IRC § 6664(a), last sentence.

[270] IRC § 6664(a).

A penalty cannot be imposed with respect to any portion of an underpayment, however, if it is shown that there was a reasonable cause for the portion and the taxpayer acted in good faith.[271]

In this regard, there is a special rule for *charitable deduction property*, which is an item of property contributed by a person in a contribution for which an income tax charitable contribution deduction was claimed.[272] This rule is: In the case of an underpayment of tax attributable to a substantial overstatement or a gross valuation overstatement with respect to charitable deduction property, the reasonable cause exception is not applicable unless (1) the claimed value of the property was based on a qualified appraisal[273] made by a qualified appraiser[274] and (2) the contributor made a good faith investigation of the value of the contributed property.[275]

Still other federal tax penalties may be applied in the context of charitable giving. Among them is the penalty for the promotion of a tax shelter. Specifically, a person is liable for a penalty if he or she does the following:

- Organizes or assists in the organization of
  - A partnership or other entity,
  - Any investment plan or arrangement, or
  - Any other plan or arrangement, or
- Participates, directly or indirectly, in the sale of any interest in this type of an entity, plan, or arrangement, and
- Makes, furnishes, or causes another person to make or furnish (in connection with such an entity or sale)
  - A statement with respect to the allowability of any tax deduction or tax credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement, which the person knows or has reason to know is false or fraudulent as to any material matter, or
  - A gross valuation overstatement as to any material matter.[276]

In this setting, a *gross valuation overstatement* is any statement as to the value of any property or services if (1) the value so stated exceeds 200 percent of the amount determined to be the correct valuation and (2) the value of the property or services is directly related to the amount of any tax deduction or tax credit allowable under the federal income tax law to any participant.[277] The penalty is, with respect to each tax shelter promotion activity, the greater of $1,000 or 100 percent of the gross income derived (or to be derived) by the person from the activity.[278]

---

[271] IRC § 6664(c)(1).

[272] IRC § 6664(c)(3)(A). This term does not, however, include any securities for which market quotations are readily available on an established securities market as of the date of the contribution. *Id.*

[273] See § 21.5(a). See also IRC § 6664(c)(3)C).

[274] See § 21.5(b). See also IRC § 6664(c)(3)(B).

[275] IRC § 6664(c)(2).

[276] IRC § 6700.

[277] IRC § 6700(b)(1).

[278] IRC § 6700(a).

A tax shelter promotion activity, with respect to each entity or arrangement, is treated as a separate activity for this purpose, as is each participation in each sale.[279] The IRS is empowered to waive all or any part of this penalty with respect to a gross valuation overstatement, on a showing that there was a reasonable basis for the valuation and that the valuation was made in good faith.[280] This penalty may be imposed in addition to any other tax penalty.[281]

There is a penalty for aiding and abetting an understatement of tax liability.[282] This penalty may be imposed on any person who:

- Aids or assists in, procures, or advises with respect to the preparation or presentation of any portion of a return, affidavit, claim, or other document,
- Knows (or has reason to believe) that the portion of a document will be used in connection with any material matter arising under the federal tax laws, and
- Knows that the portion of a document (if so used) would result in an understatement of the liability for tax of another person.[283] This penalty may be separately levied with respect to each document.[284]

For this purpose, the term *procures* includes (1) ordering (or otherwise causing) a subordinate to do an act and (2) knowing of, and not attempting to prevent, participation by a subordinate in an act.[285] In general, the amount of this penalty is $1,000.[286] If a document relates to the tax liability of a corporation, however, the amount of the penalty is $10,000.[287] This penalty may be applied whether or not the understatement is with the knowledge or consent of the persons authorized or required to present the return, affidavit, claim, or other document.[288]

Still other pertinent penalties are those imposed for a failure to file a tax return,[289] failure to file a correct information return,[290] failure to furnish a correct payee statement,[291] or failure to comply with other information reporting requirements.[292]

It may appear unlikely or even farfetched to think that a donor or someone serving on behalf of a charitable organization—or a charitable organization itself—could reasonably be subjected to one or more of these penalties. They

---

[279] IRC § 6700(a), last sentence.

[280] IRC § 6700(b)(2). An appellate court reversed the imposition of an overvaluation penalty, on the ground that the donor reasonably relied on a professional appraisal, and remanded the case for further findings. *Murphy v. Commissioner*, No. 92-70108 (9th Cir. Oct. 5, 1993) (unpublished opinion), *rev'g & remanding* 61 T.C.M. (CCH) 2935 (1991).

[281] IRC § 6700(c).

[282] IRC § 6701.

[283] IRC § 6701(a).

[284] *Id*.

[285] IRC § 6701(c)(1). A *subordinate* is a person (whether or not a director, officer, employee, or agent of the person involved) over whose activities the person has direction, supervision, or control. IRC § 6701(c)(2).

[286] IRC § 6701(b)(1).

[287] IRC § 6701(b)(2).

[288] IRC § 6701(d). A person furnishing typing, reproduction, or other mechanical assistance with respect to a document is not treated as having aided or assisted in the preparation of the document by reason of this kind of assistance. IRC § 6701(e).

[289] IRC § 6651(a)(1).

[290] IRC § 6721.

[291] IRC § 6722.

[292] IRC § 6723.

have been so applied by the courts in that context, however. There have been several court opinions concerning the application of these penalties in the charitable giving setting under pre-1990 law.[293] These include:

- Application of an underpayment penalty when a lawyer intentionally disregarded the tax regulations in claiming a charitable contribution deduction for gifts of legal services[294]
- Application of penalties when the claimed values were based on "financial fantasies"[295]
- Application of a penalty when the gift property was valued at $45,600 and the court found the value to be $4,211[296]
- Application of penalties when the value of the gift property was deliberately inflated and the transactions were tax-motivated[297]
- Application of the negligence penalty when the parties participated in a circular flow-of-funds arrangement, including charitable gifts, designed for tax avoidance[298]
- Application of the penalty for substantial underpayment of federal income tax when a charitable gift of gravesites was made as part of a tax avoidance promotion program.[299]
- Application of the valuation overstatement penalty in a case involving a charitable contribution of wild game trophy mounts.[300]

A penalty may be imposed on a person who (1) aids or assists in, procures, or advises with respect to the preparation or presentation of any portion of a return, affidavit, claim, or other document; (2) knows (or has reason to believe) that the portion will be used in connection with any material matter arising under the federal tax laws; and (3) knows that the portion (if so used) would result in an understatement of the liability for tax of another person. The penalty applies with respect to each document.[301] The amount of the penalty for persons other than corporations is $1,000; for corporations, the amount of the penalty is $5,000.[302] This penalty is applicable, for example, in an instance of violation of the charitable contribution substantiation rules.[303]

---

[293] IRC § 6662 took effect with respect to returns due after 1989.
[294] *Grant v. Commissioner*, 84 T.C. 809 (1985), *aff'd*, 800 F.2d 260 (4th Cir. 1986).
[295] *Snyder v. Commissioner*, 86 T.C. 567 (1986). See also *Parker v. Commissioner*, 86 T.C. 547 (1986).
[296] *Tallal v. Commissioner*, 52 T.C.M. (CCH) 1017 (1986).
[297] *Angell v. Commissioner*, 52 T.C.M. (CCH) 939 (1986).
[298] *Allen v. Commissioner*, 91-1 U.S.T.C. ¶ 50,080 (9th Cir. 1991), *aff'g* 92 T.C. 1 (1989).
[299] *Klavan v. Commissioner*, 66 T.C.M. (CCH) 68 (1993); *Weiss v. Commissioner*, 65 T.C.M. (CCH) 2768 (1993).
[300] *Engel v. Commissioner*, 66 T.C.M. (CCH) 378 (1993).
[301] IRC § 6701(a).
[302] IRC § 6701(b).
[303] See § 21.3. This penalty was assessed against an individual who had a practice of providing donors of used vehicles with documentation supporting a charitable deduction based on full fair market value when in fact he knew that "many of the donated vehicles could only be sold for salvage or scrap." Tech. Adv. Mem. 200243057.

There is a penalty for violation of the rules concerning disclosures to donors in the case of *quid pro quo* contributions.[304] Penalties of $10 per contribution, capped at $5,000 per particular fundraising event or mailing, may be imposed on charitable organizations that fail to make the required disclosure, unless the failure was due to reasonable cause. The penalty applies if an organization either fails to make any disclosure in connection with a *quid pro quo* contribution or makes a disclosure that is incomplete or inaccurate (such as an estimate not determined in good faith of the value of goods or services furnished to the donor).[305]

A penalty is applicable for the furnishing of a false or fraudulent acknowledgment, or an untimely or incomplete acknowledgment, by a charitable organization donee to a donor of a qualified vehicle.[306] If the vehicle is sold without any significant intervening use or material improvement[307] by the donee, the penalty is the greater of (1) the product of the highest rate of income tax and the sales price stated in the acknowledgment or (2) the gross proceeds from the sale of the vehicle. In the case of an acknowledgment pertaining to any other qualified vehicle, the penalty is the greater of (1) the product of the highest rate of income tax and the claimed value of the vehicle or (2) $5,000.

The IRS analyzed the application of this *quid pro quo* contribution penalty in the context of ''disguised'' tuition payments. Under review was a practice of a church, where a member (or family including a member) makes a contribution in an amount equal to or exceeding the amount of a child's tuition at a school that is unrelated to the church. The school bills the church for, and the church pays for, the tuition. The church retains the funds from contributions of each of its members separate; each member is required to contribute to the church an amount at least equal to each child's tuition, plus the member's ''regular'' contribution to the church's general fund. At the end of a year, the church provides a statement to the member reflecting the total contributions for the year without any reduction for tuition that the church has paid. This document states that the donor did not receive anything in exchange for the contributions (other than intangible religious benefits).[308] The IRS concluded that, if the church conducted a fundraising event or mailing involving this program, the $5,000 maximum would apply.[309] Conversely, the penalty limitation would not be applicable where participants in such a program hear about it by word of mouth or participate in it without mailings or other forms of fundraising.[310]

A penalty of $10,000 is applicable to a person that identifies applicable property as having a use that is related to an exempt purpose or function constituting the basis for the donee's tax exemption knowing that it is not intended for such a use.[311]

---

[304] IRC § 6714. These contributions are the subject of § 22.2.

[305] H. Rep. No. 103-213, 103d Cong., 1st Sess. 566 (1993).

[306] IRC § 6720. See § 9.25.

[307] See § 9.25(b), text accompanied by notes 595–596.

[308] See § 21.3.

[309] Chief Couns. Adv. Mem. 200623063.

[310] As noted, this penalty is not to be imposed in instances entailing reasonable cause. In connection with this advice, the IRS's lawyers wrote that an "honest and reasonable misunderstanding of fact or law might sometimes support a finding of reasonable cause." They were, however, quick to add: "A disguised tuition payment program so plainly violates the provisions giving rise to the quid pro quo penalty that we find it difficult to imagine a scenario in which a church could establish reasonable cause based on a misunderstanding of law or fact."

[311] IRC § 6720B. See § 4.6(c).

Penalties may be imposed for failure to file a return (or for failure to include any required information or to show the correct information) on behalf of a split-interest trust.[312]

§ 10.15 TRANSACTIONS OF INTEREST

Federal tax regulations issued in 2007[313] concern, in the tax shelter context,[314] the disclosure of *reportable transactions*, including the category of transactions known as *transactions of interest*.[315] The identification of a transaction (or a substantially similar one) as a transaction of interest alerts persons involved with these transactions to ''certain responsibilities'' that may arise from their involvement with the transaction.

(a) Successor Member Interests

The IRS, in 2007, issued two notices identifying the first of these transactions of interest.[316] One of these types of transactions concerns a transaction in which a taxpayer (1) directly or indirectly acquires certain rights in real property or in an entity that directly or indirectly holds real property, (2) transfers the rights more than one year after the acquisition to a charitable organization, and (3) claims a charitable contribution deduction that is significantly higher than the amount that the taxpayer paid to acquire the rights.[317]

In a typical version of this transaction, an ''advisor'' (Advisor) owns all of the membership interests in a limited liability company (LLC) that directly or indirectly owns real property that may be subject to long-term lease. Advisor and Taxpayer enter into an agreement, pursuant to which Advisor continues to own the membership interests in LLC for a term of years; Taxpayer purchases the successor member interest in LLC (Successor Member Interest), which entitles Taxpayer to own all of the membership interests in LLC on the expiration of the term. In some variations of this transaction, Taxpayer may hold the Successor Member Interest by means of an entity, such as a single-member limited liability company. This agreement may refer to the Successor Member Interest as a ''remainder interest.''

After holding the Successor Member Interest for more than one year (so as to treat it as long-term capital gain property[318]), Taxpayer transfers the Successor Member Interest to a charitable organization (Charity). Taxpayer claims the value of the Successor Member Interest is an amount that is significantly higher than Taxpayer's purchase price, such as an amount that is a multiple of the purchase price and is in excess of normal appreciation. Taxpayer claims an income tax charitable contribution deduction based on this higher value. Taxpayer reaches this value by taking into account an appraisal obtained by or on behalf of Advisor

[312] IRC § 6652(c)(1). A discussion of tax penalties in the appraisal context is in § 21.6.
[313] T.D. 9350.
[314] See *Tax-Exempt Organizations* § 27.15(j).
[315] IRC §§ 6111, 6112; Reg. § 1.6011-4(b)(6).
[316] IR-2007-143.
[317] Notice 2007-72, 2007-2 C.B. 544.
[318] See § 4.3.

or Taxpayer of the fee interest in the underlying real property and the federal government's valuation tables.

The IRS is concerned about various "apparent irregularities" in this transaction. One of these concerns is the "large discrepancy" between the amount Taxpayer paid for the Successor Member Interest and the amount claimed by Taxpayer as a charitable contribution. Other concerns include a mischaracterization of the ownership interests in LLC, Charity's agreement to not transfer the Successor Member Interest for a period of time (which may coincide with the expiration of the period within which Charity would have to report the transfer to the IRS), and a sale by Charity of the Successor Member Interest to a party selected by or related to Advisor or Taxpayer.

Transactions that are the same as or are substantially similar to the above-described transaction are transactions of interest as of August 14, 2007. Persons entering into these transactions on or after November 2, 2006, must disclose the transaction.[319] Material advisors who make a tax statement on or after November 2, 2006, with respect to these transactions, have disclosure and list maintenance obligations.[320]

Independent of their classification as transactions of interest, transactions that are the same as or are substantially similar to the above-described transaction already may be subject to tax shelter law requirements.[321] When the Treasury Department and IRS have gathered enough information to make an informed decision as to whether this transaction is a tax avoidance type of transaction, the government may take one or more actions, including removing the transaction from the transactions-of-interest category, designating the transaction as a *listed transaction*, or providing a new category of *reportable transaction*.

Advisor, LLC, an entity used in place of LLC, Taxpayer, and any members of Taxpayer, if it is a flow-through entity, are *participants* in this transaction for each year in which their respective tax returns reflect tax consequences or the tax strategy described in the notice.[322]

Charity is not a participant if it received the Successor Member Interest on or prior to August 14, 2007. For Successor Member Interests received after that date, Charity is a participant in the transaction as of the first year for which Charity's annual information return reflects the interest. Charity is required to report the receipt of the Successor Member Interest on its annual information return for the year in which it is received. Thus, Charity is a participant in the transaction as of the year in which it received the interest.

Persons required to disclose these transactions who fail to do so may be subject to a penalty.[323] Persons required to maintain lists of advisees who fail to do so (or who fail to provide the lists when requested to do so by the IRS) may be subject to a penalty.[324] Also, the IRS may impose other penalties on persons involved

[319] Reg. § 1.6011-4.
[320] Reg. §§ 1.6011-4(h), 301.6111-3, 301.6112-1(g).
[321] IRC §§ 6011, 6111, 6112.
[322] Reg. § 1.6011-4(c)(3)(i)(E).
[323] IRC § 6707A or 6707(a).
[324] IRC § 6708(a).

in these transactions or substantially similar transactions, including an accuracy-related penalty.[325]

Thereafter, the IRS launched an examination program pertaining to charitable contributions of certain *successor member interests*, by means of a prototype letter and information document request that was made public in late October 2007.

This IDR (11 single-spaced pages) includes some pointed questions that charitable organizations should ponder, even if they have not received one of these successor-member-interest gifts, when considering whether to accept an unconventional charitable contribution:

- Who initiated contact as to the prospective gift? The IRS wants the names and other information about the individuals involved, as well as copies of relevant written communications (including email).
- Did the charitable organization or any of its trustees, directors, or officers have a business or personal relationship with the donor or a person facilitating the transaction?
- What economic and legal rights did the charitable organization believe it would receive by accepting the successor member interest?
- The IRS wants copies of all correspondence and other documents surrounding the transaction.
- The IRS wants to know about the type and nature of any legal advice the charitable organization received in conjunction with the gift.
- The IRS is inquiring as to whether the organization was asked to agree to not sell or otherwise dispose of the interest for a period of time. If the answer is yes, the IRS wants to know the time period and the reason for the request and agreement, and wants copies of the pertinent documents.
- The IRS wants to know whether the organization was asked to agree or expected to sell or otherwise dispose of the interest to the donor, a person related to the donor, a representative of the donor, or any other specified person. Relevant documents are requested.
- The IRS wants to know what the organization knew about the value of the interest and the valuation method.
- The IRS is asking whether the organization has guidelines for accepting ''unusual'' gifts, such as those of successor member interests. The IRS wants a description and copy of these guidelines, the date they were adopted, who prepared them, and the trustees, directors, and/or officers who approved them.
- The IRS is asking whether the organization's decision to accept the interest was discussed or reviewed by its board of directors or a committee, and wants copies of minutes and other pertinent documentation.
- The IRS wants the organization's reasons for accepting the gift, including ''how and when the organization would derive financial benefit from the interest,'' whether the organization expected to use the interest in a related

[325] IRC §§ 6662, 6662A.

or unrelated activity, whether the organization expected to realize income from the interest, and the extent the organization understood its ''rights of ownership'' in the interest.

- The IRS wants information about any Form 8283 it received in connection with the gift of the interest.
- The IRS wants information about any contemporaneous written acknowledgment sent to the donor of one of these interests.
- The IRS is asking the organization to describe ''any due diligence'' the organization conducted before receipt of the interest, including ''any assessment you made of the property or obligations against the property.'' Pertinent documents, including the due diligence report, are requested.
- How did the organization report the receipt of the interest on its books and annual information return (Form 990)?
- The IRS wants details as to any disposition of the interest (including any marketing arrangements, the amount received, and the name and address of the organization's lawyer), including any filing of Form 8282.
- Is the organization aware of any ''agreements or arrangements that require any person to keep confidential the intended tax consequences'' of the transaction?
- Is the organization aware of any ''agreements or tax indemnity arrangements with respect to the sales prices or any tax benefits that could arise from these transactions''?
- Was the organization's annual information return, for the year of receipt and/or the year of disposition of the interest, reviewed by an independent accountant or outside counsel?

This is a highly unusual development. This examination program is in the nature of a compliance check project, although the IRS is not using that phrase. In its cover letter, the IRS is asking the organization to provide the answered IDR ''as part of the examination.'' Even the use of a prototype IDR is unique; in the usual compliance check project, a less formal questionnaire is deployed.[326]

(b) Asset Dispositions

The IRS, in 2008, issued another notice identifying another transaction of interest involving charitable remainder trusts.[327] In this type of transaction, a sale or other disposition of all interests in a charitable remainder trust (subsequent to the contribution of appreciated assets to and their investment by the trust) results in the grantor or other noncharitable recipient receiving the value of that person's trust interest while claiming to recognize little or no taxable gain. The IRS believes that this transaction has the ''potential for tax avoidance or evasion,'' yet lacks sufficient information to determine whether the transaction should be identified as a tax avoidance transaction.

---

[326] See Hopkins, *IRS Audits of Tax-Exempt Organizations: Policies, Practices, and Procedures* (Hoboken, NJ: John Wiley & Sons, Inc., 2008).
[327] Notice 2008-99, 2008-2 C.B. 1194.

In one variation of the transaction, the grantor creates a charitable remainder trust and contributes to it property that has appreciated in value. The grantor retains a term interest (an annuity or unitrust interest) in the trust and designates a charitable organization as the remainder interest beneficiary. The charity may but need not be controlled by the grantor. The grantor may but need not reserve the right to change the remainder interest beneficiary.

The trust then sells or liquidates (without tax) the contributed property and invests the proceeds, often to acquire a diversified portfolio. The trust's basis in its new assets is the price the trust paid for them. A portion of the trust's ordinary income and capital gains may become taxable to the grantor as the periodic term interest payments are made by the trust. The grantor and the charity, in a transaction they claim is a sale of the full interest in the trust (see below), sell or otherwise dispose of their respective interests in the trust to an unrelated third party for an amount that approximates the fair market value of the assets of the trust. The trust then terminates, distributing its assets to this party.

The grantor asserts entitlement to a charitable deduction for the gift of the remainder interest to the trust. The grantor also takes the position that there is no requirement to recognize any gain from the trust's sale or liquidation of its assets. In connection with their sale of their respective interests in the trust to the third party, the grantor and the charity take the position that they have sold the entire interest in the trust.[328] They claim that the consequence of this is that the rule that disregards basis in the case of a sale of a term interest[329] does not apply to the transaction. The grantor also takes the position that the gain on the sale of the grantor's term interest is computed by taking into account the portion of uniform basis allocable to the grantor's term interest[330] and that this uniform basis is derived from the basis of the new assets rather than the basis of the appreciated assets.

A result of the claimed tax treatment of the transaction is that the gain on the sale of the appreciated assets is never taxed, even though the grantor receives the grantor's share of the appreciated fair market value of those assets. The concern the IRS has is with this manipulation of the uniform basis rules to avoid tax on gain from the sale or other disposition of appreciated assets. Transactions of this nature include a ''coordinated sale or other coordinated disposition'' of the respective interests of the grantor or other noncharitable recipient and the charity in a transaction claimed to be a sale of the entire interest in the trust. The IRS is concerned about the grantor's claim to an increased basis in the term interest coupled with the termination of the trust in a single coordinated transaction[331] to avoid tax on gain from the sale or other disposition of the appreciated assets.

Transactions that are the same as, or substantially similar to, this transaction have been identified as transactions of interest, effective October 31, 2008. Persons entering into these transactions on or after November 2, 2006, must disclose the transaction.[332] Material advisors who make a tax statement on or after November

[328] IRC § 1001(e)(3).
[329] IRC § 1001(e)(1).
[330] Reg. §§ 1.1014-5, 1.1015-1(b).
[331] IRC § 1001(e).
[332] Reg. § 1.6011-4.

2, 2006, with respect to transactions entered into on or after that date have disclosure and list maintenance obligations.[333]

Each recipient of the term (income) interest and the trust are *participants* in this transaction for each year in which their tax returns reflect tax consequences or a tax strategy described in the IRS notice.[334] The charity is not a participant if it sold or otherwise disposed of its interest in the trust on or prior to October 31, 2008. For interests disposed of after that date, the charity is a participant for the first year for which its tax return reflects or is required to reflect the sale or other disposition of the charity's interest in the trust.

In general, the charity is required to report the sale or other disposition of its interest in the trust on its return for the year of the sale or other disposition.[335] Therefore, in general, the charity will be a participant for the year in which it sells or otherwise disposes of its interest in the trust.

Persons required to disclose these transactions who fail to do so may be subject to a penalty.[336] Persons required to maintain lists of advisees[337] who fail to do so (or who fail to provide the lists when requested by the IRS) may be subject to a penalty.[338] The IRS may impose other penalties on parties involved in these transactions or substantially similar transactions, including the accuracy-related penalty.[339]

When the IRS and the Treasury Department have gathered enough information to make an informed decision as to whether this transaction is a tax avoidance–type of transaction, the IRS and Treasury may take one or more actions, such as removal of the transaction from the transactions-of-interest category in published guidance, designation of the transaction as a listed transaction, or provision of a new category of reportable transaction.

[333] Reg. §§ 1.6011-4(h), 301.6111-3(i), 301.6112-1(g).
[334] Reg. § 1.6011-4(c)(3)(i)(E).
[335] Reg. § 1.6033-2(a)(ii).
[336] IRC §§ 6707(a), 6707A.
[337] IRC § 6112.
[338] IRC § 6708(a).
[339] IRC §§ 6662, 6662A. In general, § 10.14.

PART FOUR

Planned Giving

CHAPTER ELEVEN

Valuation of Partial Interests

§ 11.1 Overview of Statutory Law 435
§ 11.2 Standard Actuarial Factors 436
§ 11.3 General Actuarial Valuations 437
§ 11.4 Nonstandard Actuarial Factors 440

Critical to the various forms of planned giving are the charitable contribution deductions, for purposes of the federal income, estate, and gift taxes. These deductions, in turn, depend in whole or large part on the valuation of the interest in the contributed property that has passed to or is destined for charitable purposes.

The federal tax law contains methods for valuing various partial interests in property, including remainder interests in charitable remainder trusts and pooled income funds, for charitable giving purposes. This valuation is done as part of the process of calculating the *present value* of an interest, used to determine the amount of the charitable contribution deduction involved.[1]

§ 11.1 OVERVIEW OF STATUTORY LAW

The valuation of partial interests in property is the subject of legislation, which created a mechanism for determining a rate of return.[2] This legislation addresses the method for valuing an annuity, any interest for life or a term of years, or any remainder or reversionary interests—for income, estate, and gift tax purposes.

Under this approach, the value of these interests is determined by using (1) a floating interest rate (rounded to the nearest two-tenths of a percent) equal to 120 percent of the applicable federal midterm rate (used to determine the issue price (value) of certain debt instruments[3]) in effect for the month in which the valuation date falls[4]; and (2) life contingencies in mortality tables[5] prescribed by the

[1] See, e.g., § 12.11, text accompanied by notes 435, 437; and § 13.11, text accompanied by notes 113–117.
[2] IRC § 7520.
[3] IRC § 1274(d)(1).
[4] The term *valuation date* means the date as of which the valuation is made. IRC § 7520(d). Generally, it is the date on which the transaction takes place. Reg. § 1.7520-1(b)(1)(ii). See §§ 12.10, 13.11.
[5] The term *tables* includes formulas. IRC § 7520(e).

IRS in the tax regulations or elsewhere.[6] The IRS publishes a revenue ruling each month, stating the appropriate interest rate.[7]

Thus, an element of this valuation is made by means of tables prepared by the IRS[8] using the most recent mortality experience available.[9] These tables must be revised at least once every 10 years to take into account the most current mortality experience available as of the time of the revision.[10]

One can make an election to have the present value of the charitable interest (for income, estate, or gift tax charitable contribution purposes) computed by use of the federal midterm rate for either of the two months preceding the month in which the transfer is made (or, more technically, in which the valuation date falls).[11] This is known as the *prior-month election rule*. Otherwise, the interest rate used is the rate in effect in the month in which the gift is made.

An individual makes the prior-month election by so indicating on the appropriate tax return and identifying the elected month. The IRS stated that failure to include with the return other information that is required to describe the transfer, whether or not the election is made, will ordinarily not invalidate this election.[12] The tax regulations provide that the election is normally made on a timely filed tax return for the year of the transfer.[13] The election may also be made or changed, however, on an amended or supplemented return that is made within 24 months after the original return was filed.[14]

When a person transfers more than one interest in the same property, the person must use the same rate with respect to each interest.[15]

§ 11.2 STANDARD ACTUARIAL FACTORS

The actuarial tables that have been set forth in the regulations from time to time have (to date) listed only those factors most frequently needed by donors and donees. Generally, these actuarial tables have included the one-life annuity, income, and remainder factors for ages 0 through 109; and the term-certain annuity, income, and remainder factors for periods of 1 through 60 years. These one-life and term-certain factors are known as *standard actuarial factors* or, sometimes, *standard section 7520 actuarial factors*. A beneficial interest in a pooled income fund is not ordinarily valued using a standard income or remainder interest factor; the present value of a beneficial interest in a pooled income fund is determined according to rules and special remainder factors.[16]

Other standard actuarial factors that are less frequently needed are included in tables that the IRS publishes from time to time; these books of tables may be

---

[6] IRC § 7520(a). For income tax purposes, this rate is the subject of Reg. § 1.7520-1(b)(1)(i).
[7] Reg. § 601.601(d)(2)(ii)(b). A chart of these interest rates appears as Appendix H.
[8] IRC § 7520(a)(1).
[9] IRC § 7520(c)(3).
[10] *Id*.
[11] IRC § 7520(a), second sentence.
[12] Preamble to federal tax valuation regulations, T.D. 8540.
[13] Reg. § 1.7520-2(b).
[14] Reg. § 1.7520-2(b)(1).
[15] IRC § 7520(a), last sentence.
[16] See ch. 13. If, however, the individual who is the measuring life is terminally ill at the time of the transfer, special rules apply (e.g., Reg. § 1.7520-3(b)(2)(iv)). See § 11.4.

purchased from the government. The tables in these books include two-life actuarial factors, as well as many one-life factors and term-certain factors not found in the tables in the regulations.[17] These publications also include a number of examples that illustrate how to compute special actuarial factors, such as the annuity, income, or remainder factor for a period limited to the lesser of a term certain or a lifetime. Special actuarial factors have, for many years, been referred to as such in the regulations.[18]

Special actuarial factors that may apply to more unusual situations may be computed by the appropriate person or, upon request, by the IRS, using actuarial methods consistent with those used to compute the standard actuarial factors that appear in the tables in the regulations and in the IRS's publications. Examples of these more unusual situations include an annuity payable for more than two lives, a right to income for a term certain or until the prior death of the first to die of two individuals, and the right to receive a remainder after a term certain if an individual survives the term.[19] (There are computer programs that calculate income and remainder interests.)

In calculating a standard actuarial factor, certain assumptions are made. For all standard actuarial factors in the single-life and term-certain tables in the regulations,[20] the interest rate for enjoyment or the postponement of enjoyment is the applicable monthly interest rate.[21] In the case of a life annuity, income, or remainder factor, the basis for mortality rates for measuring lives is the data in an IRS mortality component table.[22] In unusual situations, however, when special actuarial factors must be computed, one or more alternative assumptions may be appropriate. For example, if the actual income is known to be below applicable standards, the monthly interest rate may not be used to project the trust income yield. Similarly, if a measuring life is that of a terminally ill individual, the standard mortality data from the mortality component table may not be used as the mortality basis. Nevertheless, even though one or both of these exceptions is applicable in a case, the monthly interest rate will ordinarily be used to discount the value of the right to any postponed enjoyment.

§ 11.3 GENERAL ACTUARIAL VALUATIONS

In cases requiring the valuation of ordinary annuities, income interests, and remainder and reversionary interests, the courts have consistently recognized the need to use the standard actuarial factors prescribed by the federal tax regulations.[23]

The income tax regulations provide for general actuarial valuations in this area, applicable to certain transactions after April 30, 1989.[24] These regulations state that the fair market value of annuities, interests for life or for a term of years

[17] See § 11.3, text accompanied by *infra* notes 39–42.
[18] See, e.g., Reg. § 20.2055-2(f)(5).
[19] See, e.g., Priv. Ltr. Rul. 8601033.
[20] Reg. § 20.2031-7(d).
[21] See § 11.1.
[22] Table 80CNSMT.
[23] See, e.g., *Ithaca Trust v. United States*, 279 U.S. 151 (1929).
[24] Reg. § 1.7520-1(a)(1).

(including unitrust interests), remainders, and reversions is their *present value*.[25] Valuations in connection with transfers to pooled income funds are the subject of separate regulations,[26] as are transfers after that date to charitable remainder trusts.[27]

These regulations discuss the two components of valuation.[28] These components are the monthly interest rate[29] and the mortality component. The latter reflects the mortality data most recently available from the U.S. census. As new mortality data becomes available after each decennial census, the mortality component is revised and updated tables are published.[30] The mortality component table[31] is contained in the estate tax regulations.[32]

The actuarial factors for determining these values (present values) are included in tables in the regulations or in IRS publications.[33] If a special factor is required to value an interest, the IRS will furnish the factor upon a request for a ruling.[34]

The following tables are in the regulations:[35]

- Table S—used in determining the present value of a single-life remainder interest in a pooled income fund.[36]
- Table D (actuarial factors used in determining the present value of a remainder interest postponed for a term of years), Table U(1) (actuarial factors for one life), and Table F (payout factors)—used in determining the present value of a remainder interest in a charitable remainder unitrust.[37]
- Table S (actuarial factors for one life), Table B (actuarial factors used in determining the present value of an interest for a term of years), Table K (annuity end-of-interval adjustment factors), Table J (term-certain annuity beginning-of-interval adjustment factors), and Table 90CM (mortality components)—used in determining the present value of annuities, life estates, remainders, and reversions.[38]

The following tables are in separate publications:[39]

- Tables of valuation factors and examples that show how to compute other valuation factors, used in determining the present value of annuities, life estates, terms of years, remainders, and reversions, measured by one or

---

[25] *Id*. See also Reg. §§ 1.7520-1(c), 1.7520-2(a)(1).
[26] These separate regulations are cross-referenced in Reg. § 1.7520-1(a)(2). See § 13.11.
[27] These separate regulations are cross-referenced in Reg. § 1.7520-1(a)(3). See § 12.12.
[28] Reg. § 1.7520-1(b).
[29] See § 11.1.
[30] Reg. § 1.7520-1(b)(2). Thus, in 2000, the IRS issued final regulations (T.D. 8886), updating the actuarial tables, based on data compiled from the 1990 census, used in valuing annuities, interests for life or terms of years, and remainder or reversionary interests.
[31] Table 80CNSMT.
[32] Reg. § 20.2031-7(d).
[33] Reg. § 1.7520-1(c).
[34] *Id*. A request for a ruling must comply with the instructions for requesting a ruling (the most recent version is in Rev. Proc. 2009-1, 2009-1 C.B. 1), as well as Reg. §§ 601.201 and 601.601(d)(2)(ii)(b), and must include payment of the requisite user fee.
[35] Reg. § 1.7520-1(c)(1).
[36] Reg. § 1.642(c)-6(e)(6).
[37] Reg. § 1.664-4(e)(6).
[38] Reg. § 20.2031-7(d)(6).
[39] Reg. § 1.7520-1(c)(2).

two lives. These factors may also be used in the valuation of interests in a charitable remainder annuity trust and a pooled income fund.[40]

- Term-certain tables and tables of one- and two-life valuation factors for determining the present value of remainder interests in a charitable remainder unitrust.[41]
- Tables for computing depreciation adjustment factors.[42]

The prior-month election rule is explained,[43] including the time and manner for making the election.[44] The rules applicable in the case of transfer of more than one interest in the same property are summarized.[45] The estate tax rules pertaining to the foregoing are generally identical,[46] as are the gift tax rules.[47]

There are additional valuation rules in the estate tax context.[48] There are rules for valuing remainder interests in charitable remainder trusts, other remainder and reversionary interests, other term-of-years and life interests, and annuities;[49] certain actuarial tables are presented.[50] Comparable rules in the gift tax setting have been promulgated.[51]

As noted, there are specific income, estate, and gift tax rules concerning the valuation of a remainder interest in property transferred to a pooled income fund.[52] The one-life actuarial tables are stated in the regulations.[53] Likewise, there are income, estate, and gift tax rules concerning the valuation of a remainder interest in property transferred to a charitable remainder unitrust.[54]

The income, estate, and gift tax regulations contain a listing of sections of the Internal Revenue Code that are not subject to the monthly interest rate rules,[55] and a description of transitional rules for income, estate, and gift tax valuations.[56]

In general, for transfers of remainder interests, the present value of the remainder interest is determined[57] by use of the interest rate component on the date the interest is transferred, unless the prior-month rule is elected.[58]

The value of a remainder interest in real property (such as a remainder interest in a personal residence[59]) following only one life is determined under the estate tax rules,[60] using the interest rate and life contingencies prescribed for the

[40] Actuarial Values, Alpha Volume (IRS Pub. 1457).
[41] Actuarial Values, Beta Volume (IRS Pub. 1458).
[42] Actuarial Values, Gamma Volume (IRS Pub. 1459).
[43] Reg. § 1.7520-2(a)(2).
[44] Reg. § 1.7520-2(b).
[45] Reg. § 1.7520-2(a)(3).
[46] Reg. §§ 20.7520-1, -2.
[47] Reg. §§ 20.7520-1, -2.
[48] Reg. § 20.2031-7(a), (d)(1).
[49] Reg. § 20.2031-7(d)(2).
[50] Reg. § 20.2031-7(d)(6).
[51] Reg. § 25.2512-5.
[52] Reg. § 1.642(c)-6.
[53] Reg. § 1.642(c)-6(e)(5).
[54] Reg. § 1.664-4.
[55] Reg. §§ 1.7520-3, 20.7520-3, 25.7520-3, respectively.
[56] Reg. §§ 1.7520-4, 20.7520-4, 25.7520-4, respectively.
[57] Reg. § 25.2512-5.
[58] Reg. § 1.170A-12(a)(3).
[59] See § 15.2(a).
[60] Reg. § 20.2031-7A.

date of the gift.[61] If any part of the real property is subject to exhaustion, wear and tear, or obsolescence, however, a special factor must be used in valuing the remainder interest in that part. Further, if any part of the property is subject to depletion of its natural resources, the depletion is taken into account in determining the value of the remainder interest.[62]

If the valuation of the remainder interest in depreciable property depends on the continuation of one life, then, as noted, a special factor (carried to the fifth decimal place) must be used. The special factor is to be computed on the basis of the interest rate and life contingencies prescribed in the estate tax regulations[63] and on the assumption that the property depreciates on a straight-line basis over its estimated useful life.[64]

§ 11.4 NONSTANDARD ACTUARIAL FACTORS

The monthly interest rate rules do not apply for purposes of any provision that may be specified in the tax regulations.[65] As noted, the courts consistently recognize the need to use the standard actuarial factors prescribed by the regulations.[66] At the same time, the courts recognized that use of the standard actuarial factors is inappropriate in certain instances.[67] The U.S. Tax Court held that the standard actuarial factors cannot be used if the individual whose life is the measuring life is terminally ill.[68] Also, a court refused to ascribe value to an income interest (for purposes of the estate tax credit for tax on prior transfers[69]) when the death of the transferee was simultaneous with the death of the transferor.[70] Further, the IRS ruled that, in cases in which the individual's death is imminent, the standard actuarial factors prescribed by the regulations may not be used.[71]

---

[61] Reg. § 1.170A-12(b)(1).
[62] *Id.*
[63] Reg. § 20.2031-7.
[64] Reg. § 1.170A-12(b)(2). See § 2.19 (as to depreciation).
[65] IRC § 7520(b).
[66] See text accompanied by *supra* note 23.
[67] See, e.g., *Robinette v. Helvering*, 318 U.S. 184 (1943) (reversionary interest with several interdependent contingencies); *Stark v. United States*, 477 F.2d 131 (8th Cir.), *cert. denied*, 414 U.S. 975 (1973) (closely held stock that was not publicly traded and did not pay dividends); *O'Reilly v. Commissioner*, 973 F.2d 1403 (8th Cir. 1992), *remanded*, 67 T.C.M. (CCH) 2176 (1994) (disparity between a 0.2 percent yield and 10 percent tables produced unrealistic and unreasonable result); *Froh v. Commissioner*, 100 T.C. 1 (1993) (similar holding involving depletable property); *Commissioner v. Sternberger Estate*, 348 U.S. 187 (1955) (charitable bequest that would occur only if decedent's unmarried daughter died without issue surviving her and her mother). One appellate court stated that "where there is sufficient evidence regarding the actual life expectancy of a life tenant, the presumptive correctness of the Treasury tables will be overcome." *Miami Beach First Nat'l Bank v. United States*, 443 F.2d 116, 119–20 (5th Cir. 1971).
[68] See, e.g., *McLendon Estate v. Commissioner*, 135 F.3d 1017 (5th Cir. 1998), *rev'g* 72 T.C.M. (CCH) 42 (1996); *id.*, 96-1 U.S.T.C. ¶ 60,220 (5th Cir. 1995), *rev'g & remanding* 66 T.C.M. (CCH) 946 (1993); *Jennings Estate v. Commissioner*, 10 T.C. 323 (1948); *Denbigh Estate v. Commissioner*, 7 T.C. 387 (1946).
[69] IRC § 2013.
[70] *Carter v. United States*, 291 F.2d 63 (5th Cir. 1991).
[71] Rev. Rul. 80-80, 1980-1 C.B. 194. In *Shapiro Estate v. Commissioner*, 66 T.C.M. (CCH) 1067 (1993), the U.S. Tax Court allowed an individual to value an annuity with a standard one-life annuity actuarial factor from Table A in Reg. § 20.2031-7(f), in a situation in which the annuity could have exhausted the fund from which the annuity was to be paid before the death of the annuitant. The IRS is of the view that the annuity factor that should have been used in this case is a special annuity factor for the right to receive annual payments for four years or until the prior death of the annuitant. See, e.g., Rev. Rul. 77-454, 1977-2 C.B. 351; see also *Moffet v. Commissioner*, 269 F.2d 738 (4th Cir 1959), *and United States v. Dean*, 224 F.2d 26 (1st Cir. 1955). The IRS refuses to follow the result in *Shapiro Estate*.

Income, estate, and gift tax regulations contain exceptions to the use of standard valuation tables for valuing annuities, interests for life or a term of years, and remainder or reversionary interests.[72] These regulations apply in valuing all interests that would, but for the exceptions, be valued under the general rules.[73]

These regulations set forth specific sections of the Internal Revenue Code that are exempt from the standard valuation rules. The rules describe other areas in which the valuation methodology applicable to standard and special actuarial factors is not to be used.

Generally, if the interest in property that is to be valued is not an ordinary annuity, income interest, or remainder interest,[74] the standard annuity, income, and remainder factors in the tables of factors set forth in the regulations and IRS publications cannot be used. In some cases in which the standard factors from the regulations and publications tables cannot be used, a special factor may be computed by the appropriate person or by the IRS. In other instances in which the standard or special factors may not be used, the property interest may be valued using other valuation techniques. Depending on the facts and circumstances, a property interest that cannot be valued using the standard or special factors may not have an ascertainable value.

A standard interest factor for an ordinary remainder (or reversionary) interest may not be used to determine the present value of the interest (whether in trust or otherwise) unless, consistent with the preservation and protection that the law of trusts would give a person who is unqualifiedly designated as the remainder beneficiary of a trust for a similar duration, the effect of the administrative and dispositive provisions for the interest (or interests) that precede the remainder interest is to assure that the property will be adequately preserved and protected (such as from erosion, invasion, depletion, or damage) until the remainder interest takes effect in possession and enjoyment.[75] This degree of preservation and protection is provided only if it was the transferor's intent, as manifested by the provisions of the arrangement and the surrounding circumstances, that the entire disposition provide the remainder interest beneficiary with an undiminished interest in the property transferred at the time of termination of the prior interest.[76]

As to income and similar interests, a standard income factor may not be used to determine the present value of the interest in trust for a term of years or for the life of one or more individuals unless the effect of the trust, will, or other governing instrument is to provide the income beneficiary with that degree of beneficial enjoyment of the property, during the term of the income interest, that the principles of the law of trusts accord to a person who is unqualifiedly designated as the income beneficiary of a trust for a similar period of time.[77] This degree of beneficial enjoyment is provided only if it was the transferor's intent, as manifested by the provisions of the governing instrument and the surrounding circumstances,

---

[72] T.D. 8630.

[73] See § 11.1.

[74] These terms are defined in Reg. § 1.7520-3(b)(1). Identical regulations apply in the estate and gift tax contexts. Reg. §§ 20.7520-3, 25.7520-4. From this footnote through note 84, only the income tax regulation is cited.

[75] Reg. § 1.7520-3(b)(2)(iii).

[76] *Id*.

[77] Reg. § 1.7520-3(b)(2)(ii)(A).

that the trust provide an income interest for the income beneficiary during the specified period of time that is consistent with the value of the trust corpus and with its preservation. In determining whether a trust arrangement evidences that intention, the treatment required or permitted with respect to individual items must be considered in relation to the entire system provided for in the administration of the trust. Similarly, in determining the present value of the right to use tangible property (whether or not in trust) for one or more measuring lives or for some other period of time, the standard interest rate component may not be used unless, during the period, the effect of the trust, will, or other governing instrument is to provide the beneficiary with that degree of use, possession, and enjoyment of the property during the term of the interest that applicable state law accords to a person who is unqualifiedly designated as a life tenant or term holder for a similar period of time.[78]

Also, a standard income factor for an ordinary income interest may not be used to value an income interest or similar interest in property for a term of years or for one or more measuring lives under two circumstances. One is when the trust, will, or other governing instrument requires or permits the beneficiary's income or other enjoyment to be withheld, diverted, or accumulated for another person's benefit without the consent of the income beneficiary. The other is when the governing instrument requires or permits trust corpus to be withdrawn from the trust for another person's benefit, during the income beneficiary's term of enjoyment. without the consent of and accountability to the income beneficiary for the diversion.[79]

A standard annuity factor may not be used to determine the present value of an annuity for a specified term of years or for the life of one or more individuals unless the effect of the trust, will, or other governing instrument is to ensure that the annuity will be paid for the entire defined period.[80] In the case of an annuity payable from a trust or other limited fund, the annuity is not considered payable for the entire defined period if, considering the applicable interest rate at the valuation date of the transfer, the annuity is expected to exhaust the fund before the last possible annuity payment is made in full. For this purpose, it must be assumed that it is possible for each measuring life to survive until age 110.[81]

The regulations contain rules concerning the mortality component of the transferred interest. The IRS previously addressed this issue. One ruling stated that the value of a life or remainder interest would be determined by taking into account the health of the life tenant if it was known on the valuation date that the life tenant was afflicted with a fatal and incurable disease in its advanced stages and that the life tenant could not survive for more than a brief period of time.[82] Subsequently, the IRS clarified the ''brief period'' test, stating that the standard life actuarial factors are to be applied to value the interest unless death is clearly

---

[78] *Id*.
[79] Reg. § 1.7520-3(b)(2)(ii)(B).
[80] Reg. § 1.7520-3(b)(2)(i).
[81] *Id*.
[82] Rev. Rul. 66-302, 1966-2 C.B.429.

imminent.[83] The IRS is of the view that this test does not satisfactorily quantify the probability of death occurring within one year from the valuation date and that the test may permit the use of standard actuarial factors in inappropriate situations. These regulations explicitly quantify the applicable standard for purposes of applying this test.

Under the regulations, if an individual who is a measuring life of the interest being transferred is known to be terminally ill, the mortality component of the general rules may not be used; a special actuarial factor—rather than a standard actuarial factor—must be used in valuing the interest.[84] *Terminal illness* is defined as an incurable illness or other deteriorating physical condition when there is at least a 50 percent probability that the individual will not survive for more than one year from the valuation date. Exceptions are made for special situations.[85]

In the instance of the simultaneous death of the transferor and an individual who is the measuring life of a property interest, the regulations specifically preclude use of the standard factors in the tables to value that interest.

[83] Rev. Rul. 80-80, 1980-1 C.B. 194. This revenue ruling, along with Rev. Rul. 66-302, 1966-2 C.B.429, was superseded by these regulations addressing nonstandard actuarial factors. Rev. Rul. 96-3, 1996-1 C.B. 348. The efficacy of Rev. Rul. 80-80 during its time was upheld by the U.S. Court of Appeals for the Fifth Circuit in *McLendon Estate v. Commissioner*, 135 F.3d 1017 (5th Cir. 1998).

[84] Reg. § 1.7520-3(b)(3).

[85] Under IRC §§ 2013, 2037, and 2042.

CHAPTER TWELVE

Charitable Remainder Trusts

§ 12.1 **Definitions** **446**
- (a) Basic Terminology 446
- (b) Trust Requirement 455
- (c) Substantial Compliance Doctrine 456

§ 12.2 **Charitable Remainder Annuity Trust Rules** **457**
- (a) Payment of Annuity Amount 457
- (b) Minimum Annuity Amount 459
- (c) Maximum Annuity Amount 460
- (d) Permissible Income Recipients 460
- (e) Other Payments 462
- (f) Period of Payment of Annuity 463
- (g) Permissible Remainder Interest Beneficiaries 464
- (h) Additional Contributions 467
- (i) Minimum Value of Remainder Interest 467
- (j) Charitable Deductions 468

§ 12.3 **Charitable Remainder Unitrust Rules** **469**
- (a) Payment of Unitrust Amount 469
- (b) Minimum Unitrust Amount 474
- (c) Maximum Unitrust Amount 475
- (d) Permissible Income Recipients 475
- (e) Other Payments 478
- (f) Period of Payment of Unitrust Amount 478
- (g) Permissible Remainder Interest Beneficiaries 480
- (h) Additional Contributions 481
- (i) Minimum Value of Remainder Interest 482
- (j) Charitable Deductions 483

§ 12.4 **Issues** **483**
- (a) Transfers of Options 484
- (b) Right to Change Charities or Trustees 487
- (c) Transfers of Tangible Personal Property 488
- (d) Allocation of Gains to Income 489
- (e) Death Taxes 490
- (f) Valuation of Unmarketable Assets 491
- (g) Time for Paying Income Amount 491
- (h) Determining Certain Gift Amounts 492
- (i) Scriveners' Errors 494
- (j) University Endowment Investment Sharing with CRTs 495
- (k) CRTs as Partners or Shareholders in REITs 496

§ 12.5 **Tax Treatment of Distributions** **497**
- (a) Characterization and Ordering Rules—In General 497

(b) Capital Gains Taxation 498
(c) Other Requirements 499
(d) Tax Treatment of Other Distributions 501
(e) Anti-Abuse Rules 501
(f) Characterization and Ordering Rules 504
§ 12.6 Division of Charitable Remainder Trusts 507
(a) Situation 1 507
(b) Situation 2 508
(c) Issue 1 (Qualification of Trusts) 509
(d) Issue 2 (Basis) 509
(e) Issue 3 (Holding Period) 509
(f) Issue 4 (Private Foundation Status) 510
(g) Issue 5 (Termination Tax) 510
(h) Issue 6 (Self-Dealing) 510
(i) Issue 7 (Taxable Expenditures) 511
§ 12.7 Early Terminations of Charitable Remainder Trusts 511
§ 12.8 Taxation of Charitable Remainder Trusts 512
§ 12.9 Mandatory Provisions 514
§ 12.10 Private Foundation Rules 514
§ 12.11 Wealth Replacement Trusts 516
§ 12.12 Calculation of Charitable Deduction 520
(a) Charitable Remainder Annuity Trusts 521
(b) Charitable Remainder Unitrusts 522
(c) Qualified Contingencies 524

In the realm of planned giving, the most common and most versatile charitable gift vehicle is the split-interest trust termed the *charitable remainder trust*.[1] Essentially, a charitable remainder trust is what its name conveys: it is an entity by which property (including money) is split, using the legal fiction of contrivance of interests in a trust, into two types of interests: an *income interest* and a *remainder interest*. The remainder interest is destined for one or more charitable organizations, while the income interest is retained by and/or created for one or more noncharitable beneficiaries. If the trust is a qualified one, the gift of the remainder interest gives rise to one or more federal tax charitable contribution deductions.

This chapter focuses on the federal income tax charitable deduction. The availability of the federal gift and estate tax charitable deductions for gifts to charitable remainder trusts is discussed in the estate and gift tax context.[2]

§ 12.1 DEFINITIONS

The federal tax law defining charitable remainder trusts and the operation of them is extensive. It is necessary, then, to begin with the basic terminology.

(a) Basic Terminology

The most fundamental definition of a qualified charitable remainder trust (CRT) is this: A CRT provides for a specified distribution, at least annually, to one or

[1] The charitable remainder trust is the subject of IRC § 664. The term is used throughout to mean a trust that qualifies under that provision. The concepts of planned giving and split-interest trusts are discussed in ch. 5. That chapter contains a general description of charitable remainder trusts.

[2] See ch. 8.

more beneficiaries, at least one of which is not a charitable organization, for one or more lives or for a term of years, with an irrevocable remainder interest to be paid over to, or held for the benefit of, charity.[3] The contribution of the remainder interest must be deductible for federal income, gift, and/or estate tax purposes.[4]

The terms *income interest* and *remainder interest* are used in their singular form, in that the income interest and remainder interest in an item of property constitute the total interest in the property. At the same time, there can be *income interests* in an item of property in a CRT and/or *remainder interests* in an item of property in a CRT, in the sense that more than one person can share the interest. Again, the income interest is the basis of payments to one or more noncharitable beneficiaries during the period preceding the time the charity or charities[5] receive the property in the trust. The remainder interest is what the charity or charities receive upon the expiration of the income interest.

Fundamentally, there are two types of CRTs: the *charitable remainder annuity trust* (CRAT) and the *charitable remainder unitrust* (CRUT). Although there are other differences, the principal distinction between a CRAT and a CRUT is the manner in which the income interest—the amount of income to be paid out to one or more eligible beneficiaries—is computed.

A CRAT has the following characteristics; it is a trust:

- From which a sum certain is to be paid, not less often than annually, to one or more persons (at least one of which is not a charitable organization and, in the case of individuals, only to an individual who is living at the time of creation of the trust),[6]
- From which the sum certain is to be paid for a term of years (not in excess of 20 years) or for the life or lives of the individual or individuals,
- Where the sum certain is not less than 5 percent of the initial net fair market value of all property placed in the trust,
- Where the sum certain is not greater than 50 percent of the initial net fair market value of all property placed in the trust,
- From which no amount, other than the income interest payments and certain qualified gratuitous transfers,[7] may be paid to or for the use of any person other than a charitable organization,
- Where the value of the remainder interest[8] is at least 10 percent of the initial net fair market value of all property placed in the trust, and
- Following the termination of the income interest payments, the remainder interest in the trust is to be transferred to, or for the use of, a charitable organization or is to be retained by the trust for a charitable use.[9]

---

[3] Reg. § 1.664-1(a)(1)(i).
[4] Reg. § 1.664-1(a)(1)(iii)(a).
[5] For this purpose, a *charity* or *charitable donee* is an organization described in IRC § 170(c). This classification entails nearly all IRC § 501(c)(3) organizations and certain other donees. See § 3.3.
[6] A person receiving an income payment from a CRT is sometimes termed a *recipient*. Reg. § 1.664-1(a)(1)(iii)(d).
[7] See § 12.2(g)(ii).
[8] See § 12.12.
[9] IRC § 664(d)(1); Reg. § 1.664-1 (a)(1)(i).

Basically, a *sum certain* is an annuity (a fixed amount). This income interest payment is termed the *annuity amount*.[10]

A CRUT has the following characteristics; it is a trust:

- From which an amount equal to a fixed percentage of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not a charitable organization) and, in the case of individuals, only to an individual who is living at the time of creation of the trust,[11]
- From which this amount—the *unitrust amount*—is to be paid for a term of years (not in excess of 20 years) or for the life or lives of the individual or individuals,
- Where the unitrust amount is not less than 5 percent of the net fair market value of the trust's assets,
- Where the unitrust amount is not greater than 50 percent of the value of the trust's assets determined annually,
- From which no amount, other than the income interest payments and certain qualified gratuitous transfers,[12] may be paid to or for the use of any person other than a charitable organization,
- Where the value of the remainder interest[13] in each item of property contributed to the trust is at least 10 percent of the net fair market value of that property as of the date the property is contributed to the trust, and
- Following the termination of the income interest payments, the remainder interest in the trust is to be transferred to, or for the use of, a charitable organization or is to be retained by the trust for a charitable use.[14]

The amount paid to an income interest beneficiary of a CRUT is termed the *unitrust amount*.[15]

There are, however, variations on the concept of the CRUT. The foregoing criteria essentially define the standard CRUT (SCRUT). This trust is also known as the *fixed percentage CRUT*.[16]

There are two types of CRUTs that are known as *income-exception CRUTs*. This means that the payout rules for SCRUTs need not be followed. One of these types of CRUTs enables income to be paid to the income interest beneficiary or beneficiaries once any income has been generated in the trust.[17] This amount may be less than the 5 percent amount. With this type of CRUT, the unitrust amount is the lesser of the fixed percentage amount or the trust's annual net income. The income payments begin once a suitable amount of income has begun to flow into the trust. That is, the income payments may begin at a future point

[10] Reg. § 1.664-1(a)(1)(iii)(b).
[11] See *supra* note 6.
[12] See § 12.2(g)(ii).
[13] See § 12.12.
[14] IRC § 664(d)(2); Reg. § 1.664-1(a)(1)(i).
[15] Reg. § 1.664-1(a)(1)(iii)(c).
[16] Reg. § 1.664-3(a)(1)(i)(a).
[17] IRC § 664(d)(3)(A).

in time and are only prospective. This form of CRUT is the *net-income CRUT* (NICRUT).[18]

The other of these types of CRUTs is similar to the NICRUT, but the trust instrument provides that, for the years in which there was no or an insufficient distribution (in relation to the 5 percent standard), the trust can, once the investment policy generates adequate income, not only begin to pay the income interest beneficiary or beneficiaries the full amount of the determined unitrust payments, but also make payments that make up for the distribution deficiencies in prior years.[19] This type of trust can thus make catch-up—or make-up—payments once the non-income-producing asset is sold. In this case, the unitrust is determined under the net-income method, with that amount also including any amount of income that exceeds the current year's fixed percentage amount to make up for any shortfall in payments from prior years when the trust's income was less than the fixed percentage amount. This *net-income make-up CRUT* is the NIMCRUT.[20]

The IRS published the following comment about NICRUTs and NIMCRUTs:

> The NIMCRUT is commonly used when the donor wants to place property that does not produce regular income and is not readily marketable into a charitable remainder unitrust. Grantors often use a NIMCRUT to hold real estate and stock or other interests in a closely held business. If the grantor were to donate only unimproved real estate to a regular unitrust, the trust would earn no income and part or all of the real estate would need to be sold in order to make the fixed payment to the noncharitable recipient. This would probably not achieve the grantor's goal, which most likely was to hold the property in trust while it appreciated. By using a NIMCRUT, the payment to the income beneficiary is $0.00, the lesser of the unitrust percentage amount or the trust accounting income. An expensive and, perhaps, fruitless effort to sell part of the trust property is avoided. In this scenario, either a NICRUT or a NIMCRUT will do.[21]

The fourth—and newest—type of CRUT is the *flip unitrust* (FLIPCRUT). The governing instrument of a FLIPCRUT provides that the CRUT will convert (flip) once from one of the income-exception methods—the NICRUT or NIMCRUT—to the fixed percentage method—the SCRUT—for purposes of calculating the unitrust amount.[22] The conversion is allowed, however, only if the specific date or single event triggering the flip—the *triggering event*—is outside the control of, or not discretionary with, the trustee or any other person or persons.[23]

Usually, the donor or donees to a CRT are an individual or individuals. There are no restrictions as to the types of persons who can be donors to a CRT, as long as the CRT requirements are satisfied. Thus, if an income interest beneficiary is to be a person other than a human being, such as a corporation, the income interest payment period must be for a term of years (not in excess of 20 years). The IRS recognized situations in which a partnership was a donor to a CRT[24] and a trust was a donor to a CRT.[25]

---

[18] Reg. § 1.664-3(a)(1)(i)(b)(1).

[19] IRC § 664(d)(3)(B).

[20] Reg. § 1.664-3 (a)(1)(i)(b)(2). The make-up amount does not have to be treated as a liability when valuing the assets of a NIMCRUT.

[21] *IRS Exempt Organizations Continuing Professional Education Program Textbook for Fiscal Year 2001*, at 87.

[22] Reg. § 1.664-3(a)(1)(i)(c).

[23] Reg. § 1.664-3(a)(1)(i)(c)(1).

[24] Priv. Ltr. Rul. 9419021.

[25] Priv. Ltr. Rul. 9821029.

A donor to a CRT must transfer property (which can be or include money) to the trust and contribute an irrevocable remainder interest in the property to or for the use of a qualified charitable organization, retaining for himself or herself, or creating for another beneficiary or beneficiaries, an income interest in the transferred property. The property may be real or personal, tangible or intangible. There are no statutory limitations on the type of property that can be transferred to a CRT.[26] The transfer of property encumbered by an indebtedness to a CRT may, however, cause the trust to have unrelated debt-financed income, which would result in income taxation of the trust.[27] Income from the distribution of the proceeds from a retirement plan contributed to a CRT is income in respect of a decedent,[28] although the income is not taxable unless the trust has unrelated business taxable income for the year.[29]

A trust is a CRT only if it is either a CRAT in every respect or a CRUT in every respect. For example, a trust that provides for the payment each year to a noncharitable beneficiary of the greater of a sum certain or a fixed percentage of the annual value of the trust assets is not a CRT, inasmuch as the trust is neither a CRAT (because the payment for the year may be a fixed percentage of the annual value of the trust assets, which is not a *sum certain*) nor a CRUT (because the payment for the year may be a sum certain, which is not a *fixed percentage* of the annual value of the trust assets).[30]

The IRS assessed the governing instrument of an otherwise qualifying CRT, which provided that the annual payment of the specified distribution (a 5 percent annuity or unitrust amount, as the case may be) to the income beneficiaries would be as follows: A is to receive $25x, B is to receive $15x, and C is to receive the balance. Upon the death of any income beneficiary, the amount of income that the beneficiary would have been entitled to receive will be retained by the trust until the death of the last income beneficiary. Upon the death of the last income beneficiary, the assets of the trust are to be distributed to the charitable organization that is the remainder interest beneficiary under the trust.

The IRS held that this trust could not qualify as a CRT.[31] The agency observed that if C dies before either A or B, the total of the designated amounts payable annually would be less than the annuity amount that must be paid out annually, in the case of a CRAT; it was also possible that the total of the designated amounts payable annually would be different from the unitrust amount that must be paid out annually, in the case of a CRUT. The IRS further noted that, even if C did not die before A or B, the designated amounts payable annually

---

[26] For example, CRTs may be funded with securities or interests in partnerships (e.g., Priv. Ltr. Rul. 9633007). Nonetheless, the IRS ruled that when it would be inappropriate to transfer an item of property to a charitable remainder trust, it would also be inappropriate to transfer to such a trust an option to purchase the property. See § 12.4(a); see also Priv. Ltr. Rul. 9417005, *withdrawing* Priv. Ltr. Rul. 9240017.

There can, of course, be other tax consequences in this area. For example, a CRT is not an eligible holder of stock in an S corporation, and thus transfer of this type of stock to a CRT can result in termination of the S corporation election. Rev. Rul. 92-48, 1992-1 C.B. 301.

[27] See § 12.8.

[28] IRC § 691.

[29] Priv. Ltr. Rul. 9633006. A like ruling pertains to distributions from an individual retirement account. Priv. Ltr. Rul. 9341008.

[30] Reg. § 1.664-1(a)(2).

[31] Rev. Rul. 76-280, 1976-2 C.B. 195.

might exceed the unitrust amount in the case of a CRUT. For example, if, in a particular tax year, 5 percent of the net fair market value of the trust assets on the valuation date equaled an amount that is less than $40x, the designated payments to A and B would exceed the unitrust amount for that tax year.

A trust is not a CRT if the trust instrument includes a provision that restricts the trustee from investing the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets.[32] It has been held that this rule does not preclude a bank, in its capacity as a trustee of a CRT, from investing the assets of the trust in common trust funds maintained by the bank.[33] Similarly, this rule does not prevent the charitable remainder beneficiary, as trustee of charitable remainder trusts, from investing the assets of the trusts in its general endowment fund.[34]

In contrast, the IRS ruled that a trust did not qualify as a CRT when the grantor of the trust contributed to the trust a collection of antiques, in addition to income-producing assets, at the time of its creation. The governing instrument of the trust provided that the grantor's spouse, who was the sole income beneficiary of the trust for her life, would have use of the antique collection for her life. At her death, the antique collection and all of the remaining assets in the trust were to be distributed to a charitable organization. The IRS held that the retention of the life estate in the antique collection for the grantor's spouse restricted the trustee from investing all the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets; therefore, the trust did not qualify as a CRT.[35]

There is no statutory limitation on the number of income beneficiaries a CRT may have. As a practical matter, however, the larger the income interest, the lesser the remainder interest,[36] so the extent of the charitable contribution deduction serves as a restraint on the number of these beneficiaries. Nonetheless, the IRS approved a CRUT that was to pay the unitrust amount in the following sequence: to the grantor for her life, then on her death in equal shares to A and B, then on the death of either of them to their survivor, then on the death of this survivor to C and D in equal shares, and then, following the death of C or D, to their survivor.[37]

For a trust to be a CRT, it must meet the definition of, and function exclusively as, a CRT from the creation of the trust. For this purpose, the trust will be deemed to be created at the earliest time that neither the grantor nor any other person is treated as the owner of the entire trust under the grantor trust rules,[38] but in no event prior to the time property is first transferred to the trust. Neither the grantor nor his or her spouse is treated as the owner of the trust merely because the grantor or his or her spouse is named as an income interest beneficiary.[39]

---

[32] Reg. § 1.664-1(a)(3).
[33] Rev. Rul. 73-571, 1973-2 C.B. 213.
[34] Rev. Rul. 83-19, 1983-1 C.B. 115. The IRS ruled that a trustee could borrow from the assets of an insurance policy held by a charitable remainder trust without disqualifying the trust. Priv. Ltr. Rul. 8745013.
[35] Rev. Rul. 73-610, 1973-2 C.B. 213.
[36] See § 12.12.
[37] Priv. Ltr. Rul. 9652011.
[38] See § 3.7.
[39] Reg. § 1.664-1(a)(4).

For federal estate tax purposes, a CRT is deemed to be created on the date of death of the decedent (even though the trust is not funded until the end of a reasonable period of administration or settlement) if the obligation to pay the annuity amount or unitrust amount with respect to the property passing in trust at the death of the decedent begins as of the date of death of the decedent, notwithstanding the fact that the requirement to pay the amount is deferred. If permitted by applicable local law or authorized by the provisions of the governing instrument of the trust, the requirement to pay the annuity amount or unitrust amount may be deferred until the end of the tax year of the trust in which complete funding of the trust occurs.[40] Within a reasonable period after that time, the trust must pay the income beneficiary (in the case of an underpayment) or must receive from the income beneficiary (in the case of an overpayment) the difference between (1) any annuity amounts or unitrust amounts actually paid, plus interest on these amounts computed at the appropriate rate of interest[41] compounded annually; and (2) the annuity amounts or unitrust amounts payable, plus interest on these amounts computed at the appropriate rate of interest compounded annually. The amounts payable must be retroactively determined by using the tax year, valuation method, and valuation dates ultimately adopted by the CRT.[42] The governing instrument of a testamentary CRT must contain rules conforming to these requirements.[43]

For purposes of retroactively determining the unitrust amount payable, plus interest, the governing instrument of a CRUT may provide that the unitrust amount with respect to property passing in trust at the death of the decedent, for the period that begins on the date of death of the decedent and ends on the earlier of the date of death of the last income beneficiary or the end of the tax year of the trust in which complete funding of the trust occurs, be computed by a formula contained in the tax regulations.[44] This alternative is available because, in many cases (for example, in the case of a residuary bequest to a CRUT), the unitrust payments the beneficiary would have received if the trust had been fully funded and functioning on the date of death, plus interest, are difficult to calculate.[45]

The application of the rules concerning the creation of a CRT is illustrated by the following examples.

---

[40] Reg. § 1.664-1(a)(5)(i).

[41] Reg. § 1.664-1(a)(5)(iv).

[42] Reg. § 1.664-1(a)(5)(i). It is thus clear that this rule is confined to testamentary trusts funded for the first time after the grantor's death; it cannot be used, with respect to an irrevocable trust established and funded by an individual during his or her lifetime, to excuse noncompliance with the CRT rules during the period preceding the trustor's death. See, e.g., *Estate of Atkinson v. Commissioner*, 115 T.C. 26 (2000).

[43] Rev. Rul. 80-123, 1980-1 C.B. 205.

[44] Reg. § 1.664-1(a)(5)(ii).

[45] A sample provision reflecting this formula appears in Rev. Rul. 77-471, 1977-2 C.B. 322. Thereafter, the IRS determined that interest should be added to the unitrust amount calculated under this approach, and published sample provisions containing that feature. Rev. Rul. 88-81, 1988-2 C.B. 127; Rev. Rul. 82-165, 1982-2 C.B. 117. After that, the IRS decided that the model language published in 1988 and 1982 was erroneous, and that the provision that appeared in 1977 was correct. Rev. Rul. 92-57, 1992-2 C.B. 123.

EXAMPLE 12.1

On September 19, 2008, H transferred property to a trust over which he retained an inter vivos power of revocation. The trust was to pay W 5 percent of the value of the trust assets, valued annually, for her life, with the remainder to charity. The trust would have satisfied all of the requirements of the CRT rules if it had been irrevocable. The trust was not deemed created in 2008, however, because H was treated as the owner of the entire trust. On May 26, 2009, H predeceased W, at which time the trust became irrevocable. For purposes of the charitable trust rules, the trust was deemed created on May 26, 2009, because that was the earliest date on which H was not treated as the owner of the entire trust. The trust became a CRT on May 26, 2009, because it met the definition of a CRT from its creation.[a]

[a] Reg. § 1.664-1(a)(6), example (1).

EXAMPLE 12.2

The facts are the same as in Example 12.1, except that H retained the inter vivos power to revoke only one-half of the trust. For purposes of the charitable remainder trust rules, the trust was deemed created on September 19, 2008, because on that date the grantor was not treated as the owner of the entire trust. Consequently, a charitable deduction was not allowable either at the creation of the trust or at the death of H, because the trust did not meet the definition of a CRT from the date of its creation. This is so because from the date of its creation, the trust was subject to a partial power to revoke on that date.[a]

[a] Reg. § 1.664-1(a)(6), example (2).

EXAMPLE 12.3

The facts are the same as in Example 12.1, except that the residue of H's estate was to be paid to the trust and the trust was required to pay H's debts. The trust was not a CRT at H's death because it did not function exclusively as a CRT from the date of its creation—which, in this case, was the date it became irrevocable.[a]

[a] Reg. § 1.664-1(a)(6), example (3).

EXAMPLE 12.4

In 2009, H transferred property to Trust A, over which he retained an inter vivos power of revocation. Trust A, which is not a CRT, was to provide income or corpus to W until the death of H. Upon H's death, the trust was required by its governing instrument to pay the debts and administrative expenses of H's estate, and then to terminate and distribute all of the remaining assets to Trust B, which met the definition of a CRT.

Trust B was a CRT from the date of its funding because it functioned as a CRT from its creation. For purposes of the estate tax charitable deduction,[a] Trust B was deemed created at H's death if the obligation to pay the annuity amount began on the date of H's death. For purposes of the CRT rules, Trust B became a CRT as soon as it was partially or completely funded. Consequently, unless Trust B has unrelated business taxable income,[b] the income of the trust is exempt from federal tax and any distributions by the trust, even before it is completely funded, are governed by the CRT rules. Any distributions made by Trust A, including distributions to a recipient in respect of annuity amounts, are governed by general trust rules[c] rather than the CRT rules.[d]

[a] Reg. § 2055. See ch. 8.
[b] See §§ 12.8, 3.5.
[c] IRC subch. J, ch. 1, subtit. A.
[d] Reg. § 1.664-1(a)(6), example (4).

Example 12.5

In 2009, H died intestate, leaving the net residue of his estate (after payment by the estate of all debts and administrative expenses) to a trust that met the definition of a CRUT. For purposes of the estate tax charitable deduction, the trust was deemed created at H's death if the requirement to pay the unitrust amount began on H's death; thus, it is a CRT, even though the estate was obligated to pay debts and administrative expenses. For purposes of the CRT rules, the trust became a CRT as soon as it was partially or completely funded. Consequently, unless the trust has unrelated business income, the income of the trust is exempt from federal tax, and any distributions by the trust, even before it is completely funded, are governed by the CRT rules. Any distributions made by H's estate, including distributions to a recipient in respect of unitrust amounts, are governed by general trust rules rather than the CRT rules.[a]

[a] Reg. § 1.664-1(a)(6), example (5).

Example 12.6

X is 50 years of age and is contemplating retiring in 10 years. X owns A, a parcel of appreciating real estate. X places this property in a NIMCRUT. The trust does not make a current payment to X, as it does not have any income. This continues for 10 years. In year 10, X retires and the trustee sells the property. The trust now pays X the unitrust percentage, which is 7 percent. The trust is earning 11 percent. The make-up provision of the NIMCRUT can now be used to pay X additional payments to make up the payments that were not received in the earlier years. X now has additional retirement income at a time when X may be in a lower income tax bracket.[a]

[a] *IRS Exempt Organizations Continuing Professional Education Program Textbook for Fiscal Year 2001*, at 87.

Example 12.7

A and B, husband and wife, want to be able to help fund the college expenses of their granddaughter, C. C is 10 years of age. A and B own property that currently is appreciating in value without producing income. They are advised to establish a FLIPCRUT. The unitrust amount is set at 10 percent. For the first eight years, the trust will be a NIMCRUT. C is the beneficiary, but she does not receive any income during the eight-year NIMCRUT period. The triggering event to flip the trust is C's 18th birthday. The property has significantly appreciated in value. It is sold and the proceeds are invested in income-producing assets. Any trust accounting income received during the year of C's 18th birthday that is in excess of the 10 percent unitrust amount may be paid to C under the make-up provision upon the flip to a SCRUT; any unpaid make-up amount is forfeited. The trust assets have greatly appreciated in value, so the 10 percent payout amount received by C should be sufficient to fund her college expenses. Even if the trust income is inadequate for this purpose, inasmuch as the trust is now a SCRUT, corpus can be invaded to pay the unitrust amount. A and B will obtain a charitable contribution deduction based on the present value of the remainder interest upon creating the trust, but the present value of C's unitrust interest will be subject to gift and generation-skipping transfer tax.[a] A and B will not have to pay capital gains taxes on the sale of the property. Income from the trust will be taxed at C's lower tax rate. The property will be removed from the estate of A and B, thereby lowering their estate tax.[b]

[a] See ch. 8.
[b] *IRS Exempt Organizations Continuing Professional Education Program Textbook for Fiscal Year 2001*, at 88.

If a trust would, but for a qualified contingency, meet the requirements of the rules concerning CRATs or CRUTs, it is considered as having met the requirements.[46] A qualified contingency is not taken into account in determining the

[46] IRC § 664(f)(1).

amount of a charitable contribution (or the actuarial value of any interest).[47] A *qualified contingency* is any provision of a trust stating that, upon the happening of a contingency, the annuity amounts or the unitrust amounts (as the case may be) will terminate no later than the payments would otherwise terminate under the trust.[48] For example, a qualified contingency was ruled to have arisen when a CRUT was created under these terms of a will; the unitrust amount was to be paid to B, and the trust's term was to end at the death of B or C, whichever occurred sooner. The provision in the will for the possible early termination of the unitrust amount constituted the qualified contingency.[49]

A CRT instrument[50] generally cannot be amended, except to ensure that it qualifies and continues to qualify as a CRT. Thus, for example, occasionally the IRS permits a trust document to be reformed to correct a drafting mistake—sometimes referred to as a *scrivener's error*—without causing loss of qualification of the trust as a CRT.[51]

(b) Trust Requirement

A CRT must initially qualify as a trust for federal income tax purposes. The rules to be considered in assessing whether an entity is an association taxable as a corporation, a partnership, or a trust focus on six characteristics: associates, an objective to carry on business and divide the profits from it, continuity of life, centralization of management, limited liability, and free transferability of interests.[52] Inasmuch as the last four of these elements are generally common to trusts and corporations, the attention in this regard is on the first two characteristics. If an entity has associates and a business purpose, it cannot be classified as a trust for federal income tax purposes.

In one of the rare instances in which this issue has arisen, the IRS ruled that a proposed trust, intended by its grantors to be a CRT, did not qualify as a trust for tax purposes in the first instance, and thus could not qualify as a CRT.[53] The trust was to be established by eight individuals: husband, wife, and six grandchildren. Cast as a CRUT, it was to be funded with $2 million. The married couple would contribute a little more than $1 million in money and appreciated securities; the balance would be contributed by the six grandchildren, again in cash and appreciated securities. Income from the trust would flow to the husband and wife for

---

[47] IRC § 664(f)(2).

[48] IRC § 664(f)(3).

[49] Priv. Ltr. Rul. 9322031. A change was made, in 1999, in the tax regulations concerning CRTs pertaining to the valuation of certain assets transferred to these trusts. These additions to the law are summarized elsewhere, for purposes of emphasizing them. See § 12.4(f).

[50] See Reg. § 1.664-1(a)(1)(iii)(e).

[51] See § 12.4(i). These types of errors can have more than adverse tax consequences—they can lead to malpractice litigation against the lawyer who prepared the trust document. E.g., Priv. Ltr. Rul. 9804036.

The CRT rules were enacted in 1969. For certain testamentary trusts created earlier, there is an income tax deduction for amounts permanently set aside for a charitable purpose. IRC § 642(c)(2). An illustration of a trust that did not comply with this rule is in *Samuel P. Hunt Trust v. United States*, 2003 WL 23095996 (D. N.H. 2003) (unpublished).

[52] Reg. § 301.7701-2(a)(2). A bank serving as trustee of a CRT was held to have breached its fiduciary duty by not sufficiently diversifying the assets of the trust on a timely basis (*Fifth Third Bank v. Firstar Bank*, 2006 Ohio 4506 (Ohio Ct. App. 2006)).

[53] Priv. Ltr. Rul. 9547004.

their joint lives, then to the survivor of them; thereafter, the grandchildren would receive the income payments. The unitrust was to have been a NIMCRUT; the unitrust amount was to have been at least actual trust income, with the percentage set at 11 percent. In years in which the income was in excess of the percentage, additional income could be paid to the income beneficiaries to make up for shortfalls in prior years.

In this case, the IRS concluded that the eight individuals were associates. Two facts were cited to support this conclusion: each of the eight individuals would be making contributions to the trust and the trust would last until the death of the last of them. The IRS also decided that these associates would be pooling their assets with an object to carry on business and divide the gains from the business. That conclusion was rested on the fact that the trustee would have the power to ''vary the investment of the grantors by investing and reinvesting the assets in the trust.'' The recipients of the unitrust amount would ''share in the profits derived from the joint investment of their assets'' held by the proposed trust.

In another instance, the IRS, noting that the trustee would have the power to vary the investment of the grantors (an S corporation and its sole shareholder) in a proposed trust, and that the grantors, as recipients of the unitrust amount, would share in the profits derived from joint investment of their assets, concluded that such an arrangement could not appropriately be classified as a trust.[54] Inasmuch as the entity could not constitute a trust, the IRS ruled that it could not be a CRT.[55]

It is common for a married couple to establish a CRT, with both individuals named as trustees and income interest beneficiaries. If these individuals subsequently divorce, a court may split the trust into two separate trusts, one trust having one of these individuals as its sole trustee and income beneficiary and the other trust having the other individual as its sole trustee and income beneficiary. The court order should also provide that each individual must name the other as successor trustee and continuing income beneficiary when one of these individuals predeceases the other. In these circumstances, the original CRT and the two resulting CRTs will not fail to qualify as charitable remainder trusts.[56] If a CRT is divided pursuant to a will settlement, the estate tax charitable contribution deduction essentially is based on the value of the assets allocated to the resulting trusts.[57]

(c) Substantial Compliance Doctrine

The *doctrine of substantial compliance*, once held applicable in another charitable giving context,[58] is not available in determining whether a trust qualifies as a

[54] In so concluding, the IRS cited *Commissioner v. North Am. Bond Trust*, 122 F.2d 545 (2d Cir. 1941), *cert. den*., 314 U.S. 701 (1942).

[55] Priv. Ltr. Rul. 200203034.

[56] E.g., Priv. Ltr. Rul. 200035014.

[57] E.g., Priv. Ltr. Rul. 200229046. In general, Feinman & Britt, ''A Fresh Look at the Benefits of Charitable Remainder Trusts,'' 134 *Trusts & Estates* (no. 8) 41 (Aug. 1994); Fischer & Jones, ''Charitable Remainder Trusts: Planning and Designing Issues,'' 131 *Trusts & Estates* (no. 1) 45 (Jan. 1992).

[58] A court held, in connection with prior appraisal requirements (cf. § 21.5), that a charitable contribution deduction was available even though the donors failed to attach a qualified appraisal of the contributed property to their income tax return (*Bond v. Commissioner*, 100 T.C. 32 (1993)). The IRS denied a charitable contribution deduction based on the fair market value of the property contributed, on the ground that the property did

CRT. (This doctrine may be applicable, for the relief of a taxpayer, where a legal requirement is procedural or directory.) This is because of the policy underlying the charitable remainder trust rules and the substantive nature of these rules. A federal court of appeals, in rejecting application of the doctrine in this setting, wrote that the statutory rules are ''not unimportant'' and that they ''protect against efforts to bend trust law to get a tax benefit.''[59]

§ 12.2 CHARITABLE REMAINDER ANNUITY TRUST RULES

A charitable remainder annuity trust is a trust that complies with the foregoing rules[60] and the rules described in this section.[61]

(a) Payment of Annuity Amount

A qualifying CRUT must pay a sum certain, not less often than annually, to an eligible person or persons[62] for each tax year of the appropriate period,[63] all as provided in the governing instrument of the trust.[64]

A *sum certain* is a stated dollar amount, which is the same either as to each income beneficiary or as to the total amount payable for each year of the income payment period of the trust. The payment requirement is satisfied by, for example, the provision for an amount which is the same every year to A until his death and concurrently an amount which is the same every year to B until her death, with the amount to each recipient to terminate at his or her death. The provision for an amount to A and B for their joint lives and then to the survivor of them also satisfies this requirement. In the case of a distribution to a charitable organization at the death of an income interest beneficiary or the expiration of a term of years, the governing instrument of a CRAT may provide for a reduction of the stated amount payable after the distribution, as long as:

---

not constitute qualified appreciated stock (see § 4.5(h)), yet allowed the donor a charitable deduction based on the cost basis in the property, even though the donor did not comply with the substantiation and appraisal requirements; this court accepted this ''concession.'' *Todd v. Commissioner*, 118 T.C. 334, n. 1 (2002). Also *Fair v. Commissioner*, 66 T.C.M. (CCH) 460 (1993). This doctrine is inapplicable, however, when the donor did not substantially comply with the requirements. E.g., *Hewitt v. Commissioner*, 109 T.C. 258 (1997); *D'Arcangelo v. Commissioner*, 68 T.C.M. (CCH) 1223 (1994).

[59] *Estate of Tamulis v. Commissioner*, 509 F.3d 343, 346 (7th Cir. 2007). This appellate court also wrote, in analyzing the origins of these rules, that ''Congress provided . . . that to obtain the [charitable] deduction the settlor would have to create the trust in the form of a charitable remainder unitrust'' (at 344), thereby leaving out the charitable remainder annuity trust. Also, the court concluded that the federal statutory law and regulations concerning charitable remainder trusts are ''perfectly clear'' (at 346), an observation that some may find to be overly generous. In general, Chouest, ''Dot All '*I*'s and Cross All '*T*'s: *Estate of Tamulis v. Commissioner* and the Narrowing of the Substantial Compliance Doctrine to the Technical Compliance Doctrine,'' 62 *Tax Law*. (no. 1) 259 (Fall 2009).

[60] See § 12.1.

[61] IRC § 664(d); Reg. § 1.664-2(a).

[62] See § 12.2(d).

[63] See § 12.2(f).

[64] IRC § 664 (d)(1)(A); Reg. § 1.664-2(a)(1)(i). A trust is not deemed to have engaged in an act of self-dealing (IRC § 4941; see *Private Foundations* ch. 5); to have unrelated debt-financed income (IRC § 514; see § 3.5); to have received an additional contribution (see § 12.2(h)); or to have failed to function exclusively as a charitable remainder trust merely because payment of the annuity amount is made after the close of the tax year, as long as the payment is made within a reasonable time after the close of the tax year. Reg. § 1.664-2(a)(1)(i)(a). There are additional requirements in this regard, which are summarized elsewhere for purposes of emphasis. See § 12.4(g).

- the reduced amount payable is the same either as to each income interest beneficiary or as to the total amount payable for each year of the balance of the period, and
- the minimum annuity amount requirements[65] are met.[66]

The stated dollar amount may be expressed as a fraction or a percentage of the initial net fair market value of the property irrevocably passing in trust as finally determined for federal tax purposes. If the stated dollar amount is expressed in this manner and the market value is incorrectly determined by the fiduciary, this requirement is satisfied if the governing instrument of the trust provides that, in this event, the trust must pay to the recipient (in the case of an undervaluation) or be repaid by the recipient (in the case of an overvaluation) an amount equal to the difference between the amount that the trust should have paid the recipient if the correct value had been used and the amount that the trust actually paid the recipient. The payment or payments must be made within a reasonable period after the final determination of the value. Any payment due to an income interest beneficiary by reason of an incorrect valuation is considered to be a payment required to be distributed at the time of the final determination for purposes of the year-of-inclusion rules.[67]

The application of the rule permitting the stated dollar amount to be expressed as a fraction or a percentage of the initial net fair market value of the property irrevocably passing in trust as finally determined for federal tax purposes is illustrated in Example 12.8.

EXAMPLE 12.8

The will of X provided for the transfer of one-half of his residuary estate to a CRAT. The trust is required to pay to W, for life, an annuity equal to 5 percent of the initial net fair market value of the interest passing in trust as finally determined for federal tax purposes. The annuity is to be paid on December 31 of each year computed from the date of X's death. The will also provided that if this initial net fair market value is incorrectly determined, the trust must pay to W, in the case of an undervaluation, or be repaid by W, in the case of an overvaluation, an amount equal to the difference between the amount that the trust should have paid if the correct value had been used and the amount that the trust actually paid. X died on March 1, 2008. The executor filed an estate tax return showing the value of the residuary estate as $250,000 before reduction for taxes and expenses of $50,000. The executor paid to W $4,192 ([$250,000 – $50,000] × 1/2 × 5% × 306/365) on December 31, 2008. On January 1, 2009, the executor transferred one-half of the residue of the estate to the trust. The trust adopted the calendar year as its tax year. The value of the residuary estate is finally determined for federal tax purposes to be $240,000 ($290,000 – $50,000). Accordingly, the amount the executor should have paid to W was $5,030 ([$290,000 – $50,000] × 1/2 × 5% × 306/365). Consequently, an additional amount of $838 ($5,030 – $4,192) had to be paid to W within a reasonable period after the final determination of value for federal tax purposes.[a]

[a] Reg. § 1.664-2(a)(1)(iii).

---

[65] See § 12.2(b).

[66] Reg. § 1.664-2(a)(1)(ii).

[67] Reg. § 1.664-2(a)(1)(iii). Those rules are the subject of § 12.5(c), text accompanied by *infra* notes 323–325. Rules relating to the subject of future contributions are the subject of § 12.2(h), text accompanied by *infra* note 132. Rules relating to required adjustments for underpayments or overpayments of these amounts in respect of payments made during a reasonable period of administration are the subject of § 12.1(a), text accompanied by *supra* notes 40–44.

The governing instrument of a CRAT must provide that, in the case of a tax year which is for a period of less than 12 months (other than the tax year in which the end of the trust period occurs), the annuity amount must be the amount otherwise determined, prorated for the trust year. That is, the annuity amount must be multiplied by a fraction the numerator of which is the number of days in the tax year of the trust and the denominator of which is 365 (366 if February 29 is a day included in the numerator).[68] The trust will not qualify as a CRAT absent a provision that states a formula for prorating the specified distribution in the tax year when the noncharitable interests terminate.[69]

The governing instrument of a CRAT must also provide that, in the tax year in which the end of the trust period occurs, the annuity amount to be distributed must be the amount otherwise determined, prorated for the trust year. That is, the annuity amount must be multiplied by a fraction, the numerator of which is the number of days in the period beginning on the first day of that tax year and ending on the last day of the period, and the denominator of which is 365 (366 if February 29 is a day included in the numerator).[70]

(b) Minimum Annuity Amount

The total amount payable as an annuity amount may not be less than 5 percent of the initial net fair market value of the property placed in a CRAT as finally determined for federal tax purposes.[71] A trust will not fail to meet the minimum annuity amount requirement, however, merely because it allows for a reduction of the stated amount payable upon the death of an income beneficiary or the expiration of a term of years, provided that:

- a distribution is made to a charitable organization at the death of the recipient or the expiration of a term of years, and
- the total amounts payable each year after the distribution are not less than a stated dollar amount that bears the same ratio to 5 percent of the initial net fair market value of the trust assets as the net fair market value of the trust assets immediately after the distribution bears to the net fair market value of the trust assets immediately before the distribution.[72]

If the grantor of an *inter vivos* trust underestimates in good faith the initial net fair market value of the property placed in trust as finally determined for federal tax purposes, and specifies a fixed dollar amount for the annuity that is less than 5 percent of the initial net fair market value of the property placed in trust as initially determined for federal tax purposes, the trust is deemed to have met the

[68] Reg. § 1.664-2(a)(1)(iv)(a).

[69] Rev. Rul. 79-428, 1979-2 C.B. 253.

[70] Reg. § 1.664-2(a)(1)(iv)(b).

[71] IRC § 664(d)(1)(A); Reg. § 1.664-2(a)(2)(i). In one instance, a trust, intended to be a CRAT, failed to make any payments to the income beneficiary during that individual's lifetime; the Tax Court concluded that "operationally" the trust did not meet the payout requirement and thus could not qualify as a CRT. *Estate of Atkinson v. Commissioner*, 115 T.C. 26, 32 (2000). The representative of the estate asked the court to "set aside or ignore[]" the distribution requirement, because the individual had no need for the income! *Id*. at 31. The court, of course, lacked the authority to grant that request.

[72] Reg. § 1.664-2(a)(2)(ii).

5 percent requirement if the grantor (or his or her representative) consents, by appropriate agreement with the IRS, to accept an amount equal to 20 times the annuity as the fair market value of the property placed in trust for purposes of determining the appropriate charitable contribution deduction.[73]

(c) Maximum Annuity Amount

A trust cannot qualify as a CRAT if the annuity for a year is greater than 50 percent of the initial net fair market value of the trust's assets.[74]

This rule was added to the law out of concern that the interplay between the rules governing the timing of income from distributions out of CRTs[75] and the rules governing the character of distributions[76] had created opportunities for abuse when the required annual payments are a large portion of the trust and realization of income and gain can be postponed until a year later than the accrual of the large payments.[77] The example commonly given of this abuse was in the context of CRUTs and is discussed in that setting.[78]

A trust that fails this maximum payout rule cannot constitute a CRT; instead, it is treated as a complex trust, so all its income is taxed either to its beneficiaries or to the trust.

(d) Permissible Income Recipients

General Rules. The annuity amount must be payable to or for the use of a named person[79] or persons, at least one of which is not a charitable organization.[80] If the amount is to be paid to an individual or individuals, all of them must be living at the time of creation of the trust. A named person or persons may include members of a named class, provided that, in the case of a class that includes any individual, all of the individuals must be alive and ascertainable at the time of creation of the trust, unless the period for which the annuity amount is to be paid to the class consists solely of a term of years. For example, in the case of a testamentary trust, the testator's will may provide that an amount shall be paid to her children living at her death.[81]

The IRS, however, approved an arrangement in which an otherwise qualifying CRAT made distributions to a second trust, when the only function of the second trust was to receive and administer the distributions for the benefit of the named individual lifetime beneficiary of the trust, who was incompetent.[82] The income beneficiary was regarded as receiving the distributions directly from the first trust. Subsequently, the IRS adopted the position that a trust serving in

---

[73] Reg. § 1.664-2(a)(2)(iii).
[74] IRC § 664(d)(1)(A).
[75] See text accompanied by *infra* note 345.
[76] See § 12.5.
[77] S. Rep. No. 105-33, 105th Cong., 1st Sess. (1997).
[78] See § 12.3(c). This change in the law was not intended to alter rules in subsequently adopted tax regulations addressing the same point. See § 12.4(g).
[79] The term *person* is defined for federal income tax purposes in IRC § 7701.
[80] IRC § 664(d)(1)(A).
[81] Reg. § 1.664-2(a)(3)(i).
[82] Rev. Rul. 76-270, 1976-2 C.B. 194.

this fashion for any income beneficiary would suffice (that is, irrespective of whether the individual income beneficiary was incompetent),[83] although this stance was later abandoned.[84] Thus, this use of a CRAT to protect the assets of a mentally incompetent individual and to ensure that the assets are used for the individual's benefit is the only circumstance in which the IRS will permit a trust to be an income interest beneficiary of a CRAT for the duration of an individual's life.[85] The IRS formalized this position in a revenue ruling.[86]

A trust is not a CRAT if any person has the power to alter the amount to be paid to any named person (other than a charitable organization), if the power would cause any person to be treated as the owner of the trust or any portion of it, or if the grantor trust rules are applicable to the trust.[87] For example, the governing instrument of a CRAT may not grant the trustee the power to allocate the annuity among members of a class unless the power falls within one of the exceptions to the rules concerning the power to control beneficial enjoyment.[88] In contrast, this rule is not violated when the grantor has reserved the right to remove the trustee for any reason and substitute any other person (including the grantor) as trustee.[89]

In one instance, the IRS reviewed a trust that was intended to qualify as a CRAT. The trust had an independent trustee. The governing instrument of the trust provided that the trustee is to pay the specified distribution to or among the named individuals—B, C, and D—in such amounts and proportions as the trustee, in its sole discretion, shall from time to time determine until the death of the survivor of B, C, or D. B is a child of A. C is unrelated to, but was a former employee of, A. D is unrelated to and was never employed by A. The IRS held that because the trustee was independent, the payments could be allocated as described without precluding the trust from qualifying as a CRT, inasmuch as the power to make the allocation would not cause any person to be treated as the owner of the trust or any portion of it.[90]

A pet animal is not a person for this purpose. Thus, an otherwise qualifying CRAT that provides for care for a pet animal during its lifetime does not qualify as a CRAT.[91]

Spousal Elective Share Law Issue. The law in most states protects spouses from disinheritance by the other spouse, by means of elective share statutes. These laws provide spouses with the right to elect to receive a statutory share of the other spouse's estate, irrespective of whether the deceased spouse made any bequests to the surviving spouse. For these purposes, the spouse's share of the

---

[83] Priv. Ltr. Rul. 9101010.

[84] Priv. Ltr. Rul. 9718030.

[85] See, e.g., Priv. Ltr. Rul. 9839024. A charitable remainder annuity trust may, however, pay income amounts to a second trust for a term of 20 years or less.

[86] Rev. Rul. 2002-20, 2007-1 C.B. 794.

[87] Reg. § 1.664-2(a)(3)(ii). *Cf.* § 12.2(d), text accompanied by *infra* note 103 (rule permitting retention by a grantor of a testamentary power to revoke or terminate the interest of an income beneficiary other than a charitable organization).

[88] Reg. § 1.664-2(a)(3)(ii). The rules concerning the power to control beneficial enjoyment are the subject of IRC § 674(a). The exceptions to these rules are in IRC § 674(b).

[89] Rev. Rul. 77-285, 1977-2 C.B. 213.

[90] Rev. Rul. 77-73, 1977-1 C.B. 175.

[91] Rev. Rul. 78-105, 1978-1 C.B. 295.

grantor's estate is referred to as an *elective share;* the right to elect to receive an elective share is referred to as the *right of election.*

In some states, the elective share is based solely on the value and elements of the probate estate. In other states, the estate involved is the *augmented estate,* which may include assets of a CRT. The distribution limitations as to permissible income recipients applicable to these trusts, in situations where the surviving spouse may elect to receive an elective share including assets in a CRT, are violated where this right of election exists—even if not exercised.

In an effort to ameliorate this matter, the IRS issued guidance providing a safe harbor procedure pursuant to which the agency will disregard certain state law rights of election for purposes of determining whether charitable remainder trusts satisfy their distribution rules.[92] This procedure generally requires the surviving spouse to irrevocably waive the right of election with regard to the assets of a CRT.[93]

This guidance generated considerable controversy and a number of requests that it be withdrawn. Complaints about the guidance are that donors are being required to be knowledgeable about state spousal election laws (including situations where donors change their place of residence), that obtaining the waivers is too unwieldy, and that it is chilling the establishment of CRTs. Proposed solutions include generally disregarding a right of election as long as the surviving spouse does not exercise the right,[94] use of the private foundation termination-of-status rules,[95] application of the private foundation self-dealing rules,[96] and/or application of the private foundation taxable expenditures rules.[97] As a practical matter, although the charitable contribution deduction is claimed for the year in which a CRT is created and funded, many years could elapse before there is a distribution to an electing spouse; by that time, the statute of limitations would have run on any opportunity to recapture the tax benefit obtained from funding the CRT.

The IRS thereafter suspended its rule concerning spousal waivers of interests in charitable remainder trusts.[98] The existence of a spouse's right of election pursuant to state law will be disregarded, for now, where the spouse does not exercise this right. The grandfather date[99] has been extended for an indefinite time, pending further guidance.

(e) Other Payments

No amount other than the annuity amount or *qualified gratuitous transfers*[100] may be paid to or for the use of any person other than a charitable organization.[101] An amount is not paid to or for the use of any person other than a charitable

[92] Rev. Proc. 2005-24, 2005-1 C.B. 909.
[93] For trusts created before June 28, 2005, the IRS disregards this right of election, even without a waiver, as long as the surviving spouse does not exercise the right.
[94] That is, use the rule summarized in *supra* note 93 without limiting it to pre–June 28, 2005 trusts.
[95] IRC § 507. See *Private Foundations*, ch. 13.
[96] IRC § 4941. See *Private Foundations*, ch. 5.
[97] IRC § 4945. See *Private Foundations*, ch. 9.
[98] Notice 2006-15, 2006-1 C.B. 501.
[99] See *supra* note 93.
[100] See § 12.2(g)(ii).
[101] IRC § 664(d)(1)(B).

organization if the amount is transferred for full and adequate consideration. The trust may not be subject to a power to invade, alter, amend, or revoke for the beneficial use of a person other than a charitable organization.[102] The grantor may, however, retain the power exercisable only by will to revoke or terminate the interest of any recipient other than a charitable organization.[103]

Also, the grantor may reserve the power to designate a substitute charitable remainder beneficiary without disqualifying an otherwise acceptable CRAT.[104]

The governing instrument of a CRAT may provide that any amount other than the annuity amount shall be paid (or may be paid in the discretion of the trustee) to a charitable organization, provided that, in the case of distributions in kind, the adjusted basis of the property distributed is fairly representative of the adjusted basis of the property available for payment on the date of payment. For example, the governing instrument of a CRAT may provide that a portion of the trust assets may be distributed currently, or upon the death of one or more of the income beneficiaries, to a charitable organization.[105]

(f) Period of Payment of Annuity

The period for which an annuity amount is payable must begin with the first year of the CRAT and continue either:

- for the life or lives of a named individual or individuals, or
- for a term of years not to exceed 20 years.[106]

Only an individual or a charitable organization may receive an amount for the life of an individual. If an individual receives an amount for life, it must be solely for his or her life. Payment of an annuity amount may terminate with the regular payment next preceding the termination of the annuity amount period. (The annuity amount period ceases upon the death of the income beneficiary(ies).) The fact that the income beneficiary may not receive the last payment cannot be taken into account for purposes of determining the present value of the remainder interest.[107]

---

[102] In one instance, a trust was disqualified as a CRAT because an income interest beneficiary was entitled to distributions, with the trust obligated to pay (by means of invasion of the trust's corpus) at least some of the resultant federal estate and state death taxes. *Estate of Atkinson v. Commissioner*, 115 T.C. 26 (2000). See also Rev. Rul. 82-128, 1982-2 C.B. 71 (providing that a trust does not qualify as a CRT "if it is possible that federal estate and state death taxes may be payable from the trust assets").

[103] Reg. § 1.664-2(a)(4). This retention, when done in connection with an individual's spouse, causes an incomplete gift to the spouse for gift tax purposes (see § 8.2) but does not defeat the charitable contribution deduction for the remainder interest. Rev. Rul. 79-243, 1979-2 C.B. 343.

[104] Rev. Rul. 76-8, 1976-1 C.B. 179.

[105] Reg. § 1.664-2(a)(4). The IRS ruled that a CRAT may make distributions of principal and income from time to time to one or more charitable organizations, during the lifetime of the income interest beneficiary, without disqualifying the trust, as long as the distributions do not endanger the trust's ability to pay the requisite annuity to the income beneficiary. Priv. Ltr. Rul. 200052035. In another instance, the IRS approved a trust arrangement under which, during the life of the individual who was the trust's founder and income beneficiary, the trustee had to distribute some or all of the trust property to one or more charitable organizations as the grantor/income beneficiary appointed in writing. Priv. Ltr. Rul. 200034019.

[106] IRC § 664(d)(1)(A).

[107] Reg. § 1.664-2(a)(5)(i).

If an annuity amount is payable for a term of years, the length of the term of years must be ascertainable with certainty at the time of creation of the trust, except that the term may be terminated by the death of the income beneficiary, or by the grantor's exercise by will of a retained power to revoke or terminate the interest of any recipient other than a charitable organization. In any event, the period may not extend beyond either the life (or lives) of a named individual (or individuals) or a term of years not to exceed 20 years. For example, the governing instrument of a CRAT may not provide for the payment of an annuity amount to A for his life and then to B for a term of years, because it is possible for the period to last longer than either the lives of recipients living (technically, "in being") at the creation of the trust or a term of years not to exceed 20 years. Conversely, the governing instrument of the trust may provide for the payment of an annuity amount to A for his life and then to B for his life or a term of years (not to exceed 20 years), whichever is shorter (but not longer), if both A and B are living at the creation of the trust, because it is not possible for the period to last longer than the lives of recipients living at the creation of the trust.[108]

The 5 percent requirement must be met until the termination of all of the annuity payments. For example, the following provisions comport with this requirement:

- An amount equal to at least 5 percent of the initial net fair market value of the property placed in trust to A and B for their joint lives and then to the survivor of them for his or her life
- An amount equal to at least 5 percent of the initial net fair market value of the property placed in trust to A for life or for a term of years not longer than 20 years, whichever is longer (or shorter)
- An amount equal to at least 5 percent of the initial net fair market value of the property placed in trust to A for a term of years not longer than 20 years and then to B for life (as long as B was living at the date of creation of the trust)
- An amount to A for her life and concurrently an amount to B for her life (the amount to each recipient to terminate at her death) if the amount given to each individual is not less than 5 percent of the initial net fair market value of the property placed in trust
- An amount to A for his life and concurrently an equal amount to B for his life, and at the death of the first to die, the trust to distribute one-half of the then value of its assets to a charitable organization, if the total of the amounts given to A and B is not less than 5 percent of the initial net fair market value of the property placed in trust.[109]

(g) Permissible Remainder Interest Beneficiaries

At the end of the annuity payment period, the entire corpus of the trust must be irrevocably transferred, in whole or in part, to or for the use of one or more

[108] *Id.*
[109] Reg. § 1.664-2(a)(5)(ii).

charitable organizations or retained, in whole or in part, for a charitable use[110] or, to the extent the remainder interest is in qualified employer securities, all or part of the securities may be transferred to an employee stock ownership plan[111] in a qualified gratuitous transfer.[112] The trustee may have the power, exercisable during the donor's life, to add and/or substitute additional charitable organizations as remainder interest beneficiaries.[113]

Charitable Organizations. If all of the trust corpus is to be retained for charitable use, the tax year of the trust must terminate at the end of the annuity payment period and the trust must cease to be treated as a CRT for all purposes. If all or any portion of the trust corpus is to be transferred to or for the use of a charitable organization or organizations, the trustee must have a reasonable time after the annuity payment period to complete the settlement of the trust. During this time, the trust will continue to be treated as a CRT for all purposes. Upon the expiration of the period, the tax year of the trust must terminate and the trust must cease to be treated as a CRT for all purposes. If the trust continues in existence, it will be subject to the charitable trust rules[114] unless the trust is tax-exempt as a charitable organization,[115] in which case the trust shall be deemed to have been created at the time it ceases to be treated as a CRT.[116]

When interests in the corpus of a charitable remainder annuity trust are given to more than one charitable organization, the interests may be enjoyed by them either concurrently or successively.[117] The governing instrument of a CRAT must provide that: (1) if an organization to or for the use of which the trust corpus is to be transferred, or for the use of which the trust corpus is to be retained, is not a charitable organization at the time any amount is to be irrevocably transferred to or for the use of the organization, then (2) the amount shall be transferred to or for the use of one or more alternative charitable organizations at that time or retained for charitable use. The alternative organization or organizations may be selected in any manner provided by the terms of the trust's governing instrument.[118]

In general, the allowable charitable deduction for property transferred to a valid CRT will be subject to the 20 percent contribution limitation[119] when the organization designated to receive the remainder interest may be redesignated from a public charity to a nonpublic charity.[120] This will not be the outcome,

---

[110] IRC § 664(d)(i)(c); Reg. § 1.664-2(a)(6)(i).

[111] A plan of this nature (authorized by IRC § 4975(e)(7)) is a qualified stock bonus plan or a combination stock bonus and money purchase pension plan, under which employer securities are held for the benefit of employees. The securities, which are held by one or more tax-exempt trusts under the plan, may be acquired through direct employer contributions or with the proceeds of a loan to the trust or trusts.

[112] A qualified gratuitous transfer of employer securities to an employee stock ownership plan gives rise to an estate tax charitable contribution deduction based on the present value of the remainder interest. IRC § 2055 (a)(5).

[113] Rev. Rul. 76-371, 1976-2 C.B. 305.

[114] IRC § 4947(a)(1). See *Private Foundations* § 3.6.

[115] That is, tax-exempt by reason of IRC § 501(c)(3).

[116] Reg. § 1.664-2(a)(6)(ii).

[117] Reg. § 1.664-2(a)(6)(iii).

[118] Reg. § 1.664-2(a)(6)(iv).

[119] See § 7.12.

[120] Rev. Rul. 79-368, 1979-2 C.B. 109. See ch. 7.

however, when the likelihood that the remainder interest will not go to a public charity is so remote as to be negligible.[121]

Qualified Gratuitous Transfers. The term *qualified employer securities* means employer securities[122] that are issued by a domestic corporation that does not have any outstanding stock that is readily tradable on an established securities market and that has only one class of stock.[123]

The term *qualified gratuitous transfer* means a transfer of qualified employer securities to an employee stock ownership plan, but only to the extent that: (1) the securities transferred must previously have passed from a decedent dying before January 1, 1999, to a CRAT (or a CRUT); (2) a deduction for contributions paid by an employer[124] was not allowable with respect to the transfer; (3) the plan contains certain provisions (see below); (4) the plan treats the securities as being attributable to employer contributions, albeit without regard to various limitations otherwise applicable to the contributions;[125] and (5) the employer whose employees are covered by the plan files with the IRS a verified written statement consenting to the application of certain taxes[126] with respect to the employer.[127]

The term *qualified gratuitous transfer* does not include a transfer of qualified employer securities to an employee stock ownership plan unless: (1) the plan was in existence on August 1, 1996; (2) at the time of the transfer, the decedent and members of the decedent's family[128] own (directly or constructively[129]) no more than 10 percent of the value of the outstanding stock of the corporation involved; and (3) immediately after the transfer, the plan owns[130] at least 60 percent of the value of the outstanding stock of the corporation.[131]

A plan contains the requisite provision if it provides that: (1) the qualified employer securities so transferred are allocated to plan participants in a manner consistent with nondiscrimination rules;[132] (2) plan participants are entitled to direct the plan as to the manner in which the securities that are entitled to vote and are allocated to the account of the participant are to be voted; (3) an independent trustee[133] votes the securities so transferred that are not allocated to plan participants; (4) each participant who is entitled to a distribution from the plan has the right to receive distributions in the form of stock and can require the employer to repurchase any shares distributed under a fair valuation formula;[134] (5) the securities are held in a suspense account under the plan to be allocated each year, up

---

[121] Rev. Rul. 80-38, 1980-1 C.B. 56.
[122] IRC § 409(1).
[123] IRC § 664(g)(4).
[124] IRC § 404.
[125] *Id.*
[126] IRC §§ 4978, 4979A.
[127] IRC § 664(g)(1).
[128] IRC § 2032A(e)(2).
[129] IRC § 318(a).
[130] That is, owns after the application of IRC § 318(a)(4).
[131] IRC § 664(g)(2).
[132] IRC § 401(a)(4).
[133] The term *independent trustee* means a trustee who is not a member of the decedent's family (IRC § 2032A(e)(2)) or a 5 percent shareholder (see *infra* note 140).
[134] IRC § 409(h)(1)(A), (B). A valuation formula is not considered fair if it takes into account a discount for minority interests. H. Rep. No. 105-148, 105th Cong., 1st Sess. 394 (1997).

to the limitations on contributions and benefits,[135] after first allocating all other annual additions for the limitation year, up to the contribution limitations;[136] and (6) on termination of the plan, all securities so transferred that are not allocated to plan participants as of the termination are to be transferred to or for the use of a charitable organization.[137]

If any portion of the assets of the plan attributable to securities acquired by the plan in a qualified gratuitous transfer are allocated to the account of (1) any person who is related to the decedent[138] or a member of the decedent's family,[139] or (2) any person who, at the time of the allocation or at any time during the one-year period ending on the date of the acquisition of qualified employer securities by the plan, is a 5 percent shareholder[140] of the employer maintaining the plan, the plan is treated as having distributed (at the time of the allocation) to the person or shareholder, the amount so allocated.[141]

(h) Additional Contributions

A trust is not a CRAT unless its governing instrument provides that no additional contributions may be made to it after the initial contribution. For this purpose, all property passing to a CRAT by reason of death of the grantor is considered one contribution.[142]

(i) Minimum Value of Remainder Interest

The value of the remainder interest in a CRAT[143] must be at least 10 percent of the initial net fair market value of all property placed in the trust.[144] This 10 percent test is measured on each transfer to the CRT. Consequently, a CRT that meets the 10 percent test on the date of transfer will not subsequently fail to meet the test if interest rates have declined between the time of creation of the trust and the death of an individual whose life is a measuring life. Similarly, when a CRT is created for the joint lives of two individuals, with a remainder to charity, the trust will not cease to qualify as a CRT because the value of the charitable remainder was less than 10 percent of the trust's assets at the first death of these two individuals.[145]

---

[135] IRC § 415(c).
[136] IRC § 415(c), (e).
[137] IRC § 664(g)(3). A plan does not fail to be a qualified plan (IRC § 401(a)) by reason of meeting the requirements of these six rules.

If the requirements of the sixth of these rules are not met with respect to any securities, an excise tax is imposed on the employer that maintains the plan; the tax is designed to recapture the estate taxes that would have been due had the transfer to the employee stock ownership plan not occurred. IRC § 664(g)(6).
[138] IRC § 267(b).
[139] IRC § 2032A(e)(2).
[140] The term *5 percent shareholder* means any person who owns, directly or constructively (IRC § 318(a), applied without regard to the exception in IRC § 318(a)(2)(B)(i)), more than 5 percent of the outstanding stock of the corporation that issued the qualified employer securities or of any corporation that is a member of the same controlled group of corporations (IRC § 409(1)(4)) as the corporation. IRC § 664(g)(5)(B).
[141] IRC § 664(g)(5)(A).
[142] Reg. § 1.664-2(b).
[143] See § 12.11.
[144] IRC § 664(d)(1)(D).
[145] H. Rep. No. 105-220, 105th Cong., 1st Sess. 607 (1997).

There are two other rules designed to provide relief for trusts that do not meet the general 10 percent requirement:

1. When a transfer is made to a CRT that fails the 10 percent test, the trust is treated as meeting the 10 percent requirement if the governing instrument of the trust is changed by reformation, amendment, construction, or otherwise to meet the requirement by reducing the payout rate or duration, or both, of any noncharitable beneficiary's interest to the extent necessary to satisfy the requirement, as long as the reformation or other means of change is commenced within the period for reformations of CRTs.[146] The statute of limitations applicable to a deficiency of any tax resulting from reformation of the trust may not expire before the date one year after the IRS is notified that the trust has been reformed.[147]
2. A transfer to a trust is treated as if the transfer had never been made when a court having jurisdiction over the trust subsequently declares the trust to be void (because, for example, application of the 10 percent rule frustrates the purposes for which the trust was created) and judicial proceedings to revoke the trust are commenced within the period permitted for reformation of CRTs. The effect of this ''unwinding'' of the trust is that any transactions engaged in by the trust with respect to the property transferred, such as income earned on the assets transferred to the trust and capital gains generated by sales of the property transferred, will be income and capital gain of the donor (or the donor's estate if the trust was a testamentary one) and the donor (or the donor's estate if the trust was testamentary) will not be permitted a charitable deduction with respect to the transfer. The statute of limitations applicable to a deficiency of any tax resulting from this type of unwinding of a trust may not expire before the date one year after the IRS is notified that the trust has been revoked.[148]

(j) Charitable Deductions

Any claim for a charitable deduction on any return for the value of a remainder interest in a CRAT must be supported by a full statement attached to the return showing the computation of the present value of the interest. The federal income tax charitable contribution deduction is limited to the fair market value of the remainder interest of a CRAT regardless of whether a charitable organization also receives a portion of the annuity.[149]

---

[146] These reformation rules (IRC § 2055(e)(3)) are the subject of § 8.7(c).

[147] H. Rep. No. 105-220, 105th Cong., 1st Sess. 607 (1997). In essence, this rule relaxes the reformation requirement in IRC § 2055(e)(3)(B) to the extent necessary for the reformation of the trust to meet the 10 percent requirement.

[148] H. Rep. 105-220, 105th Cong., 1st Sess. 147 (1997). There is a third relief rule; it is summarized in text accompanied by *infra* note 242.

[149] Reg. § 1.664-2(d). The rules for calculating this deduction are summarized in § 12.11(a). For the rules relating to the reduction of the amount of a charitable contribution deduction with respect to a contribution of certain ordinary income property or capital gain property, see §§ 4.4, 4.5. For rules for postponing the time for deduction of a charitable contribution of a future interest in tangible personal property, see § 9.21.

A transfer by a beneficiary of a life interest in a charitable remainder trust of that interest to the remainder interest beneficiary charitable organization is a deductible gift for income tax purposes. Rev. Rul. 86-60, 1986-1 C.B. 302.

§ 12.3 CHARITABLE REMAINDER UNITRUST RULES

A charitable remainder unitrust is a trust that complies with the foregoing rules[150] and the rules described in this section.[151]

(a) Payment of Unitrust Amount

There essentially are four types of qualifying CRUTs, with the distinctions among them principally being the way in which the unitrust amount is calculated. In the case of the second and third of these types of trusts, discussed below, the amount paid to one or more income beneficiaries from the trust is a function of actual trust income.

Standard Charitable Remainder Unitrust. Generally, a qualifying CRUT must pay, not less often than annually, an amount equal to a fixed percentage of the net fair market value of the trust assets, determined annually, to an eligible person or persons[152] for each tax year of the appropriate period,[153] all as provided in the governing instrument of the trust.[154] This is the standard charitable remainder unitrust (SCRUT), also known as the *fixed percentage CRUT*.[155]

The *fixed percentage* may be expressed either as a fraction or as a percentage and must be payable each year for the specified period.[156] A percentage is *fixed* if the percentage is the same either as to each income beneficiary or as to the total percentage payable each year of the period. For example, provision for a fixed percentage that is the same every year to A until his death and concurrently a fixed percentage that is the same every year to B until her death, the fixed percentage to each recipient to terminate at his or her death, would satisfy this requirement. Similarly, provision for a fixed percentage to A and B for their joint lives and then to the survivor would satisfy this rule. In the case of a distribution to a charitable organization at the death of an income beneficiary or the expiration

[150] See § 12.1.

[151] IRC § 664(d)(2); Reg. § 1.664-3(a).

[152] See § 12.3(d).

[153] See § 12.3(f). A change in the annual valuation date of a CRUT does not result in disqualification of the trust. See, e.g., Priv. Ltr. Rul. 8822035.

[154] Reg. § 1.664-3(a)(1)(i)(a). A trust that operationally fails the payout requirement cannot qualify as a charitable remainder unitrust. See, e.g., *Estate of Atkinson v. Commissioner*, 115 T.C. 26 (2000). A trust is not deemed to have engaged in an act of self-dealing (IRC § 4941; see *Private Foundations* ch. 5); to have unrelated debt-financed income (IRC § 514; see § 3.5); to have received an additional contribution (see IRC § 664(d)(2)(A); § 12.3(h)); or to have failed to function exclusively as a charitable remainder unitrust merely because payment of the unitrust amount is made after the close of the tax year, as long as the payment is made within a reasonable time after the close of the tax year. Reg. § 1.664-2(a)(1)(i)(a). For these purposes, a reasonable time does not ordinarily extend beyond the date by which the trustee is required to file the trust's income tax return (Form 1041-B) (including extensions) for the year. Reg. § 1.664-2(a)(1)(i)(a).

If any portion of a CRUT trustee's fee is charged against the unitrust amount, the trust cannot qualify. Rev. Rul. 74-19, 1974-1 C.B. 155. Trustees' fees may be deductible, however, in computing the trust's income used in determining the unitrust amount. Priv. Ltr. Rul. 9434018.

[155] Reg. § 1.664-3(a)(1)(i)(a). The IRS ruled that a CRUT may pay its unitrust amount in accordance with the following formula: (1) 50 percent of the unitrust amount to the income beneficiary (IB) for IB's life; (2) 35 percent of the unitrust amount to the charitable organization that is the remainder interest beneficiary for a five-year term (or, if earlier, the termination of the trust), then to IB for the remainder of IB's life; and (3) 15 percent of the unitrust amount to the charity for IB's life. Priv. Ltr. Rul. 200108035.

[156] The requisite period is the subject of § 12.3(f).

of a term of years, the governing instrument may provide for a reduction of the fixed percentage payable after the distribution, provided that:

- the reduced fixed percentage is the same either as to each recipient or as to the total amount payable for each year of the balance of the period, and
- the appropriate minimum unitrust amount requirements[157] are met.[158]

In one instance, the IRS reviewed the governing instrument of a trust which provided that the trustee would pay A, the unitrust amount beneficiary, 7 percent of the net fair market value of the trust assets, valued annually, until the death of the donor. Upon the donor's death, the trustee was to pay A 9 percent of the net fair market value of the trust assets until death. This arrangement was held not to constitute a fixed percentage, and the trust did not qualify as a SCRUT for that reason.[159] A similar situation, in which the trust also failed, was this: The trustee was to pay A 7 percent of the property's value until A's death and 9 percent thereafter to B until B's death.[160]

As is discussed next, there are three other types of charitable remainder unitrusts. Generally, the governing instrument of a CRUT must contain only language suitable for its particular type. Mistakes in this regard can be made, however, and a judicial reformation to correct a drafting error will not alone disqualify a trust.[161]

Net-Income Charitable Remainder Unitrust. There are two types of CRUTs that are known as *income-exception CRUTs*. This means that the payout rules for SCRUTs need not be followed. One of these types of CRUTs enables income to be paid to the income interest beneficiary or beneficiaries once any income has been generated in the trust.[162] This amount may be less than the 5 percent amount. With this type of CRUT, the unitrust amount is the lesser of the fixed percentage amount or the trust's annual net income. The income payments begin once a suitable amount of income has begun to flow into the trust. That is, the income payments may begin at a future point in time and are only prospective. This form of CRUT is the *net-income CRUT* (NICRUT).[163]

On one occasion, the IRS ruled that a trust did not satisfy the requirements of a NICRUT. The governing instrument of the trust, which otherwise qualified as a charitable remainder unitrust, provided that the trustee was to pay income to the grantor for the grantor's lifetime, with income to be paid to his spouse should she survive the grantor. The trust instrument also provided that, upon the death of the grantor's spouse, or upon the grantor's death if his spouse predeceased him, the trustee was to divide the then-remaining trust assets into two equal parts.

---

[157] See § 12.3(b).
[158] Reg. § 1.664-3(a)(1)(ii).
[159] Rev. Rul. 80-104, 1980-1 C.B. 135.
[160] *Id.*
[161] In one instance, a trust was intended to be a SCRUT. The governing instrument of the trust, however, inadvertently contained a provision reflecting operation of the trust as a NIMCRUT. The trust was always administered as a SCRUT. A court ordered the trust reformed, *ab initio*, to constitute a SCRUT. The IRS ruled that this judicial reformation did not adversely affect the qualification of the trust. Priv. Ltr. Rul. 9804036. In general, see § 12.4(i).
[162] IRC § 664 (d)(3)(A).
[163] Reg. § 1.664-3(a)(1)(i)(b)(1).

Each part was to be operated separately for the respective benefit of A and B, the children of the grantor and his spouse. The trustee was to pay to A the lesser of 5 percent of the net fair market value of one equal part of the total trust assets valued annually or the annual income of this equal part. Upon the death of A, the trustee must make the payments to B. Likewise, the trustee was to pay to B the lesser of 5 percent of the net fair market value of the other equal part of the total trust assets valued annually or the annual income of this equal part. Upon the death of B, the trustee must make the payments to A. Thereafter, the trust assets were destined for a charitable remainder beneficiary.

The IRS held that the income exception was not satisfied in this situation. The IRS said that the provisions of the trust agreement directing the separate operation of these parts might cause the trustee, in some tax years, to fail to distribute the amount required to be paid from the entire trust in accordance with legal requirements. The IRS wrote:

> For example, in some taxable years of the trust, it is possible that one part of the total trust assets will earn little or no income while the other part of the total trust assets will earn income exceeding 5 percent of the net fair market value of its assets. Thus, under the income exception form of payment and in accordance with the provisions of the trust instrument that directs the separate operation of the two equal parts, the total payments in some taxable years, which consist of the trust income of one part limited by the amount of income earned plus the trust income of the other part limited by the amount that is not more than the designated fixed percentage of the net fair market value of that part's assets, could be less than the total of all trust income earned by the entire trust assets and required to be distributed by the trustee [under these rules].[164]

These provisions precluded the trust from qualifying as a NICRUT.

Net-Income Make-Up Charitable Remainder Unitrust. The other of the income-exception type of CRUT is similar to the NICRUT, except that the trust instrument provides that, for the years in which there was no or an insufficient distribution (in relation to the 5 percent standard), the trust can, once the investment policy generates adequate income, not only begin to pay the income interest beneficiary or beneficiaries the full amount of the determined unitrust payments, but also make payments that make up for the distribution deficiencies in prior years.[165] This type of trust can thus make catch-up—or make-up—payments once the non-income-producing asset is sold. Thus, in this situation, the unitrust is determined under the net-income method, with that amount also including any amount of income that exceeds the current year's fixed percentage amount to make up for any shortfall in payments from prior years when the trust's income was less than the fixed percentage amount. This *net-income make-up CRUT* is the NIMCRUT.[166]

Flip Charitable Remainder Unitrust. The fourth type of CRUT is the *flip unitrust* (FLIPCRUT). The governing instrument of a FLIPCRUT provides that the CRUT will convert (flip) once from one of the income-exception methods—the

---

[164] Rev. Rul. 76-310, 1976-2 C.B. 197.
[165] IRC § 664(d)(3)(B).
[166] Reg. § 1.664-3(a)(1)(i)(b)(2). In general, Cafferata, "Putting More Flexibility into the Net Income Limitation on Charitable Remainder Unitrusts," 7 *J. Tax. of Exempt Orgs.* (no. 1) 1 (July/Aug. 1995).

NICRUT or NIMCRUT—to the fixed percentage method—the SCRUT—for purposes of calculating the unitrust amount.[167] The conversion is allowed, however, only if the specific date or single event triggering the flip—the *triggering event*—is outside the control of, or not discretionary with, the trustee or any other person or persons.[168]

Permissible triggering events with respect to an individual include marriage, divorce, death, or birth.[169] The sale of an unmarketable asset, such as real estate, is a permissible triggering event.[170] Examples of impermissible triggering events include the sale of marketable assets and a request from the unitrust amount beneficiary or that recipient's financial advisor that the CRUT's payout mechanism be converted to the fixed percentage method.

The conversion to the fixed percentage method must occur at the beginning of the tax year that immediately follows the tax year in which the triggering date or event occurs.[171] Any make-up amount is forfeited when the trust converts to the fixed percentage method.

The term *unmarketable assets* means assets other than cash, cash equivalents, or assets that can be readily sold or exchanged for cash or cash equivalents. Unmarketable assets include real property, closely held stock, and unregistered securities for which there is no available exemption under the securities laws permitting public sale.[172]

Thus, when these rules are satisfied, a donor can fund a CRUT with unmarketable assets that produce little or no income. The donor likely wants the income beneficiary or beneficiaries of the CRUT to receive a steady stream of payments based on the total return available from the value of the assets. Of course, these payments cannot be made until the unmarketable assets can be converted into liquid (marketable) assets that can be used to generate income to pay the fixed percentage amount.

Using these FLIPCRUT rules, a donor can establish a CRUT that uses one of the two income-exception methods in calculating the unitrust amount until the unmarketable assets are sold. Following the sale, the CRUT's payout method is altered so that the fixed percentage method can be used to calculate the unitrust amount. Thus, the permissible FLIPCRUT patterns are a NICRUT flipped to a SCRUT or a NIMCRUT flipped to a SCRUT.

Other Requirements. The governing instrument of a CRUT must provide that if the net fair market value of the trust assets is incorrectly determined by the fiduciary, the trust must pay to the income beneficiary (in the case of an undervaluation)

---

[167] Reg. § 1.664-3 (a)(1)(i)(c). Prior to the 1998 law change that permits a FLIPCRUT, the law was that the type of CRUT could not be changed once it was selected. This rule was designed to prevent possible manipulation of the trust assets to the detriment of the charitable organization with the remainder interest. In one situation, a CRUT was reformed so that it was changed from a SCRUT to a NIMCRUT; the IRS ruled that this alteration in the unitrust amount payment method caused the trust to cease to qualify as a CRUT. Priv. Ltr. Rul. 9506015.

[168] Reg. § 1.664-3(a)(1)(i)(c)(1).

[169] Reg. § 1.664-3(a)(1)(i)(d).

[170] *Id.*

[171] Reg. § 1.664-3(a)(1)(i)(c)(2).

[172] Reg. § 1.664-1(a)(7)(ii). In general, McKinnon, "Planning to Meet a Range of Donor Needs with 'Flip' Charitable Remainder Unitrusts," 12 *J. Tax. Exempt Orgs.* (no. 6) 253 (May/June 2001).

or be repaid by the income beneficiary (in the case of an overvaluation) an amount equal to the difference between the amount the trust should have paid the income beneficiary if the correct value had been used and the amount that the trust initially paid the income beneficiary. These payments or repayments must be made within a reasonable period after the final determination of the value. Any payment due to an income beneficiary by reason of an incorrect valuation must be considered to be a payment required to be distributed at the time of the final determination for purposes of the year-of-inclusion rules.[173]

In computing the net fair market value of the trust assets, all assets and liabilities must be taken into account without regard to whether particular items are taken into account in determining the income of the trust. The net fair market value of the trust assets may be determined on any one date during the tax year of the trust, or by taking the average of valuations made on more than one date during the tax year of the trust, as long as the same valuation date or dates and valuation methods are used each year. If the governing instrument of the trust does not specify the valuation date or dates, the trustee must select the date or dates and indicate the selection on the first tax return (Form 1041-B) which the trust is required to file. The unitrust amount that must be paid each year must be based on the valuation for that year.[174]

The governing instrument of the trust must provide that, in the case of a tax year of the trust that is for a period of less than 12 months, other than the tax year in which the end of the trust's income payment period occurs:

- the unitrust amount determined under the general rules[175] must be multiplied by a fraction, the numerator of which is the number of days in the tax year of the trust and the denominator of which is 365 (366 if February 29 is a day included in the numerator);
- the unitrust amount determined under one of the income-only exceptions[176] (if applicable) must be similarly allocated; and
- if no valuation date occurs before the end of the tax year of the trust, the trust assets must be valued as of the last day of the tax year of the trust.[177]

The governing instrument of the trust must provide that, in the case of the tax year in which the end of the trust's income payment period occurs:

- The unitrust amount that must be distributed will be the amount otherwise determined under the general unitrust amount rules (if that is the case) prorated for the trust year. That is, the unitrust amount must be multiplied by a fraction, the numerator of which is the number of days in the period beginning on the first day of this last tax year and ending on the last day of the period and the denominator of which is 365 (366 if February 29 is a day included in the numerator).

---

[173] Reg. § 1.664-3(a)(1)(iii). The year-of-inclusion rules are the subject of text accompanied by *infra* note 348.
[174] Reg. § 1.664-3(a)(1)(iv).
[175] See § 12.3(a), text accompanied by *supra* notes 152–161.
[176] See § 12.3(a), text accompanied by *supra* notes 162–166.
[177] Reg. § 1.664-3(a)(1)(v)(a).

- The unitrust amount must be the amount otherwise determined under one of income-only exceptions (if applicable).
- If no valuation date occurs before the end of the period, the trust assets shall be valued as of the last day of the period.[178]

The trust will not qualify as a charitable remainder trust absent a provision that states a formula for prorating the specified distribution in the tax year when the noncharitable interests terminate.[179]

A special rule allows termination of payment of the unitrust amount with the regular payment next preceding the termination of the income payment period.[180]

Definition of Income. For purposes of the charitable remainder unitrust rules, *trust income* generally means income as defined under the basic federal tax law rules.[181] Trust income may not, however, be determined by reference to a fixed percentage of the annual fair market value of the trust property, any state law notwithstanding.

Proceeds from the sale or exchange of any assets contributed to the trust must be allocated to principal and not to trust income, at least to the extent of the fair market value of those assets on the date of their contribution to the trust. Proceeds from the sale or exchange of assets purchased by the trust must also be allocated to principal, at least to the extent of the trust's purchase price of those assets.

Otherwise, proceeds from the sale or exchange of any assets contributed to or purchased by the trust may be allocated to income, pursuant to the terms of the governing instrument, if not prohibited by local law. A discretionary power to make this allocation may be granted to the trustee under the terms of the governing instrument, but only to the extent that the state statute permits the trustee to make adjustments between income and principal so as to impartially treat beneficiaries.[182]

(b) Minimum Unitrust Amount

The fixed percentage (see above) with respect to all income beneficiaries taken together may not be less than 5 percent.[183] However, a trust will not fail to meet the minimum unitrust amount requirement by reason of the fact that it provides for a reduction of the fixed percentage payable upon the death of an income beneficiary or the expiration of a term of years, provided that:

- a distribution is made to a charitable organization at the death of the income beneficiary or the expiration of the term of years, and
- the total of the percentage after the distribution is not less than 5 percent.[184]

---

[178] Reg. § 1.664-3(a)(1)(v)(b)(1). The IRS has set forth an acceptable method for determining the net fair market value of the assets of a CRUT from which payments are made to the income beneficiary prior to the annual valuation date. Rev. Rul. 76-467, 1976-2 C.B. 198.
[179] Rev. Rul. 79-428, 1979-2 C.B. 253.
[180] Reg. § 1.664-3(a)(1)(v)(b)(2). This special rule is the subject of § 12.3(f).
[181] See § 10.13.
[182] Reg. § 1.664-3(a)(1)(i)(b)(3) (revised).
[183] IRC § 664(d)(2)(A); Reg. § 1.664-3(a)(2)(i).
[184] Reg. § 1.664-3(a)(2)(ii).

(c) Maximum Unitrust Amount

A trust cannot qualify as a CRUT if the unitrust amount for a year is greater than 50 percent of the fair market value of the trust's assets determined annually.[185] This rule was added to the law out of concern that the interplay between the rules governing the timing of income from distributions out of CRTs[186] and the rules governing the character of distributions[187] had created opportunities for abuse when the required annual payments are a large portion of the trust and realization of income and gain can be postponed until a year later than the accrual of the large payments.[188]

The example commonly given of this abuse was the creation of a charitable remainder unitrust with a required annual payout of 80 percent of the trust's assets. The trust was then funded with highly appreciated nondividend-paying stock, which the trust sold in a year subsequent to when the required distribution was includible in the beneficiary's income. The proceeds from the sale were used to pay the required distribution attributable to the prior year. The distribution of 80 percent of the trust's assets attributable to the trust's first required distribution was treated as a nontaxable distribution of corpus, because the trust had not realized any income in its first tax year.[189] This practice was regarded by Congress as abusive and inconsistent with the purpose of the CRT rules.

A trust that fails this maximum payout rule cannot constitute a CRT; instead, it is treated as a complex trust, so all its income is taxed either to its beneficiaries or to the trust.

(d) Permissible Income Recipients

The unitrust amount must be payable to or for the use of a named person or persons, at least one of which is not a charitable organization.[190] If the unitrust amount is to be paid to an individual or individuals, all of these individuals must be living at the time of creation of the trust. A named person or persons may include members of a named class, except that in the case of a class that includes any individual, all of the individuals must be alive and ascertainable at the time of creation of the trust, unless the period for which the unitrust amount is to be paid to the class consists solely of a term of years. For example, in the case of a

[185] IRC § 664(d)(2)(A).
[186] See text accompanied by *infra* note 345.
[187] See § 12.5.
[188] S. Rep. No. 105-33, 105th Cong., 1st Sess. 201 (1997).
[189] As this illustration shows, sophisticated tax planners in the planned giving context overstepped a line in using short-term CRUTs to convert appreciated property into money while avoiding a substantial portion of the tax on the gain. The IRS issued a warning in 1994 that these arrangements will be challenged, notwithstanding the fact that these approaches mechanically and literally adhere to the tax law. Notice 94-78, 1994-2 C.B. 555. Nonetheless, the rules as to the maximum unitrust amount (discussed in this section) and as to the minimum value of remainder interests (see § 12.3(i)) are designed to curb this abuse.
[190] IRC § 664(d)(2)(A).

testamentary trust, the testator's will may provide that the required amount is to be paid to his children living at his death.[191]

The IRS, however, approved an arrangement under which an otherwise qualifying charitable remainder unitrust made distributions to a second trust, when the only function of the second trust was to receive and administer the distributions for the benefit of the named individual lifetime beneficiary of the trust, who was incompetent.[192] The income beneficiary was regarded as receiving the distributions directly from the first trust. Subsequently, the IRS adopted the position that a trust serving in this fashion for any income beneficiary would suffice (that is, irrespective of whether the individual income beneficiary was incompetent),[193] although this stance was later abandoned.[194] Thus, this use of a CRUT to protect the assets of a mentally incompetent individual and to ensure that the assets are used for the individual's benefit is the only circumstance in which the IRS will permit a trust to be an income interest beneficiary of a CRUT for the duration of an individual's life.[195] The IRS subsequently formalized this position in a revenue ruling.[196]

A trust is not a charitable remainder unitrust if any person has the power to alter the amount to be paid to any named person, other than a charitable organization, if that power would cause any person to be treated as the owner of the trust or any portion of it. For example, in general, the governing instrument of the trust may not grant the trustee the power to allocate the fixed percentage among members of a class.[197] (The grantor may, however, retain a testamentary power to revoke or terminate the interest of an income beneficiary other than a charitable organization.[198]) In contrast, this rule is not violated when the grantor reserves the right to remove the trustee for any reason and substitute any other person (including the grantor) as trustee.[199]

The IRS considered the following situation involving the qualification of two trusts as CRUTs.[200] The unitrust amount in one of these trusts was payable to the grantor for life, then to A for life, then to B for life. In the trust instrument, the grantor reserved the testamentary power to revoke the interests of A and B. The trust was to terminate following the death of the final survivor among the three recipients or upon the earlier termination of the trust pursuant to its instrument. The trust was to terminate on the death of the grantor if any federal estate taxes or state death taxes for which the trust was determined to be liable upon the

---

[191] Reg. § 1.664-3(a)(3)(i). The payment scheme initially established in connection with these trusts need not always be followed, as illustrated by a renunciation of an income interest by a surviving spouse (Priv. Ltr. Rul. 200324023) and a disclaimer by a child who was a prospective income interest beneficiary of a CRUT of his or her income interest in the trust (Priv. Ltr. Rul. 200204022).

[192] Rev. Rul. 76-270, 1976-2 C.B. 194.

[193] Priv. Ltr. Rul. 9101010.

[194] Priv. Ltr. Rul. 9718030.

[195] See, e.g., Priv. Ltr. Rul. 9839024. A charitable remainder unitrust may, however, pay income amounts to a second trust for a term of 20 years or less.

[196] Rev. Rul. 2002-20, 2002-1 C.B. 794.

[197] Reg. § 1.664-3(a)(3)(ii). In one instance, the IRS ruled that a trust would be disqualified as a CRUT if the trust document was amended to change the order in which the life income beneficiaries would receive payment. Priv. Ltr. Rul. 9143030.

[198] See § 12.3(e), *infra* note 210.

[199] Rev. Rul. 77-285, 1977-2 C.B. 213.

[200] Priv. Ltr. Rul. 9252023.

death of the grantor were not paid out of the estate of the grantor (other than the assets of the trust) or, if the estate failed to do so, by A or B.

The trust instrument provided that A had the power, exercisable by his will or by written instrument delivered to the trustees of the trust during his life, to designate the specific charitable organizations that would receive the remainder interest. If A failed to make this designation, then B had that right, and if B failed to make the designation, then the grantor had that right. The grantor, A, and B were trustees of the trust. The grantor had the right to remove any trustee and appoint a successor trustee. The second trust was identical to the first one, except for the order in which A and B were entitled to receive the unitrust payments and to designate the charitable organizations that would receive the remainder interest.

The threshold issue, as to the qualification of these trusts, concerned the *creation* requirement.[201] A related issue concerned application of the grantor trust rules.[202] As noted, the grantor could remove and replace the other trustees. The trust instrument, however, fixed the unitrust amount payable to the noncharitable beneficiaries, and the grantor did not have the power to alter these amounts. The IRS ruled that the fact that the grantor was one of the trustees and had the power to remove the others did not cause the grantor to be treated as the owner of any portion of the trusts. Thus, the trusts complied with that aspect of the rules.

The IRS then examined the impact of the power in A and B, and ultimately in the grantor, to designate the specific charitable remainder interest beneficiaries. The IRS ruled that this right came within an exception to the general ownership rule[203] and thus did not cause the grantor to be treated as the owner of any portion of the trusts. (The IRS also ruled that no other provision of the grantor trust rules would cause the grantor to be treated as the owner of the trusts.)

In another instance, the IRS reviewed a trust that was intended to qualify as a charitable remainder trust. The trust had an independent trustee. The trust's governing instrument provided that the trustee was to pay the specified distribution to or among the named individuals (B, C, and D) in such amounts and proportions as the trustee, in its sole discretion, from time to time determined until the death of the survivor of B, C, or D. B was a child of A. C was unrelated to, but was a former employee of, A. D was unrelated to and never employed by A. The IRS held that because the trustee was independent, the payments could be allocated as described without precluding the trust from qualifying as a charitable remainder trust, inasmuch as the power to make the allocation would not cause any person to be treated as the owner of the trust or any portion of it.[204]

The issue concerning spousal elective share law[205] is also applicable in this context.

A pet animal is not a person for this purpose. Thus, an otherwise qualifying charitable remainder unitrust that provides for care for a pet animal during its lifetime does not qualify as a CRUT.[206]

---

[201] See § 12.1(a) and (b), *supra* notes 17–51.
[202] These rules are the subject of § 3.7.
[203] IRC § 674 (b)(4).
[204] Rev. Rul. 77-73, 1977-1 C.B. 175.
[205] See § 12.2(d), text accompanied by *supra* notes 92–99.
[206] Rev. Rul. 78-105, 1978-1 C.B. 295.

(e) Other Payments

No amount other than the unitrust amount may be paid to or for the use of any person other than a charitable organization.[207] An amount is not paid to or for the use of any person other than a charitable organization if the amount is transferred for full and complete consideration.[208] The trust may not be subject to a power to invade, alter, amend, or revoke for the beneficial use of a person other than a charitable organization.[209] The grantor may, however, retain the power exercisable only by will to revoke or terminate the interest of any income beneficiary other than a charitable organization.[210] Also, the grantor may reserve the power to designate a substitute charitable remainder beneficiary without disqualifying an otherwise qualifying charitable remainder unitrust.[211]

The governing instrument of the trust may provide that any amount other than the unitrust amount may be paid (or may be paid in the discretion of the trustee) to a charitable organization, provided that, in the case of a distribution in kind, the adjusted basis of the property distributed is fairly representative of the adjusted basis of the property available for payment on the date of payment. For example, the governing instrument of the trust may provide that a portion of the trust assets may be distributed currently, or upon the death of one or more income beneficiaries, to a charitable organization.[212]

(f) Period of Payment of Unitrust Amount

The period for which a unitrust amount is payable must begin with the first year of the CRUT and continue either

- for the life or lives of a named individual or individuals, or
- for a term of years not to exceed 20 years.[213]

Only an individual or a charitable organization may receive an amount for the life of an individual.[214] If an individual receives an amount for life, it must be solely for his or her life. Payment of a unitrust amount may terminate with the regular payment next preceding the termination of the period. (Again, the income payment period terminates at the death of the income beneficiary(ies).) The fact that the income beneficiary may not receive this last payment may not be taken

[207] IRC § 664(d)(2)(B).
[208] If an income interest beneficiary of a CRUT decides to terminate the CRUT by selling the interest to the remainder interest beneficiary, the income interest beneficiary will be taxable (IRC § 1001) on the amount of money and/or fair market value of the property received; the beneficiary would not have any basis in the property, so the full amount must be recognized (IRC § 1001(c)) and is taxable as long-term capital gain. Rev. Rul. 72-243, 1972-1 C.B. 233. See, e.g., Priv. Ltr. Rul. 200127023.
[209] Reg. § 1.664-3(a)(4). See, e.g., *Estate of Atkinson v. Commissioner*, 115 T.C. 26 (2000).
[210] See § 12.2(e), *supra* note 114. See, e.g., Rev. Rul. 74-149, 1974-1 C.B. 157; Priv. Ltr. Rul. 9252023 (holding that a CRUT is not disqualified by reason of such a provision).
[211] Rev. Rul. 76-8, 1976-1 C.B. 179.
[212] Reg. § 1.664-3(a)(4).
[213] IRC § 664(d)(2)(A).
[214] Thus, a corporation can be an income interest beneficiary of a CRUT when the unitrust amount payment period is a qualified term of years. Priv. Ltr. Rul. 9205031. This is so when the corporation is an S corporation. Priv. Ltr. Rul. 9340043. Similarly, a partnership can be an income interest beneficiary of a CRUT (Priv. Ltr. Rul. 9419021), as can a limited liability company (Priv. Ltr. Rul. 199952071). See § 3.2.

into account for purposes of determining the present value of the remainder interest.[215]

In the case of an amount payable for a term of years, the length of the term of years must be ascertainable with certainty at the time of the creation of the trust, except that the term may be terminated by the death of the income beneficiary or by the grantor's exercise by will of a retained power to revoke or terminate the interest of any income beneficiary other than a charitable organization. In any event, the period may not extend beyond either the life or lives of a named individual or individuals or a term of years not to exceed 20 years. For example, the governing instrument of a CRUT may not provide for the payment of a unitrust amount to A for his life and then to B for a term of years, because it is possible for the period to last longer than either the lives of recipients living at creation of the trust or a term of years not to exceed 20 years. By contrast, the governing instrument of the trust may provide for the payment of a unitrust amount to A for her life and then to B for her life or a term of years (not to exceed 20 years), whichever is shorter (but not longer), if both A and B are living at the creation of the trust, because it is not possible for the period to last longer than the lives of income beneficiaries living at creation of the trust.[216]

The 5 percent requirement[217] must be met until the termination of all of the income payments. For example, the following provisions would satisfy this requirement:

- A fixed percentage of at least 5 percent to A and B for their joint lives and then to the survivor for his or her life
- A fixed percentage of at least 5 percent to A for life or for a term of years not longer than 20 years, whichever is longer (or shorter)
- A fixed percentage of at least 5 percent to A for a term of years not longer than 20 years and then to B for life (assuming B was living at creation of the trust)
- A fixed percentage to A for his life and concurrently a fixed percentage to B for her life (the percentage to each recipient to terminate at his or her death), if the percentage given to each individual is not less than 5 percent
- A fixed percentage to A for his life and concurrently an equal percentage to B for her life, and at the death of the first to die, the trust to distribute one-half of the then value of its assets to a charitable organization, if the total of the percentages is not less than 5 percent for the entire period[218]

The IRS also approved the following unitrust provision. Each year, quarterly distributions at an annual rate of 6 percent of the net fair market value of the trust assets, determined annually, are to be made to B for a term of 20 years. If B dies before the expiration of the 20-year term, the payments will be made to C for the balance of the term remaining. If C also dies before the expiration of the 20-year period, then distributions for the balance of the period remaining are to be

[215] Reg. § 1.664-3(a)(5)(i).
[216] *Id.*
[217] See §12.3(b).
[218] Reg. § 1.664-3(a)(5)(ii).

made to C's heirs at law, excluding the donor and his spouse. At the end of the 20-year term, the balance remaining in the trust is to be distributed to the remainder interest beneficiary.[219]

(g) Permissible Remainder Interest Beneficiaries

At the end of the income payment period (see above), the entire corpus of the trust must be irrevocably transferred, in whole or in part, to or for the use of one or more charitable organizations or retained, in whole or in part, for a charitable use[220] or, to the extent the remainder interest is in qualified employer securities, all or part of the securities may be transferred to an employee stock ownership plan[221] in a qualified gratuitous transfer.[222] The trustee may have the power, exercisable during the donor's life, to add and/or substitute additional charitable organizations as remainder interest beneficiaries.[223]

If all of the trust corpus is to be retained for charitable use, the tax year of the trust must terminate at the end of the income payment period and the trust will cease to be treated as a charitable remainder trust for all purposes. If all or any portion of the trust corpus is to be transferred to or for the use of a charitable organization or organizations, the trustee must have a reasonable time after the income payment period to complete the settlement of the trust. During that time, the trust must continue to be treated as a charitable remainder trust for all purposes. Upon the expiration of the period, the tax year of the trust must terminate and the trust must cease to be treated as a charitable remainder trust for all purposes. If the trust continues in existence, it will be considered a charitable trust[224] unless the trust becomes a tax-exempt organization.[225] For purposes of determining whether the trust is tax-exempt as a charitable organization,[226] the trust is deemed to have been created at the time it ceased to be treated as a CRT.[227]

When interests in the corpus of a CRT are given to more than one charitable organization, the interests may be enjoyed by them either concurrently or successively.[228]

The governing instrument of a CRT must provide that (1) if an organization to or for the use of which the trust corpus is to be transferred, or for the use of which the trust corpus is to be retained, is not a charitable organization at the time any amount is to be irrevocably transferred to or for the use of the

[219] Rev. Rul. 74-39, 1974-1 C.B. 156.

[220] IRC § 664(d)(2)(C); Reg. § 1.664-3(a)(6)(i).

[221] A plan of this nature (authorized by IRC § 4975(e)(7)) is a qualified stock bonus plan or a combination stock bonus and money purchase pension plan under which employer securities are held for the benefit of employees. The securities, which are held by one or more tax-exempt trusts under the plan, may be acquired through direct employer contributions or with the proceeds of a loan to the trust or trusts.

[222] A qualified gratuitous transfer of employer securities to an employee stock ownership plan gives rise to an estate tax charitable contribution deduction based on the present value of the remainder interest. IRC § 2055 (a)(5).

[223] Rev. Rul. 76-371, 1976-2 C.B. 305. A charitable remainder unitrust does not fail to qualify because the grantor retains the power to change the charitable remainder beneficiary. Priv. Ltr. Rul. 9204036.

[224] IRC § 4947(a)(1).

[225] That is, becomes tax-exempt under IRC § 501(a) by reason of qualification under IRC § 501(c)(3).

[226] That is, an IRC § 501(c)(3) organization. See § 3.3.

[227] Reg. § 1.664-3(a)(6)(ii).

[228] Reg. § 1.664-3(a)(6)(iii).

organization, then (2) the amount will be transferred to or for the use of or retained for the use of one or more alternative organizations that are charitable entities at that time. This alternative organization (or these alternative organizations) may be selected in any manner provided by the terms of the governing instrument of the trust.[229]

In general, the allowable charitable deduction for property transferred to a valid charitable remainder trust will be subject to the 20 percent contributions limitation[230] when the organization designated to receive the remainder interest may be redesignated from a public charity to a nonpublic charity.[231] This will not be the outcome, however, when the likelihood that the remainder interest will not go to a public charitable organization is so remote as to be negligible.[232]

The rules as to qualified employer securities and qualified gratuitous transfers were summarized previously.[233]

(h) Additional Contributions

A trust is not a CRUT unless its governing instrument either prohibits additional contributions to the trust after the initial contribution, or provides that for the tax year of the trust in which the additional contribution is made:

- when no valuation date occurs after the time of the contribution and during the tax year in which the contribution is made, the additional property must be valued as of the time of contribution, and
- the unitrust amount must be computed by multiplying the fixed percentage by the sum of (1) the net fair market value of the trust assets (excluding the value of the additional property and any earned income from and any appreciation on the property after its contribution) and (2) that proportion of the value of the additional property (that was excluded), with the number of days in the period that begins with the date of contribution and ends with the earlier of the last day of the tax year or the last day of the income payment period bears to the number of days in the period that begins with the first day of the tax year and ends with the earlier of the last day of the tax year or the last day of the income payment period.[234]

This additional-contribution feature offers unique tax planning opportunities, such as use of a unitrust as a retirement program. In one instance, a husband and wife created a CRUT with joint and survivorship income payments. The husband was in the process of retiring from his business of raising cattle for slaughter and farming crops. The first contributions to the trust were of cattle and crops;

---

[229] Reg. § 1.664-3(a)(6)(iv).
[230] See § 7.12.
[231] Rev. Rul. 79-368, 1979-2 C.B. 109.
[232] Rev. Rul. 80-38, 1980-1 C.B. 56.
[233] See § 12.2(g), text accompanied by *supra* notes 122–141.
[234] Reg. § 1.664-3(b). Despite the fact that the governing instrument of a CRUT provided that additional contributions could not be made to the trust, the donors made an additional contribution; the IRS viewed the second gift, which was undone, as a legal nullity and ruled that the qualification of the trust was not disturbed. Priv. Ltr. Rul. 200052026.

thereafter, as the business wound down, there were additional contributions of farming and ranching assets (including farm machinery) and more cattle and crops. The charitable organization involved had the right to sell the stock and machinery.[235] Thus, these individuals were able to gradually disband the business, transferring properties to the trust as they did so. The charitable trustee was able to dispose of these properties without tax, the resulting proceeds were used to fund the annual payout to the retirees, and the individuals received a charitable contribution deduction for the gifts of remainder interests.[236]

For these purposes, all property passing to a CRUT by reason of death of the grantor must be considered one contribution.[237]

The application of these rules is illustrated by the following examples.

EXAMPLE 12.9

On March 1, 2009, X makes an additional contribution of property to a CRUT. The tax year of the trust is the calendar year, and the regular valuation date is January 1 of each year. The fixed percentage is 5 percent. For purposes of computing the required payout with respect to the additional contribution for the year of contribution, the additional contribution is valued on March 1, 2009 (the date of contribution). The property had a value on that date of $5,000. Income from this property in the amount of $250 was received on December 31, 2009. The required payout with respect to the additional contribution for the year of contribution was $208 (5% × $5,000 × 305/365). The income earned after the date of contribution and after the regular valuation date did not enter into the computation.[a]

[a] *Id.*, example (1).

EXAMPLE 12.10

On July 1, 2009, X makes an additional contribution of $10,000 to a CRUT. The tax year of the trust is the calendar year and the regular valuation date is December 31 of each year. The fixed percentage is 5 percent. Between July 1, 2009, and December 31, 2009, the additional property appreciated in value to $12,500 and earned $500 of income. Because the regular valuation date for the year of contribution occurred after the date of the additional contribution, the additional contribution (including income earned by it) is valued on the regular valuation date. Thus, the required payout with respect to the additional contribution is $325.87 (5% × [$12,500 + $500] × 183/365).[a]

[a] Reg. § 1.664-3(b), example (2). Also Rev. Rul. 74-481, 1974-2 C.B. 190.

(i) Minimum Value of Remainder Interest

With respect to each contribution of property to a CRUT, the value of the remainder interest in the property[238] must be at least 10 percent of the net fair market value of the property as of the date the property is contributed to the trust.[239]

---

[235] The IRS ruled that occasional sales of these items would not constitute an unrelated business that is regularly carried on. See § 3.5(c).

[236] Priv. Ltr. Rul. 9413020.

[237] Reg. § 1.664-3(b).

[238] See ch. 11.

[239] IRC § 664(d)(2)(D). In one instance, the value of a remainder interest in a trust at inception was less than 10 percent of the initial net fair market value of the trust property, with the value of the remainder interest calculated without regard to a qualified contingency (see § 12.11(c)). Priv. Ltr. Rul. 200414011.

This 10 percent test is applicable with respect to each transfer of property to a charitable remainder trust. Consequently, a CRUT that meets the 10 percent test on the date of transfer will not subsequently fail to meet the test if interest rates have declined between the time of creation of the trust and the death of an individual whose life is a measuring life. Similarly, when a CRT is created for the joint lives of two individuals, with a remainder to charity, the trust will not cease to qualify as a CRT because the value of the charitable remainder was less than 10 percent of the trust's assets at the first death of these two individuals.[240]

There are three other rules designed to provide relief for trusts that do not meet the general 10 percent requirement. Two of them are discussed above.[241] The third is this: when an additional contribution is made after June 28, 1997, to a charitable remainder unitrust created before July 29, 1997, and the unitrust would not meet the 10 percent requirement with respect to the additional contribution, the additional contribution is to be treated as if it had been made to a new trust that does not meet the 10 percent requirement but which does not affect the status of the original unitrust as a charitable remainder trust.[242]

(j) Charitable Deductions

The federal income tax charitable contribution deduction is limited to the fair market value of the remainder interest of a CRUT, regardless of whether a charitable organization also receives a portion of the unitrust amount.[243] A federal income tax charitable contribution deduction is available for a gift of an undivided fractional share of the donor's unitrust interest in a CRUT.[244] This type of contribution does not cause disqualification of the trust.

§ 12.4 ISSUES

The creation and utilization of CRTs continually generates new legal issues. These are usually reflected in private letter rulings issued by the IRS; on occasion, the matter is reflected in a court opinion. A summary of the issues of this nature follows.

---

[240] H. Rep. No. 105-220, 105th Cong., 1st Sess. 607 (1997).

[241] See § 12.2(i).

[242] IRC § 664(d)(4).

[243] Reg. § 1.664-3(d). The IRS ruled that a retired individual, with a qualified (IRC § 401(a)) retirement plan permitting a participant to have any portion of an eligible rollover distribution paid directly to a single eligible retirement plan, and who was entitled to a distribution including employee stock ownership plan stock, could direct a rollover of a portion of the stock to his individual retirement account and transfer the rest of the stock to a CRUT, without recognizing net unrealized appreciation because the plan distribution was a lump sum (IRC § 402(e)(4)(B)). Priv. Ltr. Rul. 200038050. A charitable contribution deduction was allowed for the contribution of shares of stock to the CRUT equal to the fair market value of the remainder interest in these securities. See ch. 11.

The rules for calculating this deduction are summarized in § 12.11(b). For the rules relating to the reduction of the amount of a charitable contribution deduction with respect to a contribution of certain ordinary income property or capital gain property, see §§ 4.4, 4.5. For rules for postponing the time for deduction of a charitable contribution of a future interest in tangible personal property, see § 9.21.

[244] E.g., Priv. Ltr. Rul. 200205008.

(a) Transfers of Options

The IRS ruled that the transfer of an option to a CRT is a transaction that may cause the trust to lose its remainder trust tax status.[245] This is certainly so when it would be inappropriate to transfer the underlying property to the trust.

In the subject case, an individual created a CRUT, funding it with a small amount of money. Subsequently, this donor transferred certain unencumbered real property to the trust. The contributor, as income beneficiary, was entitled to an annual unitrust amount of 9 percent.

The donor proposed to enter into an agreement with the trustee by which the trust would possess the right (but not the obligation) to acquire an interest in certain encumbered real property from the donor for a sum of money (an option). The grant of this option would be gratuitous, in that the donor would not receive any financial compensation in exchange for the transfer. The encumbered real property was contiguous with the unencumbered real property previously contributed to the trust. The donor was personally liable on the underlying mortgage on the property that would be the subject of the option.

The trust's rights under this option agreement would be assignable by it and by any third-party assignee. It was not anticipated that the trust would exercise this option. Rather, the plan was that the trust would assign it to a third-party purchaser and receive as consideration an amount approximating the difference between the fair market value of the real property at the time of the assignment and the exercise price. The trust would invest the sales proceeds in income-producing securities, to be held by the trust to pay the unitrust amount. The third-party purchaser of the option would not be related to the donor or the trustee, and the donor would not participate in any negotiations relating to the assignment of the option.

The IRS was asked to rule that the donor would not be treated as the owner of the trust under the grantor trust rules[246] and that the donor would not recognize any gain or loss as a result of the trust's contemplated assignment of the option to a third-party purchaser for valuable consideration. The IRS was asked to assume that the trust was a valid CRT. The IRS refused to proceed on this assumption. Instead, it first considered whether the transfer of the option would disqualify the trust as a charitable remainder trust for federal tax purposes. As noted, the IRS ruled that it would.

In this ruling, the IRS reviewed the rules for CRUTs[247] and observed that these rules were created to ensure that the amount a charitable organization receives at the end of the income payment period reflects the amount on which the donor's charitable deduction was based. Notice was taken of the fact that these trusts provide various benefits, including a charitable deduction for the present value of the donated remainder interest[248] and tax exemption for the trust's income.[249]

---

[245] Priv. Ltr. Rul. 9501004.
[246] These rules are the subject of § 3.7.
[247] These rules are the subject of § 12.3.
[248] The deduction is the subject of § 12.12.
[249] This exemption is the subject of § 12.8.

A CRT is a trust with respect to which a charitable deduction is allowable—for income, gift, or estate tax purposes. The IRS added that a trust must be a CRT in every respect, and must meet the definition of and function exclusively as a CRT from its creation.[250] The core of its position is that these requirements cannot be met ''unless each transfer to the trust during its life qualifies for a charitable deduction.''

The IRS continued with this analysis, stating that in situations in which a tax deduction is not allowable for a transfer to the trust, ''it appears that the donor is merely using the trust as a means to take advantage of the exemption from current income tax on the gain from the sale of the property.'' This use of a CRT was held to be inconsistent with the purpose intended by Congress in writing rules for these trusts.

The IRS pointed out that certain federal tax law provisions limit the type of property that can be transferred directly to a CRT.[251] The agency wrote that ''[w]hen an option to purchase property, rather than the property itself, is transferred to a charitable remainder trust, the donor is attempting to avoid the requirements that would be applicable to a direct transfer of the property.'' In this case, the donor was characterized as ''using the purported option in an attempt to avoid the restrictions that would be applicable to a direct transfer of encumbered real estate to a charitable remainder trust.''

The IRS thus turned to the question of whether the transfer of the option to the trust would qualify for an income tax or gift tax charitable contribution deduction. (The proposed transaction being a lifetime one, the estate tax deduction was not involved.) The IRS ruled that the grant of an option to a charitable organization is not a deductible contribution for federal income tax purposes.[252] The transfer of an option is akin to the transfer of a note[253] or a pledge,[254] so that the grantor of an option is entitled to an income tax charitable deduction in the year the option is exercised, not the year in which it was granted.

In this case, the facts indicated that the trust would not exercise the option but would assign it to a third party for compensation. The IRS held that even if the third-party purchaser were a charitable organization, there would be a ''payment'' when the option was exercised, but no charitable deduction because of the general rule denying a charitable deduction for the transfer of an interest in property consisting of less than the contributor's interest in the property.[255] In any event, the payment to the third-party charitable organization or other purchaser would be outside the trust.

---

[250] See § 12.1.

[251] The ruling does not contain any citation to these provisions—because there are none. The reference in this case is to the fact that encumbered real estate that gives rise to unrelated debt-financed income would likely, when in a CRT, cause the trust to lose its tax-exempt status because of the receipt of unrelated business taxable income. See § 12.8. Likewise, there can be tax law difficulties when the property transferred is tangible personal property. See § 12.4(c). There are, however, no ''limitations'' (in the nature of prohibitions) on these types of transfers.

[252] See § 6.9.

[253] See § 6.7.

[254] See § 4.9.

[255] See § 9.23.

As for the gift tax charitable deduction,[256] the same rules largely apply. There is no gift tax deduction for the transfer of a remainder interest in trust unless the trust is a qualifying one, such as a CRT. The transfer of an option to purchase real property for a specified period is a completed gift on the date the option is transferred.[257] This outcome occurs only when the option is, under state law, binding and enforceable on the date of the transfer. In this instance, the option would not be binding on the donor when granted because it would have been granted gratuitously. Also, the donor would have the power to withdraw the option at any time. Neither the trustee nor a third-party purchaser of the option from the trustee could prevent the donor from doing so. Because the proposed transfer of the option to the trust would not constitute a completed gift, a gift tax charitable deduction was not allowable.

It was argued that the option would be supported by consideration in the form of the trustee's obligation to pay the unitrust amount to the donor. The IRS rejected this view, relying on a body of case law.[258]

The parties also contended that under local contract law, a benefit conferred upon the promisor or upon a third party can constitute consideration, and that detrimental reliance by the third-party charitable remainder beneficiary may result in consideration. The IRS, not impressed with this position, reiterated that the option could not support consideration because it would be granted gratuitously and could be revoked at any time. Also, the charitable organization would not have been provided any guarantee or promise as to the amount of the corpus in the trust, so it would not have any basis for reliance that would stop the donor from revoking it. Thus, the IRS wrote, whether the option would become enforceable would depend upon ''hypothetical and somewhat speculative future events,'' making it clear that the option would not be enforceable at the time it was transferred to the trust. Again, the IRS concluded that the transfer of the option to the trust would not be a completed gift and consequently could not give rise to a charitable deduction.

The IRS maintained that the sale of the option by the trustee to a third party would not be treated as completing the donor's gift to the trust, assuming the sale did not render the option enforceable at that time. A subsequent sale of the real estate by the donor to a third-party assignee at the option price might, the IRS conjectured, be viewed as a gift (in the form of a bargain sale)[259] from the donor to the assignee on the date of sale. If the third-party assignee were a charitable organization, the gift could qualify for a gift tax charitable deduction. In this situation, the gift would be considered to be made to the third-party charity outside the trust. Accordingly, the transfer would not constitute a transfer to the trust for which a gift tax charitable contribution would be allowable with respect to the trust.

Because neither charitable contribution deduction would be allowable, the IRS concluded that the trust could not be a CRT in every respect and could not function exclusively as a CRT from its inception. Thus, upon transfer of the

---

[256] See § 8.2(k).

[257] Rev. Rul. 80-186, 1980-2 C.B. 280.

[258] E.g., *Estate of Gregory v. Commissioner*, 39 T.C. 1012 (1963) (retention of a life estate in one's own property cannot be consideration for a transfer).

[259] See § 9.19.

option to the trust, it would cease to qualify as a CRT under the federal tax law. Presumably, therefore, the proposed transfer of the option did not take place.[260]

(b) Right to Change Charities or Trustees

The IRS ruled that the power in grantors to CRTs to change the flow of remainder interests to charitable organizations, or to alter the nature of the trusteeship, does not adversely affect the federal tax status of the trusts.[261]

In the case, the grantors were the sole recipients of the income interest payments (unitrust amounts). These payments were to be made to the grantors in equal shares for their joint lives and thereafter to the survivor of the two for his or her life. The charitable organizations that were to receive the remainder interest were listed in the trust agreement. The grantors, however, retained the right to modify, amend, or revoke these remainder interest designations and substitute new ones or change the proportions to be received by each charitable organization.

Moreover, the grantors elected to serve as the initial trustees of the trust. The trust agreement provided that, upon the resignation of a trustee, a successor trustee could be appointed by either or both of the grantors, depending on circumstances prescribed in the agreement. If there was no appointment, the couple's child was to serve as successor trustee.

A trust does not qualify as a CRUT if any person has the power to alter the amount to be paid to any named person, other than a charitable organization, if the power would cause any person to be treated as the owner of the trust, or a portion of it, under the grantor trust rules.[262] A grantor is treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or income from it is subject to a power of disposition exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.[263] This rule does not apply, however, to a power, regardless of who holds it, to determine the beneficial enjoyment of the corpus or income from it if the corpus or income is irrevocably payable for a charitable purpose.[264]

A power held by a grantor or a nonadverse party to choose between charitable beneficiaries or to affect the manner of their enjoyment of a beneficial interest will not cause the grantor to be treated as the owner of a portion of the trust.[265] The IRS previously observed that a power retained by the grantor of an otherwise qualifying CRT to designate a substitute charitable organization as a remainder interest beneficiary is not a power that disqualifies the trust as a CRT for federal income tax purposes.[266]

In this case, however, the powers reserved by the grantors were more extensive: they could not only revise the list of charitable beneficiaries, but they could

---

[260] As to the issue for which the ruling was sought, the IRS ruled that the donor would be treated as the owner of the trust's assets for federal income tax purposes, so that the donor's taxable income would include the trust's items of income, including any gain the trust realized on transfer of the option to a third party.

[261] E.g., Priv. Ltr. Rul. 9504012.

[262] See § 12.3(d), text accompanied by *supra* note 197.

[263] See § 3.7, text accompanied by note 542.

[264] *Id.*, text accompanied by note 543.

[265] *Id.*, text accompanied by note 544.

[266] See §§ 12.2, text accompanied by *supra* note 104, and § 12.3, text accompanied by *supra* note 211.

also change the proportion of the remainder that would pass to any particular charitable organization. Inasmuch as these powers are embraced by the exception to the grantor trust rules, the IRS was enabled to then hold that the powers did not adversely affect the trust's qualification as a CRT.

An otherwise qualifying CRT that authorizes the grantor to remove the trustee for any reason and substitute any person, including himself or herself, is not disqualified, as long as the trustee does not have the discretion to allocate the specified distribution among the income beneficiaries.[267] In the case, the IRS ruled that, because the trust instrument fixed the proportion of the unitrust amount distributable to each grantor, the trustees did not have the discretion to allocate this amount between the grantors. Thus, the authority of the grantors or their child under the trust agreement to serve as trustees was held not to cause either grantor to be treated as an owner of any portion of the trust. That, in turn, enabled the IRS to rule that the service as trustees by the grantors or their child did not adversely affect the qualification of the trust as a charitable remainder unitrust under the federal tax law—assuming it otherwise qualified.[268] Indeed, a CRT may be structured so that the grantor of the trust is initially the sole trustee of it, without disqualifying the trust.[269]

(c) Transfers of Tangible Personal Property

The IRS addressed the tax consequences of the transfer of an item of tangible personal property to a CRT.[270] In the particular case, an individual wanted to transfer a musical instrument to a CRT.

The first consideration is the future interest rule. A charitable contribution of a future interest in tangible personal property is treated as made for tax purposes only when all intervening interests in, and rights to, the actual possession or enjoyment of the property have expired or are held by persons other than the donor or those standing in a close relationship to the donor.[271] By contributing the instrument to the trust, the donor would be creating and retaining an income interest in it, thus triggering the future interest rule. There would be an income tax charitable contribution deduction, however, when the trustee sold the instrument. This is because the income interest would then be in the proceeds of the sale of the instrument rather than in the instrument itself.

When there is a charitable contribution of tangible personal property and the donee uses the property in a manner unrelated to its exempt purpose, the amount of the charitable deduction must be reduced by the amount of gain that would have been long-term capital gain if the property had been sold for its fair market value.[272] Under the facts of this ruling, it was contemplated that the trust would sell the instrument (a long-term capital asset) within the calendar year of the gift. The sale would be an unrelated use. Therefore, the donor's charitable deduction

---

[267] See §§ 12.2, text accompanied by *supra* note 89; § 12.3, text accompanied by *supra* note 199.

[268] In one instance, the IRS ruled that a trust did not become disqualified as a CRT when its grantors exercised their authority pursuant to the trust instrument to remove the initial institutional trustee and appoint themselves as the trustees of the trust. Priv. Ltr. Rul. 200029031.

[269] E.g., Priv. Ltr. Rul. 200245058.

[270] Priv. Ltr. Rul. 9452026.

[271] See § 9.21.

[272] See § 4.6.

(already confined to a remainder interest and in existence only after the sale of the property) would have to be reduced to the amount of the donor's basis in the property allocable to the remainder interest.

When there is a charitable contribution of property and the donee is not a public charity,[273] the charitable deduction for the gift generally must be confined to an amount equal to 20 percent of the donor's contribution base.[274] When the recipient is a public charity, there is a 30 percent limitation.[275] The donor in this instance wanted the 30 percent limitation to apply, presumably on the ground that the remainder interest beneficiary would be a public charity. However, the charitable remainder donee for the trust was not specifically designated.

Under the terms of the trust, the donor reserved a lifetime power of appointment and a testamentary power to designate the charitable beneficiary. The trust instrument did not confine the class of charitable beneficiaries to those that are public charities. Thus, the IRS held that it was possible that one or more beneficiaries would be other than public charities. Were there to be a charitable deduction for the gift of the instrument (after working through the previous three tax rules), the IRS ruled that the 20 percent limitation would apply.

As noted, the IRS also ruled that the deduction would not come into being until the instrument was sold. The gift then would be of the sales proceeds—money. For these types of gifts, the percentage limitations generally are 50 percent for public charities[276] and 30 percent for other charitable organizations.[277] Therefore, the IRS ruled that the 30 percent limitation would apply in this case. (That is, that limit would apply once the aforementioned deduction reductions were taken into account.)

(d) Allocation of Gains to Income

The federal tax law on this point has been revised.[278] The following is a summary of the state of the law preceding and leading up to these changes.

The IRS has ruled that the governing instrument of a CRT may direct the trustee to allocate realized capital gains to trust income, without jeopardizing the tax status of the trust.[279] The IRS also ruled, however, that this type of allocation must be in conformity with applicable state law.

In general, for federal tax purposes, the word *income*, when applied in the trust or estate context, means the amount of income of the trust or estate for the tax year determined under the terms of the governing instrument and applicable local law.[280] Nonetheless, trust provisions that depart fundamentally from concepts of local law in the determination of what constitutes income are not recognized by the IRS.[281]

---

[273] See § 3.4.
[274] See § 7.12.
[275] See § 7.6.
[276] See § 7.5.
[277] See § 7.8.
[278] See § 10.13.
[279] Priv. Ltr. Rul. 9511007.
[280] IRC § 643(b).
[281] Reg. § 1.643(b)-1. For example, this would occur when a trust instrument defined ordinary dividends and interest as principal. *Id*.

In this case, under the applicable state law, principal included consideration received by a trustee on the sale or other transfer of capital property. Thus, capital gains were generally allocated to principal under state law. The state's law, however, also allowed the terms of the governing instrument to control the allocation of receipts and expenditures.

This case also involved the fact that the CRT was a NIMCRUT.[282] The IRS took note of the fact that the trustee's ability to allocate capital gains to trust income created the potential for manipulation of the trust assets to the detriment of the charitable remainder interest. That is, the trustee would be able to inflate the unitrust amount each year by amounts that would be payable to the noncharitable beneficiary upon the sale of assets. Under these circumstances, the amount that would be paid to the charitable organization at the termination of the trust could well be less than the amount that would be paid to the charity if the fixed unitrust amount were paid annually.

The IRS wrote that when the trust's capital gains are otherwise lawfully allocated to trust income, the ''trust's obligation to pay the prior years' deficiency to the noncharitable beneficiary must be accounted for to the extent that the trustee would trigger that obligation if he sold the assets on the valuation date.'' This is accomplished as follows. In determining the fair market value of the assets on the annual valuation date, the governing instrument must require the trustee to treat as a liability the amount of any deficiency for prior years. The amount treated as a liability need not exceed the trust's unrealized appreciation that would be trust income under the terms of the governing instrument and applicable local law if the trustee sold all the assets in the trust on the valuation date. The IRS wrote that this type of trust provision ''will ensure that the timing of the realization of the gain by the trustee cannot be manipulated to the detriment of the charitable remainder interest.'' In the case, the trust's tax status was not adversely affected because its governing instrument provided that, for purposes of determining the unitrust amount each year, the fair market value of the assets must be reduced by the amount of any deficiency in unitrust payments from prior years and that the reduction could not exceed the amount of the unrealized gain in the trust's assets as of the valuation date. Thus, in this particular instance, the trust provision allocating capital gains to trust income did not adversely affect the tax status of the trust, because it was coupled with a provision treating a specific amount of any unitrust deficiency as a liability in valuing the trust's assets.[283]

(e) Death Taxes

The IRS ruled that certain provisions in the governing instrument of a CRT concerning the payment of death taxes will not disturb the tax qualification of the trust.[284] One article of the subject trust instrument provided that no

[282] Reg. § 1.664-3(a)(1)(i)(b). See § 12.3(a), text accompanied by *supra* notes 165 and 166.

[283] There is a prohibition on the allocation of precontribution gain to trust income for an income-exception CRUT. Reg. § 1.664-3(a)(1)(i)(b)(4). As discussed, however, the governing instrument, if permitted under applicable local law, may allow the allocation of postcontribution capital gains to trust income.

[284] Priv. Ltr. Rul. 9512016.

death taxes of any character and irrespective of their name, including the federal estate tax (and any accompanying interest and penalties), could be allocated to or recoverable from the trust. It also provided that the grantor's estate was obligated to pay any such death taxes from sources other than the trust. In addition, the article provided that if for any reason the trust became liable for any such death taxes, the interest of an income interest beneficiary would continue or take effect only if the beneficiary furnished the funds for payment of all such taxes attributable to the interest in trust received by the beneficiary. Finally, this article provided that if a beneficiary failed to furnish all such funds, the beneficiary would be deemed to have predeceased the donor. These provisions were held not to adversely affect the trust's federal tax status, because they did not present an opportunity for interference with the charitable beneficiary's remainder interest.

(f) Valuation of Unmarketable Assets

If unmarketable assets[285] are transferred to or held by a CRT, the trust will not be a trust with respect to which one or more charitable contribution deductions are available, or will be treated as failing to function exclusively as a charitable remainder trust, unless, whenever the trust is required to value assets of this nature, the valuation is performed exclusively by an independent trustee or determined by a current qualified appraisal[286] prepared by a qualified appraiser.[287]

An *independent trustee* is a person who is not the grantor of the trust, a noncharitable beneficiary, or a related or subordinate party to the grantor, the grantor's spouse, or a noncharitable beneficiary.[288]

(g) Time for Paying Income Amount

For years, the law permitted the trustee of a CRT to pay the annuity amount or unitrust amount within a reasonable time following the close of the trust's tax year.[289] This was intended as an administrative convenience for trustees. The government came to the view, however, that in certain instances CRTs were manipulated in abuse of this rule, such as in the case of accelerated remainder trusts.[290] As a consequence, the tax regulations were altered to provide that, for CRATs and SCRUTs, the annuity amount or unitrust amount may be paid within a reasonable time after the close of the year for which that income interest payment is due, if the character of the entire annuity amount or unitrust amount in the hands of the recipient is income under the distribution characterization rules,[291] except to the extent it is characterized as corpus under those rules because

[285] See § 12.3(a), text accompanied by *supra* note 172.
[286] See § 21.5(a).
[287] Reg. § 1.664-1(a)(7)(i). See § 21.5(b).
[288] Reg. § 1.664-1(a)(7)(iii).
[289] See § 12.2(a), *supra* note 64.
[290] See § 12.3(e).
[291] See § 12.5.

- the trust distributes property (other than money) that it owned as of the close of the tax year to pay the annuity amount or unitrust amount, and
- the trustee elects (on Form 5227) to treat any income generated by the distribution as occurring on the last day of the tax year for which the annuity amount or unitrust amount is due.[292]

EXAMPLE 12.11

X is a CRAT. The prorated annuity amount payable from X for Year 1 is $100. The trustee of X does not pay the annuity amount to the recipient by the close of Year 1. At the end of Year 1, X has $95 in the ordinary income category and no income in the capital gain or tax-exempt income categories. By April 15 of Year 2, in addition to $95 in money, the trustee distributes to the recipient of the annuity amount a capital asset with a $5 fair market value and a $2 adjusted basis, to pay the $100 annuity amount for Year 1. The trust owned the asset at the end of Year 1. The distribution is treated as a sale by X,[a] resulting in recognition by X of a $3 capital gain. The trustee elects to treat the capital gain as occurring on the last day of Year 1. The character of the annuity amount for Year 1 in the recipient's hands is $95 of ordinary income, $3 of capital gain income, and $2 of trust corpus. For Year 1, X satisfied this rule.[b]

[a] Reg. § 1.664-1(d)(5).
[b] Reg. § 1.664-2(a)(1)(i)(d). A similar example as to a SCRUT appears in Reg. § 1.664-3(a)(1)(i)(i)).

For NICRUTs and NIMCRUTs, the law continues to be that, if the unitrust pays the unitrust amount within a reasonable time after the close of the trust's year, the trust is not deemed to have engaged in an act of self-dealing, have unrelated debt-financed income, have received an additional contribution, or have failed to function exclusively as a CRT.[293]

(h) Determining Certain Gift Amounts

There are special rules for determining the amount of the gift when an individual makes a transfer in trust to or for the benefit of a family member and the individual or an applicable family member retains an interest in the trust.[294] This body of law, until recently, did not—by reason of a provision in the gift tax regulations[295]—apply with respect to CRATs or CRUTs.

The retained interest in these situations (that is, where these rules apply) generally is valued at zero (namely, is ignored for this purpose) unless the interest is a *qualified interest*.[296] A qualified interest includes the right to receive fixed payments at least annually and the right to receive amounts at least annually that are a fixed percentage of the annual fair market value of the property in the trust.[297]

---

[292] Reg. §§ 1.664-2(a)(1)(i)(a), (b); 1.664-3(a)(1)(i)(g), (h). The proposed regulations were more stringent in this regard; the IRS proposed a relaxed rule for 1997. Notice 97-68, 1997-2 C.B. 330. The final regulations closely resemble the 1997 notice (which was rendered obsolete as of December 10, 1998).
[293] Reg. § 1.664-3(a)(1)(i)(j).
[294] IRC § 2702.
[295] Former Reg. § 25.2702-1(c)(3).
[296] IRC § 2702(a).
[297] IRC § 2702(b).

This body of law was amended in 1996 to exclude a transfer, to the extent that regulations provide that the transfer is not inconsistent with the purposes of that rule.[298] This regulatory authority may be used to create an exception from the application of this body of law for a CRT that does not create an opportunity to transfer property to a family member free of transfer tax.

Some individuals created NICRUTs or NIMCRUTs to take advantage of this exclusion granted to CRTs in general. This was done in an attempt to use the exclusion and the income-exception feature of one of these CRUTs to pass substantial assets to family members with minimal transfer tax consequences.

EXAMPLE 12.12

A donor establishes a NIMCRUT to pay the lesser of trust income or a fixed percentage to the donor for a term of 15 years or her life, whichever is shorter, and then to her daughter for the daughter's life. If the tables[a] are used to value the donor's retained interest and the donor's gift to the daughter, the amount of the gift to the daughter is relatively small compared to the amount the daughter may actually receive. The trustee may invest in assets that produce little or no trust income while the donor retains the unitrust interest, creating a substantial make-up amount. At the end of the donor's interest, the trustee alters the NIMCRUT's investments to generate significant amounts of trust income. The trustee then uses the income to pay to the donor's daughter the current fixed percentage amount and the make-up amount, which includes the make-up amount accumulated while the donor was the unitrust recipient.

[a] See § 11.3.

The use of a CRUT in this fashion would permit the shifting of a beneficial interest in the trust from the donor to another family member and thus would create an opportunity to transfer property to a family member free of transfer tax. A transfer of this nature is contrary to the intent underlying the provision enacted in 1996.

Therefore, the gift tax regulations were amended to provide that the unitrust interest in a CRUT, using an income-exception method (generally including a FLIPCRUT), retained by the donor or any applicable family member generally is valued at zero when someone other than the donor, the donor's spouse, or both the donor and the donor's spouse (who is a citizen of the United States) is a noncharitable beneficiary of the trust. (This rule does not apply when there are only two consecutive noncharitable beneficial interests and the transferor holds the second of the two interests.) In these situations, the value of the donor's gift is the fair market value of all the property transferred to the CRUT. The present value of the remainder interest passing to the charitable organization involved will qualify for the gift tax charitable contribution deduction. Accordingly, the amount used to calculate the donor's gift tax liability is the value of the property transferred to the trust less the value of the interest passing to charity.[299]

[298] IRC § 2702(a)(3)(A)(iii).
[299] Reg. § 25.2702-1(c)(3)(i).

This gift tax exclusion continues to exclude transfers to CRATs and SCRUTs (and to pooled income funds) from the application of this body of law.[300]

(i) Scriveners' Errors

As the varieties of CRTs increase, so too does the opportunity for mistakes in the preparation of trust documents. Errors can be made by lawyers and other financial planners who draft documents, and inadvertently insert one or more provisions that should not be in the document or fail to include one or more provisions that are required to be in the document. (This phenomenon is exacerbated by prototype forms and word processing, and occasionally by incompetence.) Sometimes there is miscommunication between donors and their advisors; donors often fail to understand, or perhaps not even read, the trust documents.

In one instance, a financial planner, who was advising two prospective donors and working with a planned giving specialist at a charitable organization, provided the individuals with illustrations of a SCRUT and a NIMCRUT. The individuals selected a NIMCRUT. The financial planner informed the planned giving specialist that the couple wanted to establish a charitable remainder trust; he sent the SCRUT form to the individuals' lawyer for final preparation of the trust document. These three individuals communicated only by e-mail. The donors executed the SCRUT document. The error was subsequently discovered by the donors' accountant.[301] In a comparable circumstance, a trust document that was supposed to set up a SCRUT contained a provision causing the trust to function as a NIMCRUT.[302] Conversely, parties that intended to create a NIMCRUT executed a trust document that was mistakenly prepared as a SCRUT.[303] In another instance, a trust document contained the wrong valuation date.[304] The IRS issues rulings from time to time concerning other instances of these types of mistakes.[305]

The IRS generously considers mistakes of this nature to be scrivener's errors. A judicial reformation of the trust instrument usually is required to remedy these errors. In one situation, however, the IRS ignored a second contribution of stock to a SCRUT, inasmuch as the trust document prohibited additional contributions.[306] The IRS almost always will rule that a required reformation of the trust document will not disqualify the trust.[307]

If, however, a donor, after discovery of an error of this nature, successfully pursues a court-ordered rescission of the trust, the order takes effect for tax purposes as of the date of creation of the trust, and the amount of the charitable deduction claimed by the donor for the transfer of the remainder interest created by

[300] See ch. 13.
[301] Priv. Ltr. Rul. 200218008.
[302] Priv. Ltr. Rul. 9804036.
[303] Priv. Ltr. Rul. 200219012.
[304] Priv. Ltr. Rul. 200233005.
[305] E.g., Priv. Ltr. Rul. 200251010. Mistakes (not literally scrivener's errors) can also be made in connection with the funding of a charitable remainder trust; a court-supervised correction of the mistake is not likely to lead to disqualification of the trust. E.g., Priv. Ltr. Rul. 200601003.
[306] Priv. Ltr. Rul. 200052026.
[307] See, however, § 12.3(a), *supra* note 167.

the trust is includible in the donor's gross income for the year in which the trust assets were returned to the donor.[308]

(j) University Endowment Investment Sharing with CRTs

The IRS was presented with the issue as to whether a tax-exempt university would be considered engaged in an unrelated business if it enabled CRTs, as to which it is trustee and remainder interest beneficiary, to participate in the investment return generated by the university's endowment fund. The IRS ruled that unrelated business would not occur because the university would not be receiving any economic return by reason of the arrangements.[309]

Under a typical fact situation, a university endows its various departments and schools; the university has an internal ''share'' concept, by which each department or school ''owns'' a certain number of shares of the endowment, the value of which is based on the value of the underlying investments in the endowment. The university annually determines a payout rate on the endowment based in part on investment performance. Each department and school is entitled to a payout in accordance with the number of shares in the endowment it owns. This university is the trustee and remainder interest beneficiary of a number of CRTs. Both the university and donors to the trusts were concerned about the investment return on the assets in the trusts. The university's endowment fund has outperformed the trusts on an annualized return basis in most years.

The university wants a higher investment return for these trusts, greater economies of scale in the management of the trusts, and increased diversification of the trusts' investments. The institution wants to achieve these goals by enabling the trusts to participate indirectly in the return on the endowment fund. This is to be accomplished by issuance, by the university, to each of the trusts a contractual right by which the trusts would hold ''endowment shares.'' The trusts are to receive periodic payments based on the number of shares owned, as does the university's various schools and departments, thereby receiving an investment return equal to that of the endowment.

Pursuant to these contracts, the trusts will not have any interest in the investment assets of the endowment—they will have a contractual right against the university for the payout amounts. Also, as is the case with the schools and departments, a trust can either reinvest a part of the payout amount or redeem additional shares, depending on its cash needs. The trust shares will have the same value that the university uses for internal accounting purposes.

In favorably ruling in this context, the IRS took note of the fact that this enhancement of the investment return for the CRTs (and ultimately for the benefit

[308] E.g., Priv. Ltr. Rul. 200219012. Inclusion of the claimed charitable contribution deduction in the donor's gross income in these instances is occasioned by the *tax benefit rule*. See, e.g., *Hillsboro Nat'l Bank v. Commissioner*, 460 U.S. 370 (1983); *Unvert v. Commissioner*, 656 F.2d 483 (9th Cir. 1981); *Rosen v. Commissioner*, 611 F.2d 942 (1st Cir. 1980).

[309] Priv. Ltr. Rul. 200703037. Even if the university charged a fee for these investment services or otherwise received income from the investment activity, the funds would not be taxable as unrelated business income because the services would be provided to affiliated entities (viz., the trusts as to which the university is the trustee (see *Tax-Exempt Organizations* § 26.5(i)).

of the university as remainder interest beneficiary) will also result in greater income payouts (at least in connection with unitrusts) to the income beneficiaries. The agency wrote that these facts ''limit the scope of the service provided to 'others' and distinguishes it [the investment activity] from a commercial venture.''[310]

(k) CRTs as Partners or Shareholders in REITs

The IRS considered the matter of a CRT as a partner in a partnership or a shareholder in a real estate investment trust (REIT), where the partnership or REIT has excess inclusion income from holding a residual interest in a real estate mortgage investment conduit (REMIC). One of the issues was whether a CRT in this circumstance would have unrelated business taxable income.[311]

The IRS posited two situations involving qualified charitable remainder trusts. In one instance, a CRT held a 10-percent interest in a partnership. Because this partnership holds a residual interest in a REMIC, it is required to take into account its daily portion of the REMIC's net income or net loss.[312] For 2004, a portion of the REMIC's net income taken into account by the partnership was an excess inclusion.[313]

In the other situation, a CRT held a 10-percent equity interest in a corporation that has elected, and is qualified, to be treated as a REIT.[314] Because this corporation holds a residual interest in a REMIC, it is required to take into account its daily portion of the REMIC's net income or net loss. For 2004, a portion of the REMIC's net income taken into account by the corporation was an excess inclusion. The corporation's REIT taxable income[315] excluding net capital gain was zero.

As to the first of these instances, the IRS noted that, as a partner of the partnership, the CRT has a distributive share of the excess inclusion income of the partnership.[316] Excess inclusion income is treated as unrelated business taxable income (UBTI) to the holder of a REMIC residual interest but only if the holder ''is an organization subject to the tax imposed by section 511'' (that is, subject to the unrelated business income tax (UBIT)).[317] The IRS observed that, in the case of a CRT, the law ''employs the definitional rules of section 512 and the other UBIT provision to determine whether any of the trust's income is UBTI, but it does not

---

[310] Although the IRS did not invoke the term, these arrangements entail private benefit to those income interest beneficiaries who will be receiving a benefit from the change in investment practices. Apparently this benefit is being considered either incidental or an unavoidable byproduct of an exempt function (see *Tax-Exempt Organizations* §§ 20.11, 6.3(b)).

The IRS declined to extend this ruling policy to charitable lead trusts (see ch. 16) in which the university is involved. The agency wrote: ''We are concerned that non-charitable beneficiaries may benefit inappropriately from deferrals that can be controlled and designed for tax benefit.''

[311] At the time the IRS considered this matter, the receipt by a CRT of unrelated business taxable income (UBTI) caused the trust to lose its tax exemption for the year involved; under current law, however, a CRT that receives UBTI remains exempt but becomes subject to an excise tax in the full amount of the UBTI. See § 12.7.

[312] IRC § 860C(a).

[313] IRC § 860E(c).

[314] IRC subchapter M.

[315] IRC § 857(b)(2).

[316] IRC § 702(a), (b).

[317] IRC § 860E(b).

subject the trust to section 511."[318] Tax-exempt organizations are generally subject to the UBIT and could be subject to a tax on excess inclusion income; a *disqualified organization* is a tax-exempt entity that is not subject to the UBIT.[319] A CRT is a disqualified organization.

The IRS reviewed the federal tax law provisions pertaining to REMICs. The agency observed that if a pass-through entity (the equity owners of which are disqualified organizations or other tax-exempt entities) holds REMIC residual interests, the tax law[320] ensures that the excess inclusion income is taxable to the pass-through entity or to its tax-exempt entity owner that is subject to the UBIT. The IRS ruled that, inasmuch as a CRT is a disqualified organization, excess inclusion income allocated to it is not UBTI and that a pass-through entity that has excess inclusion income allocable to a CRT is subject to a pass-through entity tax.[321]

§ 12.5 TAX TREATMENT OF DISTRIBUTIONS

Income interest beneficiaries of CRTs usually are subject to income taxation on the amounts distributed to them. At the federal level, the tax treatment accorded these annual amounts is determined by a tier of characterization rules.

(a) Characterization and Ordering Rules—In General

Distributions from CRATs and CRUTs are treated as having the following tax characteristics in the hands of the recipients (whether or not the trust is tax-exempt):

- First, the amounts are treated as ordinary income, to the extent of the sum of the trust's ordinary income for the tax year of the trust and its undistributed ordinary income for prior years. An ordinary loss for the current year must be used to reduce undistributed ordinary income for prior years and any excess must be carried forward indefinitely to reduce ordinary income for future years.[322]
- Second, the amounts are treated as capital gain, to the extent of the charitable remainder trust's undistributed capital gains.[323]

---

[318] Rev. Rul. 2006-58, 2006-2 C.B. 876, Analysis § 1. This remains the case under the new statutory regime (see *supra* note 311).

[319] IRC § 860E(e)(5)(B).

[320] IRC § 860E(b), (e)(6)(A).

[321] Rev. Rul. 2006-58, 2006-2 C.B. 876, Analysis §§ 2, 3. This tax is imposed by IRC § 860E(e)(6)(A).

[322] IRC § 664(b)(1); Reg. § 1.664-1(d)(1)(i)(a). For these purposes, the amount of current and prior years' income must be computed without regard to the deduction for net operating losses provided by IRC §§ 172 or 642(d). IRC § 664(b)(1); Reg. § 1.664-1(d)(1)(i)(a).

A consent dividend (IRC § 565) paid to a CRUT by a corporation was ruled by the IRS not to be income under IRC § 643(b) (see § 12.3(a)(iv)), because under state law the trust does not have income until it is in actual receipt of the money. Thus, the consent dividend amounts are included in the trust's income for purposes of IRC § 664(b)(1), but do not constitute income of the trust for purposes of the income exception rules (see § 12.3(a)(ii), (iii)). Priv. Ltr. Rul. 199952035.

[323] IRC § 664(b)(2); Reg. § 1.664-1(d)(1)(i)(b). Undistributed capital gains of a charitable remainder trust are determined on a cumulative net basis without regard to the capital loss carrybacks and carryover rules (IRC § 1212). IRC § 664(b)(2); Reg. § 1.664-1(d)(1)(i)(b).

  - If, in any tax year of a CRT, the trust has both undistributed short-term capital gain and undistributed long-term capital gain, the short-term capital gain must be deemed distributed prior to any long-term capital gain.[324]
  - If a CRT has capital losses in excess of capital gains for any tax year, any excess of the net short-term capital loss over the net long-term capital gain for the year must be a short-term capital loss in the succeeding tax year, and any excess of the net long-term capital loss over the net short-term capital gain for the year must be a long-term capital loss in the succeeding tax year.[325]
  - If a CRT has capital gains in excess of capital losses for any tax year, any excess of the net short-term capital gain over the net long-term capital loss for the year must be, to the extent not deemed distributed, a short-term capital gain in the succeeding tax year, and any excess of the net long-term capital gain over the net short-term capital loss for the year must be, to the extent not deemed distributed, a long-term capital gain in the succeeding tax year.[326]
- Third, the amounts are treated as other income to the extent of the sum of the trust's other income for the taxable year and its undistributed other income for prior years. A loss in this category for the current year must be used to reduce undistributed income in this category for prior years, and any excess must be carried forward indefinitely to reduce this income for future years.[327]
- Finally, the amounts are treated as a distribution of trust corpus. For these purposes, the term *corpus* means the net fair market value of the trust's assets less the total undistributed income (but not loss) in each of the above categories.[328]

The character of a CRT's income is determined at the time the income is realized by the trust. Legislative changes in 2003 caused qualified dividend income to be taxed at the rates applicable to long-term capital gains,[329] causing different types of ordinary income to be subject to different federal income tax rates.[330]

(b) Capital Gains Taxation

The federal tax law as to taxation of capital gains was significantly altered in 1997, when the maximum rate of tax on long-term capital gains was reduced. This change entailed a variety of rates, categorizing capital gains and losses into three groups: a 28 percent group, a 25 percent group, and a 20 percent group. This law change generally became effective as to dispositions occurring on or after May 7, 1997.[331] These developments, of course, affect the tax treatment of distributions of

[324] Reg. § 1.664-1(d)(1)(i)(b)(1).
[325] Reg. § 1.664-1(d)(1)(i)(b)(2).
[326] Reg. § 1.664-1(d)(1)(i)(b)(3).
[327] IRC § 664(b)(3); Reg. § 1.664-1(d)(1)(i)(c).
[328] IRC § 664(b)(4); Reg. § 1.664-1(d)(1)(i)(d).
[329] See § 12.5(b).
[330] See § 2.15.
[331] See § 2.16(a).

capital gains from a charitable remainder trust. This is because the general principle of these rules is that income subject to the highest federal income tax rate is deemed distributed prior to income subject to a lower (or no) federal income tax rate; thus, short-term capital gain is deemed distributed prior to any long-term capital gain. The IRS issued guidance on the point, stating that (1) undistributed long-term capital gains that a CRT took into account before January 1, 1997, are taxed at the 20 percent rate; and (2) long-term capital gains taken into account from January 1, 1997, through May 6, 1997, are taxed at the 28 percent rate.[332]

A law change in 1998 changed this aspect of the law somewhat, causing certain long-term capital gains, which would be in the 28 percent group under the 1998 IRS guidance, to be in the 25 percent group or the 20 percent group. The IRS issued guidance in 1999 reflecting the alterations in this area wrought by the 1998 legislation.[333]

This guidance states that a CRT's long-term capital gain in the 28 percent group (other than collectibles gain) that was properly taken into account during 1997 and distributed in years ending after 1997 falls within either the 25 percent group or the 20 percent group. Thus, a remainder trust's long-term capital gain of this type now falls within the 25 percent group if the gain

- was from property held more than 12 months but not more than 18 months,
- was properly taken into account for the portion of the year after July 28, 1997, and before January 1, 1998, and
- otherwise satisfies certain requirements for unrecaptured gain from dispositions of certain depreciable realty.[334]

Any remaining long-term capital gain falls within the 20 percent group.

A change in the law in 2003 further altered and reduced the tax law scheme for the taxation of capital gains.[335]

(c) Other Requirements

The determination of the character of amounts distributed must be made as of the end of the tax year of the trust. There are various classes of items within the four preceding categories of income. Amounts treated as paid from one of the categories must be viewed as consisting of (1) the same proportion of each class of items included in such category as (2) the total of the current and accumulated income of each class of items bears to the total of the current and accumulated income for that category. A loss in one of these categories may not be used to reduce a gain in any other category.[336]

Items of deduction of a CRT for a tax year of the trust, which are deductible in determining taxable income[337] and which are directly attributable to one or more classes of items within a category of income or to corpus, must be allocated to these classes of items or to corpus. All other allowable deductions for the tax

[332] Notice 98-20, 1998-1 C.B. 776.
[333] Notice 99-17, 1999-1 C.B. 871.
[334] IRC § 1250.
[335] See § 2.16(b).
[336] Reg. § 1.664-1(d)(1)(ii).
[337] This phrase is inapplicable to the deductions permitted by IRC §§ 642(b), 642(c), 661, and 1202.

year, not directly attributable to one or more classes of items within a category of income or to corpus,[338] must be allocated among the classes of items within the category (excluding classes of items with net losses) on the basis of the gross income of these classes for the tax year, reduced by the deductions allocated to them. In no event, however, may the amount of expenses allocated to any class of items exceed the income of that class for the tax year. Items of deduction that are not allocable under these rules as previously stated may be allocated in any manner.[339] All unrelated business income taxes[340] and all private foundation excise taxes[341] must be allocated to corpus. Any expense that is not deductible in determining taxable income and that is not allocable to any class of items must be allocated to corpus.[342]

If there are two or more income beneficiaries, each is treated as receiving his or her pro rata portion of the categories of income and corpus.[343]

The annuity amount or unitrust amount is includible in the income beneficiary's (or beneficiaries') gross income for the tax year in which the amount is required to be distributed. This is the case even though the annuity amount or unitrust amount is not distributed until after the close of the tax year of the trust. If a recipient of an income interest has a tax year[344] that is different from the tax year of the trust, the amount the beneficiary is required to include in gross income must be included in the tax year in which or with which ends the tax year of the trust in which the amount is required to be distributed.[345]

Notwithstanding the previous rule, any payments that are made or required to be distributed by a CRT because of the rules applicable to testamentary transfers,[346] or an incorrect valuation[347] must be included in the gross income of the income interest beneficiary in his or her tax year in which or with which ends the tax year of the trust in which the amount is paid, credited, or required to be distributed. A recipient is allowed a deduction from gross income for amounts repaid to a CRT because of an overpayment during the reasonable period of administration or settlement or until the trust is fully funded; because of an amendment; or because of an incorrect valuation, to the extent these amounts were included in his or her gross income.[348]

If the tax year of the trust does not end with or within the last tax year of the income beneficiary because of the recipient's death, the extent to which the annuity amount or unitrust amount required to be distributed to him or her is included in the gross income of the recipient for his or her last tax year, or in the gross amount of his or her estate, is determined by making the computations for

---

[338] *Id.*
[339] *Id.*
[340] See § 3.5.
[341] See § 3.4(c).
[342] Reg. § 1.664-1(d)(2). The deductions allowable to a trust under IRC §§ 642(b), 642(c), 661, and 1202 are not allowed in determining the amount or character of any class of items within a category of income or corpus. Reg. § 1.664-1(d)(2).
[343] Reg. § 1.664-1(d)(3).
[344] IRC §§ 441 or 442.
[345] Reg. § 1.664-1(d)(4)(i).
[346] See ch. 8.
[347] See § 12.2(a), text accompanied by *supra* notes 67 and 68; § 12.3(a), text accompanied by *supra* note 173.
[348] Reg. § 1.664-1(d)(4)(ii). IRC § 1341 contains rules relating to the computation of tax when an individual restores substantial amounts held under a claim of right.

the tax year of the trust in which his or her last tax year ends. The gross income for the last tax year of an income beneficiary on the cash basis includes amounts actually distributed to the recipient before his or her death. Amounts required to be distributed which are distributed to his or her estate are included in the gross income of the estate as income in respect of a decedent.[349]

The annuity amount or unitrust amount may be paid in money or in other property. In the case of a distribution of property other than money, the amount paid, credited, or required to be distributed must be considered as an amount realized by the trust from the sale or other disposition of property. The basis of the property in the hands of the recipient is its fair market value at the time it was paid, credited, or required to be distributed.[350]

(d) Tax Treatment of Other Distributions

An amount distributed by a charitable remainder trust to a charitable organization, other than an annuity amount or unitrust amount, must be considered a distribution of corpus and of those categories of income specified above[351] in an order inverse to that prescribed in those rules. The character of the amount must be determined as of the end of the trust tax year in which the distribution is made after the character of the annuity amount or unitrust amount has been determined.[352]

In this type of distribution, no gain or loss is realized by the trust by reason of a distribution in kind unless the distribution is in satisfaction of a right to receive a distribution of a specific dollar amount or in specific property other than that distributed.[353]

(e) Anti-Abuse Rules

Anti-abuse rules concerning CRTs are designed to prevent certain abusive transactions, in which a remainder trust is used to convert appreciated assets into money while avoiding tax on the gain from the disposition of the assets.[354] This technique rested on an aggressive interpretation of the rules concerning the manner in which distributions to noncharitable beneficiaries of these trusts are taxed. As discussed,[355] this structure is multitiered, with distributions taxed first as income, then capital gain, then other revenue (such as nontaxable interest), and then nontaxable return of corpus.

Summary of Transaction. In a transaction of this type, an individual typically contributes highly appreciated assets to a CRT that has a relatively short term

---

[349] Reg. § 1.664-1(d)(4)(iii). The tax rules concerning income in respect of a decedent are contained in IRC § 691.
[350] Reg. § 1.664-1(d)(5).
[351] See § 1.5(a).
[352] Reg. § 1.664-1(e)(1).
[353] Reg. § 1.664-1(e)(2).
[354] Earlier, Congress revised the CRT qualification rule to end another version of the abusive accelerated charitable remainder trust. See § 12.1(a), *supra* notes 9 and 14). The IRS observed, as to this development: "Nothing is ever really put to rest. It comes back with a twist. Some tax professionals are advocating or promoting the revival of the accelerated charitable remainder trust in different form." *IRS Exempt Organizations Continuing Professional Education Program Textbook for Fiscal Year 2001*, at 103.
[355] See § 12.5(a).

and a relatively high payout rate. Instead of selling the assets to generate money to pay the income interest beneficiary, the trustee borrows money, enters into a forward sale of the assets, or engages in a similar transaction. Because the transaction does not result in current income to the trust, the parties attempt to characterize the distribution of money to the beneficiary as a tax-free return of corpus.[356]

Distributions may continue to be funded in this manner for the duration of the trust term. As noted, this term usually is short to meet the 10 percent remainder requirement.[357] The appreciated assets may be sold and the transaction closed out (e.g., repayment of the loan) in the last year of the trust. In another approach, the trustee may distribute the appreciated assets to the charitable beneficiary, subject to a contractual obligation to complete the transaction (e.g., the forward sale contract).

This is one of these arrangements that involves what the IRS terms a ''mechanical and literal'' application of the CRT rules. In other words, technically this approach is within the bounds of the language of the statute and regulations, but it is outside the purposes and intent of the rules. Like the accelerated CRT schemes that Congress endeavored to stymie in 1997,[358] these abusive manipulations of the law yield a result that the IRS will not respect.

Summary of Anti-Abuse Rules. The rules target distributions of an annuity or unitrust amount from a CRT when the funds are not characterized in the hands of the recipient as ordinary income, capital gain, or other revenue.[359] When this occurs, and when the distribution was made from an amount received by the trust that was neither a return of basis in any asset sold by the trust nor attributable to a contribution of money to the trust as to which a charitable deduction was allowable, the trust will be treated as having sold, in the year for which the distribution is due, a pro rata portion of the trust assets.[360]

A transaction that has the purpose or effect of circumventing this rule will be disregarded.[361] For example, a return of basis in an asset sold by a CRT would not include basis in an asset purchased by the trust from the proceeds of a borrowing secured by previously contributed assets. Notwithstanding the foregoing, a distribution of money made within a reasonable period of time after the close of the year may be characterized as corpus to the extent it was attributable to: (1) a contribution of money to the trust with respect to which a charitable deduction was allowable; or (2) a return of basis in any asset contributed to the trust with respect to which a charitable deduction was allowable, and sold by the trust during the year for which the income payment amount was due.[362]

[356] IRC § 664(b)(4).
[357] See §§ 12.2(i), 12.3(i).
[358] See, e.g., § 12.2(c), text accompanied by *supra* note 74.
[359] IRC § 664(b)(1)–(3).
[360] Reg. § 1.643(a)-8(b)(1).
[361] Reg. § 1.643-8(b)(2).
[362] Reg. §§ 1.664-2(a)(1)(i)(a), 1.664-3(a)(1)(i)(g).

Example 12.13

An example as to how this deemed sale rule works concerns an individual who contributes stock to a CRUT. The stock has a basis of $400,000 and a value of $2 million. The CRUT has a two-year term and a unitrust amount of 50 percent of the net fair market value of trust assets. In year 1, the CRUT receives dividend income of $20,000. As of the valuation date, the CRUT's assets have a value of $2,020,000 (the original $2 million value plus the dividend income). To obtain additional money to pay the unitrust amount ($1,010,000), the trustee borrows $990,000, using the stock as collateral. Before the close of year 1, the CRUT distributes $1,010,000 to the income beneficiary.

Under prior law, $20,000 of this distribution was characterized in the hands of the income interest beneficiary as dividend income.[a] Arguably, under prior law, the remaining $990,000 was tax free,[b] inasmuch as it was not characterized within one of the preceding tiers.[c]

This $990,000 is attributable to an amount received by the CRUT that did not represent either a return of basis in any asset sold by the trust or a cash contribution to the trust to which a charitable deduction was available. Under the rule, the stock is a trust asset because it was not purchased with the proceeds of the borrowing.

Under this rule, in year 1, the CRUT is treated as having sold $990,000 of stock and as having realized $792,000 of capital gain. (The CRUT's basis in the stock deemed sold is $198,000.) Thus, in the hands of the income beneficiary, $792,000 of the distribution is characterized as capital gain[d] and $198,000 is characterized as a tax-free return of corpus.[e]

[a] IRC § 664(b)(1).
[b] IRC § 664(b)(4).
[c] That is, the preceding tiers of IRC § 664(b).
[d] IRC § 664(b)(2).
[e] IRC § 664(b)(4). This example is based on Reg. § 1.643(a)-8(c), example 1.

Example 12.14

The facts are the same as in the previous example. During year 2, the CRUT sells the stock for $2,100,000. The trustee uses a portion of the proceeds of the sale to repay the outstanding loan, plus accrued interest.

Under the rule, the CRUT's basis in the stock is $1,192,000 ($400,000 plus the $792,000 of gain recognized in year 1). Therefore, the CRUT recognizes capital gain[a] in year 2 of $908,000.[b]

[a] For purposes of IRC § 664(b)(2).
[b] Reg. § 1.643(a)-8(c), example 2.

Example 12.15

On the death of D, the proceeds of a life insurance policy on D's life are payable to a CRAT. The terms of the CRAT provide that, for a period of three years, commencing on D's death, the CRAT shall pay an annuity amount annually to A, the child of D. After the expiration of this three-year period, the remainder interest in the CRAT is to be transferred to a charitable organization. In year 1, the CRAT receives payment of the life insurance proceeds and pays the appropriate pro rata portion of the annuity amount to A from the proceeds. During year 1, the CRAT has no income.

This entire distribution is attributable to a cash contribution (the insurance proceeds) to the CRAT for which an estate tax charitable deduction was allowable, with respect to the present value of the remainder interest passing to charity. Thus, under the rule, the CRAT will not be treated as selling a pro rata portion of the trust assets. The distribution is thus characterized in A's hands as a tax-free return of corpus.[a]

[a] For purposes of IRC § 664(b)(2). This example is based on Reg. § 1.643(a)-8(c), example 3.

As to distributions of this nature before the effective date, the IRS announced that it has several enforcement options: It may: (1) apply an ''appropriate legal doctrine'' to recast the transaction, characterize the distribution as gross income rather than corpus, or challenge the qualification of the trust;[363] (2) impose the self-dealing tax;[364] (3) subject the trust to the tax on unrelated business income;[365] and/or (4) assess one or more penalties on the participants to the transaction.[366] This approach is nearly identical to that announced in 1994 when attempts were underway to stop the use of another type of accelerated charitable remainder trust.[367]

(f) Characterization and Ordering Rules

The rules for characterizing a distribution from a CRT were revised, to take into account the differences in the federal income tax rates applicable to various items of income. As discussed,[368] a CRT's income is assigned, in the year it is required to be taken into account by the trust, to one of three categories: the ordinary income category, the capital gains category, or the other income category. Within the ordinary income and capital gains categories, items are also assigned to different classes based on the federal income tax rate applicable to each type of income in the category. Overall, a CRT distribution is treated as being made from the categories in the following order: ordinary income, capital gain, other income, and trust corpus. Within the ordinary income and capital gains categories, income is treated as distributed from the classes of income in that category beginning with the class subject to the highest federal income tax rate and ending with the class subject to the lowest federal income tax rate. The law on this point has been made somewhat more complex because of law changes in 1997, 1998, and 2003.[369]

The IRS adopted regulations to revise these rules to take into account these law changes.[370] These regulations incorporate previous guidance from the IRS.[371] The new rules also provide guidance for netting different classes of capital gains and losses, based on prior guidance.[372]

The regulations reflect these three categories of CRT income.[373] As noted, there may be assignments of items, within the ordinary income and capital gains categories, to classes based on the applicable federal income tax rate.[374] For example, the ordinary income category may include a class of qualified dividend income[375] and a class of all other ordinary income. Likewise, the capital gains category may include separate classes for short-term capital gains and losses, for

[363] That is, challenge the qualification of the trust under IRC § 664.
[364] See § 12.9.
[365] See § 3.5.
[366] See § 10.14.
[367] Notice 94-78, 1994-2 C.B. 555.
[368] See § 12.5(a).
[369] See § 2.15, 2.16(b).
[370] T.D. 9190.
[371] See text accompanied by *supra* notes 332 and 333.
[372] See § 2.16(b), text accompanied by note 85.
[373] Reg. § 1.664-1(d)(1)(i)(a).
[374] Reg. § 1.664-1(d)(1)(i)(b).
[375] IRC § 1(h)(11).

28-percent rate gain,[376] for certain unrecaptured gain,[377] and for all other long-term capital gains and losses.

After items are assigned to a class, the tax rates may change so that items in two or more classes would be taxed at the same rate if distributed during a year. If the changes to the tax rates are permanent, the undistributed items in those classes are combined into one class. If, however, the changes to the tax rates are temporary (such as when a rate for a class is scheduled to sunset), the classes are kept separate.

The categories and classes of income are used to determine the character of an annuity or unitrust amount distribution from the trust in the hands of the recipient (irrespective of whether the CRT is tax-exempt for the year of the distribution). The determination of the character of amounts distributed must be made as of the end of the tax year of the CRT. The recipient is taxed on the distribution based on the tax rates applicable in the year of the distribution to the classes of income that are deemed distributed from the trust. The character of the distribution in the hands of the annuity or unitrust amount recipient is determined by treating the distribution as being made from each category in the following order: (1) from ordinary income to the extent of the sum of the trust's ordinary income for the tax year and its undistributed ordinary income for prior years, (2) from capital gain to the extent of the trust's capital gains, (3) from other income of the CRT to the extent of the sum of the trust's other income for the tax year and its undistributed other income for prior years, and (4) from trust corpus.[378]

If the CRT has different classes of income in the ordinary income category, the distribution from that category is treated as being made from each class, in turn, until exhaustion of the class, beginning with the class subject to the highest federal income tax rate and ending with the class subject to the lowest federal income tax rate. If the CRT has different classes of net gain in the capital gains category, the distribution from that category is treated as being made first from the short-term capital gain class and then from each class of long-term capital gain, in turn, until exhaustion of the class, beginning with the class subject to the highest federal income tax rate and ending with the class subject to the lowest rate. If two or more classes within the same category are subject to the same current tax rate, but at least one of those classes will be subject to a different tax rate in a future year (for example, if the current rate sunsets), the order of that class in relation to other classes in the category with the same current tax rate is determined on the basis of the future rate or rates applicable to those classes. Within each category, if there is more than one type of income in a class, amounts treated as distributed from that class are to be treated as consisting of the same proportion of each type of income as the total of the current and undistributed income of that type bears to the total of the current and undistributed income of all types of income included in that class.[379] A net ordinary loss for the current year is first used to reduce undistributed ordinary income for prior years that is assigned to the same class as the loss. Any excess loss is then used to reduce the current and undistributed ordinary income from other classes, in turn, beginning with the class subject to the

[376] IRC § 1(h)(4).
[377] IRC § 1(h)(6). This gain is the subject of IRC § 1250.
[378] Reg. § 1.664-1(d)(1)(ii)(a).
[379] Reg. § 1.664-1(d)(1)(ii)(b).

highest federal income tax rate and ending with the class subject to the lowest federal income tax rate. If any of the loss exists after all the current and undistributed ordinary income from all classes has been offset, the excess is carried forward indefinitely to reduce ordinary income for future years and retains its class assignment.[380] A net loss in the other income category for the current year is used to reduce undistributed income in this category for prior years and any excess is carried forward indefinitely to reduce other income for future years.[381]

For each tax year, current and undistributed capital gains and losses within each class are netted to determine the net gain or loss for that class, and the classes of capital gains and losses are then netted against each other in the following order: (1) a net loss from a class of long-term capital gain and loss (beginning with the class subject to the highest federal income tax rate and ending with the class subject to the lowest rate) is used to offset net gain from each other class of long-term capital gain and loss, in turn, until exhaustion of the class, beginning with the class subject to the highest federal income tax rate and ending with the class subject to the lowest rate, and (2) either (a) a net loss from all the classes of long-term capital gain and loss (beginning with the class subject to the highest federal income tax rate and ending with the class subject to the lowest rate) is used to offset any net gain from the class of short-term capital gain and loss, or (b) a net loss from the class of short-term capital gain and loss is used to offset any net gain from each class of long-term capital gain and loss, in turn, until exhaustion of the class, beginning with the class subject to the highest federal income tax rate and ending with the class subject to the lowest federal income tax rate.[382]

If, at the end of a tax year, a CRT has, after application of the netting rule, any net loss or any net gain that is not treated as distributed, the net gain or loss is carried over to succeeding tax years and retains its character in succeeding tax years as gain or loss from its particular class.[383]

Example 12.16

A CRAT was created on January 1, 2009. The annual annuity amount was $100. This trust's income for 2009 was interest income of $80 and qualified dividend income of $50. There were no capital gains and losses, nor any tax-exempt income. In 2009, qualified dividend income was subject to a different rate of federal income tax than interest income and is, therefore, a separate class of income in the ordinary income category. The annuity amount is deemed to be distributed from the classes within the ordinary income category, beginning with the class subject to the highest federal income tax rate and ending with the class subject to the lowest rate. Because during 2009 qualified dividend income was taxed at a lower rate than interest income, the interest income is deemed distributed prior to the qualified dividend income. Consequently, in the hands of the income interest beneficiary of this CRAT, the 2009 annuity amount has these characteristics: interest income of $80 and qualified dividend income of $20. The remaining $30 of qualified dividend income is carried forward to 2010 as undistributed qualified dividend income.[a]

[a] This example is based on Reg. § 1.664-1(d)(1)(viii), example 1.

[380] Reg. § 1.664-1(d)(1)(iii)(a).

[381] Reg. § 1.664-1(d)(1)(iii)(b).

[382] Reg. § 1.664-1(d)(1)(iv).

[383] Reg. § 1.664-1(d)(1)(v). Portions of these regulations are effective after 1998 (being based on prior IRS guidance; see *supra* note 309); otherwise, these regulations are applicable for tax years ending after November 20, 2003 (Reg. § 1.664-1(d)(1)(ix)).

EXAMPLE 12.17

A CRAT was created on January 1, 2002. The annual annuity amount is $100. Other than qualified five-year gain of $200 realized before May 6, 2003, but not distributed, this trust does not have any other gains or losses carried over from prior years. This CRAT's income for 2007 is classified in this way: interest income class of $10, net gain in short-term capital gains class of $5, net long-term capital gain in 28-percent gain class of $5, net long-term capital gain in unrecaptured IRC § 1250 gain class of $10, and net long-term capital gain in all other long-term capital gain class of $10.

This annuity amount is deemed to be distributed from all of the classes in the ordinary income category and then from the classes in the capital gains category, beginning with the class subject to the highest federal income tax rate and ending with the class subject to the lowest rate. In 2007, gains distributed to a recipient from both the qualified five-year gain class and the all-other long-term capital gains class are taxed at a 15/5 percent rate. Inasmuch as after December 31, 2008, gains distributed from the qualified five-year gain class will be taxed at a lower rate than gains distributed from the other classes of long-term capital gain and loss, distributions from the qualified five-year gain class are made after distributions from the other classes of long-term capital gain and loss. In the hands of the income interest beneficiary of this CRAT, the 2007 annuity amount has these characteristics: interest income of $10, short-term capital gain of $5, 28-percent gain of $5, unrecaptured § 1250 gain of $10, all other long-term capital gain of $10, and qualified five-year gain (taxed as all other long-term capital gain) of $60.

The remaining $140 of qualified five-year gain that is not treated as distributed to the income-interest recipient in 2007 is carried forward to 2008 as qualified five-year gain.[a]

[a] This example is based on Reg. § 1.664-1(d)(1)(viii), example 5.

§ 12.6 DIVISION OF CHARITABLE REMAINDER TRUSTS

The IRS issued guidance as to the federal tax consequences of division of a charitable remainder trust.[384] This ruling posits two fact situations, then resolves seven issues of law.

(a) Situation 1

A trust qualifies as either a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT). Two or more individuals are entitled to an equal share of the annuity or unitrust amount, payable annually, during the recipient's lifetime. At the death of an income beneficiary, each surviving recipient becomes entitled for life to an equal share of the decedent's annuity or unitrust amount. Thus, the last surviving recipient becomes entitled to the entire annuity or unitrust amount for the balance of his or her life. On the death of the last surviving recipient, the assets of the trust are to be distributed to one or more charitable organizations, as remainder interest beneficiaries. The trust has not made any distributions to charitable beneficiaries, nor has it committed any act or failure to act giving rise to any Chapter 42 tax liability.

The state court with jurisdiction over this trust has approved a pro rata division of it into as many separate and equal trusts as are necessary to provide a trust for each income beneficiary living at the time of the division. Each resulting trust is intended to qualify as the same type of charitable remainder trust as the trust. The separate trusts may have different trustees. The income recipients pay

[384] Rev. Rul. 2008-41, 2008-2 C.B. 170. This guidance is reflective of the IRS's previous ruling position on these issues (e.g., Priv. Ltr. Rul. 200728026).

all of the costs associated with the division of the trust, including legal fees relating to the court proceeding and administrative costs of creation and funding of the separate trusts.

Each asset of the original trust will be divided equally and transferred to the separate trusts. For purposes of determining the character of distributions to the income beneficiary of each of the resulting trusts, each separate trust is deemed to have an equal share of the trust's income in each of the distribution tiers.[385] Likewise, on each subsequent consolidation of trusts by reason of the death of an income recipient, the income in each tier of the consolidated trust is the sum of the income in that tier formerly attributed to the combined trusts.

The separate trusts generally have the same governing provisions as the original trust. There are four exceptions:

1. Immediately after the division of the trust, each separate trust has only one recipient, and that recipient is not an income beneficiary of any of the other trusts.
2. Each separate trust is administered and invested independently by its trustee(s).
3. On the death of the recipient, each asset of that recipient's trust is to be divided on a pro rata basis and transferred to the trusts of the surviving recipient(s). In that connection, the annuity amount payable to the recipient of each separate CRAT will thereby be increased by an equal share of the deceased recipient's annuity amount. Similarly, the unitrust amount of each separate CRUT will be increased as a result of the augmentation of the CRUT's corpus; each separate CRUT incorporates the requirements concerning the subsequent computation of the unitrust amount from that trust.[386]
4. On the death of the last surviving recipient, that recipient's trust will terminate and distribute its assets to the remainder beneficiaries.

The remainder beneficiaries of the original trust are the remainder beneficiaries of the separate trusts and are entitled to the same remainder interest after the division of the trust as before. Each income recipient is entitled to receive from his or her trust the same annuity or unitrust amount as the recipient was entitled to receive under the terms of the original trust. Because the annual net fair market value of the assets in each of the separate trusts may vary due to differing investment strategies, in situations where the original trust is a CRUT, the amount of the unitrust payments from each separate CRUT may be different. Nonetheless, the unitrust percentage of each separate CRUT remains the same as each recipient's share of the unitrust percentage under the terms of the original trust.

(b) Situation 2

The facts are generally the same as in situation 1. The original trust, however, has only two income beneficiaries, who are U.S. citizens married to each other but in the process of divorcing. Also, each separate trust provides that, on the death of

---

[385] See § 12.5.
[386] Reg. § 1.664-3(b). See § 12.3(a).

the recipient, that recipient's separate trust terminates and its assets are to be distributed to the remainder beneficiaries.

In this instance, the IRS observed, the remainder beneficiaries will receive a distribution of one-half of the assets following the death of the first of these spouses to die and the remaining one-half of the assets on the death of the surviving spouse. Consequently, the value of the remainder payable to the charitable beneficiaries may be larger than the present value of that interest as computed at the creation of the original trust. Nonetheless, this outcome does not give rise to any additional charitable deduction.

(c) Issue 1 (Qualification of Trusts)

The IRS ruled that, in either of these situations, the division of the original trust into the separate trusts will not cause the original trust or any of the separate trusts to fail to qualify as a charitable remainder trust.[387] A transfer of the assets from a deceased recipient's separate trust to the separate trust(s) of the surviving recipient(s), in situation 1, is not treated as a transferred remainder interest[388] and is not treated as a prohibited additional contribution to a CRAT.[389] In situation 2, after the creation of the separate trusts, the total annuity amount or unitrust percentage amount to be paid annually remains the same as it was under the terms of the original trust, other than the relinquishment of the survivorship rights.

(d) Issue 2 (Basis)

In both situations, the creation of the separate trusts is not a sale, exchange, or other disposition producing gain or loss. The IRS ruled that, in these situations, the basis of each separate trust's share of each asset immediately after the division of the original trust is the same share of the basis of that asset in the possession of the original trust immediately before the division.[390] Similarly, on the death of a recipient and consolidation of the assets of the deceased recipient's separate trust into the separate trust(s) of the surviving recipient(s), in situation 1, each separate trust of a surviving recipient receives the same share of each asset of the deceased recipient's separate trust and of the basis of each asset in the possession of the deceased recipient's separate trust immediately before the consolidation.

(e) Issue 3 (Holding Period)

The IRS ruled that each separate trust's holding period of each asset transferred to it from the original trust includes the holding period of the asset as held by the original trust immediately before the division.[391] Likewise, the holding period of each asset transferred to a separate trust of a surviving recipient includes the

---

[387] That is, a trust qualifying under the rules summarized in §§ 12.2 or 12.3.
[388] That is, a transfer in violation of IRC §§ 664(d)(1)(C) or (d)(2)(C).
[389] See Reg. § 1.664-2(b). See § 12.2(h).
[390] IRC § 1015(b).
[391] IRC § 1223(2).

holding period of the asset as held by the deceased recipient's separate trust immediately before the consolidation.

(f) Issue 4 (Private Foundation Status)

The IRS noted that, in both situations, the separate trusts have the same governing provisions as the original trust (albeit with the above exceptions) and, collectively, the same income recipients, remainder beneficiaries, and assets as the original trust. Also, each recipient and remainder beneficiary is entitled to the same benefits before and after the division of the original trust (again, with exceptions). All this is by way of saying that the separate trusts continue to be split-interest trusts generally subject to the private foundation rules.[392]

(g) Issue 5 (Termination Tax)

In both situations, all of the assets of the original trust are transferred to the separate trusts pursuant to a transfer in the nature of a reorganization.[393] Thus, held the IRS, the original trust does not terminate its private foundation status[394] as the result of the division of the trust (or a subsequent consolidation of the separate trusts in situation 1), because a notice of termination was not filed or was required to be filed.[395] Thus, the termination tax[396] is not applicable.

(h) Issue 6 (Self-Dealing)

The IRS observed that, in these situations, the income beneficiaries may be disqualified persons with respect to the original trust.[397] The only interest these recipients have in this trust is the right to payment of the annuity or unitrust amount. The annuity or unitrust payments a recipient receives from his or her separate trust remains equivalent to the recipient's share of the annuity or unitrust payments under the terms of the original trust (other than the relinquishment of survivorship rights in situation 2).

The IRS ruled that, following the division of the original trust, the income recipients are ''insulated'' from self-dealing with respect to their income interests. Because of the pro rata distributions to the separate trusts, no disqualified persons (if any) receive any additional interest in the assets of the original trust; thus, there is no self-dealing.[398] The remainder interest of the original trust remains preserved exclusively for charitable interests; there is no increase in the annuity or unitrust amount at the expense of a charitable beneficiary. Additionally, the division of the original trust's assets is not a sale or exchange (see the resolution of issue 2) and the income recipients will pay the costs involved. Thus, the IRS ruled that, as to both situations, there will not be any self-dealing in connection with the division

[392] IRC § 4947(a)(2). See § 12.9.
[393] IRC § 507(b)(2). See *Private Foundations* § 13.5.
[394] That is, does not terminate pursuant to IRC § 507(a)(1).
[395] Reg. § 1.507-1(b)(6).
[396] IRC § 507(c).
[397] IRC § 4946. See *Private Foundations*, ch. 4.
[398] IRC § 4941. See *Private Foundations*, ch. 5.

of the original trust or, in situation 1, by reason of a subsequent consolidation of the separate trusts arising from the death of a recipient.

(i) Issue 7 (Taxable Expenditures)

The IRS ruled that this type of division of a trust does not entail taxable expenditures.[399] The transfers of the original trust's assets to the separate trusts, in either situation, are not expenditures that require expenditure responsibility[400] by the original trust. Because that trust did not make any prior distributions for which expenditure responsibility is required, the separate trusts will not assume any preexisting expenditure responsibility from the original trust.[401] The IRS said that a similar analysis applies regarding a subsequent consolidation of the separate trusts arising from the death of a recipient in situation 1.

§ 12.7 EARLY TERMINATIONS OF CHARITABLE REMAINDER TRUSTS

A CRT may be terminated sooner than is provided in the trust instrument. There are several reasons for the premature termination of this type of a trust, such as a desire to transfer the trust assets earlier to the remainder interest beneficiary[402] or an income beneficiary's dissatisfaction with the level of income payments.[403]

The IRS tends to scrutinize proposed early terminations of CRTs. The principal concern is that the early termination will result in greater allocation of the trust assets to the income beneficiary, to the detriment of the charitable remainder interest beneficiary, than would be the case if the termination instead occurred at the initially prescribed time.[404] Also, the self-dealing rules potentially apply to the transaction.[405]

Nonetheless, in appropriate circumstances, the IRS will permit an early termination of a CRT. The elements the agency reviews are whether: (1) the trustee will be distributing to the income and remainder beneficiaries lump sums equal to the present value of their respective interests as of the termination date;[406] (2) the income and remainder interests are vested; (3) all income beneficiaries are of full legal capacity; (4) all of the beneficiaries favor early termination; (5) any of the income beneficiaries have a medical condition that is expected to result in a shorter period of longevity for the beneficiary;[407] (6) the trust instrument prohibits early termination; and (7) state law (and/or state regulatory authorities) permits early termination.

---

[399] IRC § 4945. See *Private Foundations*, ch. 9.
[400] IRC § 4945(h). See *Private Foundations*, § 9.6.
[401] Reg. § 1.507-3(a)(9).
[402] E.g., Priv. Ltr. Rul. 200304025.
[403] E.g., Priv. Ltr. Rul. 200208039.
[404] An early termination of a CRT would, if the terms of the transfers were not reasonable, deprive the charitable remainder beneficiary of the benefit to which it is entitled, inconsistent with the charitable contribution deduction allowed to the donor or donors.
[405] See § 12.9.
[406] The IRS usually expects the valuation to be in conformance with the rules stated at § 11.3.
[407] It is the policy of the IRS to secure an affidavit from a physician stating that the income beneficiary does not have a medical condition that would unduly shorten the beneficiary's life.

The self-dealing rules apply except with respect to "amounts payable under the terms of such trust to income beneficiaries."[408] The trust instrument may be silent on the point, but state law allowing early terminations of trusts may be considered implied terms of the instrument. Also, the early termination may not be discretionary with the trustee.[409] The foregoing factors are taken into account in the self-dealing context, with early termination of a CRT found not to be impermissible self-dealing when the method of allocating assets of the trust on its termination was reasonable, the income beneficiaries had life expectancies reflecting average longevity, state law allowed the early termination, and all the beneficiaries favored the early termination.[410] The IRS, from time to time, issues rulings as to early termination of CRTs.[411]

§ 12.8 TAXATION OF CHARITABLE REMAINDER TRUSTS

For many years, if a CRT had any unrelated business taxable income for a tax year, the trust in its entirety was subject to federal tax for that year. In applying this rule, activities of the trust deemed unrelated were those unrelated activities of the charitable organization that is the remainder interest beneficiary of the trust.

The nature of this rule was litigated, with those advocating on behalf of a CRT arguing that the rule does not literally mean what it says. Nonetheless, it was held that, under this rule, a CRT is taxable on all of its net income once it receives any unrelated business income; the thought that the tax is applicable only as to the unrelated income was rejected.[412]

The case concerned a CRT that was funded with shares of stock of a publicly traded corporation. Eight years later, the corporation underwent a partial liquidation. It transferred certain real estate and mineral rights holdings in limited partnerships and distributed depository receipts for units in the partnerships to its stockholders. Thus, the trust acquired one unit each in two limited partnerships. Two years after that, the corporation underwent a complete liquidation. It transferred the remainder of its assets to a limited partnership and distributed depository receipts for units in the limited partnership to its stockholders, including the trust. The three limited partnerships were publicly traded. The trust did not purchase or otherwise acquire any interests in these or any other partnerships.

The trust did not have any influence in the decision to liquidate the corporation and convert its structure to a partnership. It did not intend to use its status as a CRT to gain any competitive advantage for its investment in the corporation or

---

[408] IRC § 4947(a)(2)(A).

[409] Reg. § 53.4947-1(e).

[410] This, then, is one of the few instances in which the concept of *reasonableness* is factored into a self-dealing law analysis.

[411] E.g., Priv. Ltr. Rul. 200124010. In one instance, the income interest was also sold to the remainder interest beneficiary. Priv. Ltr. Rul. 200310024. In another instance, the IRS ruled that the partial termination of a charitable remainder trust, made to accelerate the payment of various charities' remainder interests and to substantially reduce trustee fees, would not have any adverse generation-skipping transfer tax (see § 8.5) consequences. E.g., Priv. Ltr. Rul. 200922013.

[412] *Leila G. Newhall Trust v. Commissioner*, 104 T.C. 236 (1995), *aff'd*, 105 F.3d 482 (9th Cir. 1996). The appellate court concluded: "If the statute has unintended consequences, it is for Congress, not the courts, to take appropriate measures to avert them." *Id.*, 105 F.3d at 487.

the partnerships. The amount of annual income received by the trusts from the partnerships was substantial (nearly $292,000 in one year).

The trust advanced the argument that it never possessed the requisite intent to form a partnership; that is, its investments in corporate stock were converted to interests in limited partnerships through no effort of its own. The court, however, held that persons are ordinarily bound by the form of their transaction. Also, the record was devoid of evidence that the trust did not sign and transmit proxies in favor of the creation of and participation in the partnerships. The court thus concluded that the proxies were signed by the trust, so that it did join with the other stockholders in the formation of the partnerships. This "vote" was construed by the court as the equivalent of an application to become a partner in the partnership.

Inasmuch as the businesses conducted by the partnerships would have been unrelated businesses if conducted directly by the trust, the income received by the trust as the consequence of being a member of the partnerships was found taxable as unrelated business income.

The court held that the regulation, which extends the tax to all net income, is valid. It conceded the possibility of some ambiguity in the statute, but ruled that any vagueness was removed by the regulation, which the court in turn found to be a reasonable interpretation of the statute. The court left open the possibility of a different result in the case of a de minimis level of unrelated income.

For years beginning after December 31, 2006, however, the foregoing law has been eliminated; CRTs remain tax-exempt but are subject to an excise tax in the full amount of the unrelated business taxable income.[413]

An illustration of application of this excise tax regime is as follows.

EXAMPLE 12.18

For 2009, a charitable remainder annuity trust on the calendar year has $60,000 of ordinary income, including $10,000 of gross income from a partnership that constitutes unrelated business income to the trust. The trust does not have any deductions that are directly connected with that income. The trust has, for 2009, administration expenses (deductible in computing taxable income) of $16,000, resulting in net ordinary income of $44,000. The amount of UBTI is computed by taking gross income from an unrelated business and deducting expenses directly connected with carrying on the business, both computed using the IRC § 512(b) modifications.[a] Under these facts, the only modification is the specific deduction. This trust, therefore, has UBTI in the amount of $9,000. Undistributed ordinary income from prior years is $12,000, and undistributed capital gains from prior years are $50,000. The trust is required to pay an annuity for 2009 in the amount of $100,000 to the noncharitable beneficiary. The excise tax on this trust is $9,000. The character of the distribution to the beneficiary is, under the ordering rules, $56,000 of ordinary income ($44,000 from 2007 plus $12,000 from prior years) and $44,000 of capital gains. The $9,000 excise tax is allocated to corpus. At the beginning of 2010, the amount of undistributed capital gains in the trust is $6,000 ($50,000–$44,000); there is no undistributed ordinary income.[b]

[a] See *Law of Tax-Exempt Organizations* § 24.6.
[b] This example is based on Reg. § 1.664-1(c)(2), example 2.

[413] IRC § 664(c)(2), added by § 424 of the Tax Relief and Health Care Act of 2006. The IRS issued final regulations concerning these rules on June 19, 2008 (T.D. 9403). A CRT cannot be tax-exempt by reason of IRC § 501(c)(3) because of the private benefit (see *Tax-Exempt Organizations* § 20.11(a)) accorded the income interest beneficiaries (Priv. Ltr. Rul. 200735027).

§ 12.9 MANDATORY PROVISIONS

As references throughout the foregoing portions of this chapter indicate, there are a variety of provisions that must appear in a CRT instrument, as a condition of qualification of the trust under the applicable federal tax rules. Many of these provisions are required by the tax regulations. Others are required by various IRS pronouncements.[414] Following the issuance of these requirements, the IRS published prototypes of CRTs.[415] The IRS announced that it ordinarily would not issue rulings as to the qualification of CRTs.[416]

Nonetheless, when a trust document contains provisions that differ from the sample provisions, the IRS is likely to rule as to whether the differing provisions disqualify the trust.[417] For example, the IRS will rule as to the qualification of a CRT when the income interests are measured by three lives.[418] Also, when a court proposes to modify the provisions of a trust in an effort to qualify it as a CRT, the IRS will rule in advance as to whether the proposed judicial modifications will allow the trust to qualify.[419]

§ 12.10 PRIVATE FOUNDATION RULES

Inasmuch as CRTs are split-interest trusts,[420] they are subject to at least some of the prohibitions that are imposed on private foundations, most particularly the rules concerning self-dealing[421] and taxable expenditures.[422] Thus, reference to the other private foundation rules is not necessary,[423] although on occasion there are references in the trust instrument to the private foundation law prohibitions on excess business holdings[424] and jeopardizing investments.[425] In one instance, a charitable remainder trust was judicially reformed, *ab initio*, to remove a limitation on excess business holdings; the IRS ruled that the reformation did not adversely affect the qualification of the trust.[426]

The interplay of the private foundation rules in the CRT context was illustrated by a private letter ruling issued by the IRS concerning a gift of a joint venture interest to a CRUT.[427] The donor owned an interest in and to a joint venture, which was created by an agreement dated January 15, 1969. The donor acquired

---

[414] Rev. Rul. 72-395, 1972-2 C.B. 340; Rev. Rul. 80-123, 1980-1 C.B. 205; Rev. Rul. 82-128, 1982-2 C.B. 71; Rev. Rul. 82-165, 1982-2 C.B. 117; Rev. Rul 88-81, 1988-2 C.B. 127.

[415] The IRS provided prototype declarations of trust that meet the requirements of forms of CRATs. Rev. Proc. 2003-53, 2003-2 C.B. 230 through Rev. Proc. 2003-60, 2003-2 C.B. 274. Thereafter, the IRS provided prototype declarations of trust that meet the requirements of forms of CRUTs. Rev. Proc. 2005-52, 2005-2 C.B. 326 through Rev. Proc. 2005-59, 2005-2 C.B. 412.

[416] Rev. Proc. 91-3, 1991-1 C.B. 364, § 4.01(34). This non-ruling position of the IRS is also reflected in Rev. Proc. 2009-3, 2009-1 C.B. 107, § 4.01(16), (36), (37), (45), (49). Prior to 1991, the IRS issued rulings as to the qualification of charitable remainder trusts. E.g., Priv. Ltr. Rul. 7842062.

[417] E.g., Priv. Ltr. Rul. 9309029.

[418] E.g., Priv. Ltr. Rul. 9342026.

[419] E.g., Priv. Ltr. Rul. 9309034.

[420] IRC § 4947(a)(2); Reg. § 53.4947-1(c)(1)(ii). See *Private Foundations* § 3.7.

[421] IRC § 4941. See *Private Foundations* ch. 5.

[422] IRC § 4945. See *Private Foundations* ch. 9.

[423] Reg. §§ 1.508-2(b)(1)(vi), 1.664-1(b).

[424] IRC § 4943. See *Private Foundations* ch. 7.

[425] IRC § 4944. See *Private Foundations* ch. 8.

[426] Priv. Ltr. Rul. 9743004.

[427] Priv. Ltr. Rul. 8536061.

all of the interest by July 13, 1977. The sole asset of the joint venture was an apartment complex, which was subject to a nonrecourse mortgage indebtedness. The mortgage indebtedness was placed on the real property in 1970. Because it was a nonrecourse debt, none of the venturers had any personal liability with respect to the indebtedness. Furthermore, under the terms of the agreement, all other debts, obligations, or liabilities of the venture were to be borne severally, according to the percentage ownership interest. Thus, no venturer was personally liable for the venture debt or any of the debts or obligations of any of the other venturers. Each venturer was liable for any future cash calls in the event the venture needed additional capital and did not borrow the money from commercial sources.

The joint venture agreement required that any transferor of venture interests would remain primarily and directly liable for the performance of any obligations of the transferee. The proposed gift agreement stated that the donor ''agrees to indemnify and hold harmless the trust from and against all expenses, losses, and payments, or obligations which might arise as a result of its ownership of the venture interest.''

The owner of the joint venture interest wanted to contribute the interest to charity by means of a CRUT. The trustee would not be restricted from investing the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain. The grantor remained primarily liable for any obligation arising under the venture agreement for which the trust might otherwise be liable. The trust did not assume any portion of the venture debt, as the debt was nonrecourse and the trust was without personal liability.

The IRS reasoned that, inasmuch as the venture debt was placed on the venture property in 1970, and because the joint venture was not a disqualified person[428] with respect to the donor, the transfer of the venture interest by the grantor to the trust would not constitute a sale or exchange of property for purposes of the self-dealing rules. Thus, the gift of the venture interest would not constitute an act of self-dealing between the trust and the grantor.

The IRS ruled, however, that reformation of a CRUT to switch the income payment method, from a net-income approach to a fixed percentage of trust assets, would be an act of self-dealing.[429] According to the IRS, the switch would constitute an unwarranted use by disqualified persons (here, the grantor and trustee) of the income and assets of the trust.[430] The agency said: ''Reforming the trust in the manner proposed will remove interests in the trust which were previously dedicated to charity and transfer them to the benefit of a disqualified person.'' As discussed, however, this type of conversion has since been sanctioned by the law, albeit only under certain circumstances.[431]

In another instance, the IRS ruled that the contribution of assets to a CRT for the purpose of using the remainder interest to satisfy an outstanding and legally enforceable pledge balance owed by the donor (a disqualified person with respect

[428] IRC § 4946. See *Private Foundations* ch. 4.
[429] Priv. Ltr. Rul. 9522021.
[430] IRC § 4941(d)(1)(E).
[431] See § 12.3(a), text accompanied by *supra* notes 167–172.

to the trust) was self-dealing.[432] This was a reversal of an earlier position, holding that there is no self-dealing in these instances because the benefit to the donor/disqualified person is incidental or tenuous.[433]

§ 12.11 WEALTH REPLACEMENT TRUSTS

The wealth replacement trust is often used in conjunction with CRTs. This is usually done in the estate planning context.[434] This approach is also sometimes combined with the use of a CRT in the retirement planning setting.

A *wealth replacement trust* is a trust established to create an asset, for the heirs of the donors, in replacement of the assets transferred to one or more charitable organizations. This type of trust is usually funded by means of life insurance.

The following six examples illustrate these concepts.

EXAMPLE 12.19

H and W, aged 64 and 62, respectively, have built a profitable manufacturing business worth approximately $4 million. They receive annual combined compensation of $200,000 from the business. Their total net worth, including their home, personal investments, and other property, is about $5 million. H and W have two daughters, both of whom have families of their own.

H and W plan to sell their business as a way to create a secure, comfortable retirement. They intend to travel extensively, and visit their children and grandchildren often. They also would like to increase their involvement with the local children's hospital (having lost a son to leukemia when he was 12).

H and W believe they can sell the business for its full value. However, their accountant has calculated that selling the business would result in a tax liability of about $1.1 million. They meet with a charitable gift planner and formulate these objectives: (1) to maximize the value of their business as of the time of sale; (2) to create an inflation-proof retirement income stream; (3) to provide at least a $2 million inheritance to each of their daughters; and (4) to leave a maximum charitable gift, if possible, in lieu of estate tax. The following plan is formulated.

A CRT is created. H and W transfer 75 percent of their stock in the business to the trust; a charitable contribution deduction of nearly $620,000 is thereby created. The stock is subsequently sold, free of tax, by the trust and reinvested for income. The remaining 25 percent of the stock will be sold by H and W. They will receive a lifetime income stream from the trust.

To meet their inheritance objectives, H and W establish an irrevocable life insurance trust. They will make annual gifts to the trust out of their tax savings and their new income. The trust will purchase $3 million of survivorship-type life insurance.

At the death of H and W, the proceeds of the insurance policy will be distributed to the two daughters free of estate tax. Additionally, H and W leave a total of $1.2 million to their daughters, the maximum amount that can pass from their estate tax-free. The balance of the estate of H and W which exceeds the $1.2 million and the assets in the CRT will be passed to a foundation named H and W.

In this example, capital gain and estate tax savings of $2.3 million create increased lifetime income ($.4 million), increased benefit to heirs ($1.6 million), and future charitable gifts ($3.7 million), for a total of benefits of $5.7 million.

---

[432] Priv. Ltr. Rul. 9714010.
[433] Priv. Ltr. Rul. 9233053.
[434] In general, see § 8.6.

Example 12.20

H is 35 and W is 34. Their combined annual income is $55,000. They do not have any children, although they plan to start a family soon. They are purchasing a new condominium and trying to set some money aside for the future.

Although retirement planning is not a high financial priority for H and W, they realize that this is a good time to be setting money aside, while they are both working and do not have children. They have been contributing $4,000 each year to an individual retirement account. Because there is no federal income tax deduction for these contributions, they cannot receive income from the IRA without penalty until one of them is 59-1/2 years of age. They are not as enamored of the IRA as they once were. This year, they have decided to explore some alternatives before making their annual IRA contribution.

After investigating several options, H and W decide to create a NIMCRUT with a 6 percent payout. They can make annual contributions to the unitrust just as they did to the IRA. Money in the trust grows tax-free and they receive a partial income tax deduction for making the annual contributions (total of $29,608, based on some assumptions stated below). This deduction will increase each year as H and W grow older.

Aside from providing the same types of benefits that first attracted H and W to an IRA, the CRT offers several other distinct advantages: (1) there is no contribution limit; (2) they can begin receiving income at any time; (3) if they need to increase the flow of income from the trust to pay educational expenses and then decrease the flow until retirement, they can do so; (4) by using some of the funds in the trust to purchase life insurance, they can assure that their goals will be met even if something happens to one of them before retirement; and (5) H and W can thus make a substantial gift to a local community charitable organization. (Both employers of H and W are community oriented, and the fact that they were farsighted enough to make this gift did not go unnoticed.)

If H and W continued to make contributions of $4,000 each year to the trust until H reached 64 (30 years), they would contribute a total of $120,000. Assuming a normal retirement span (i.e., both H and W live to their life expectancies), they would receive $807,965 in net spendable income. They would ultimately cause the making of $820,672 in charitable contributions.[a]

[a] The illustrations in Examples 12.19 and 12.20 were provided courtesy of Renaissance, Inc., Carmel, Indiana.

Example 12.21

A, an executive (vice president of marketing) of a large company, has a dilemma. In recent years, she has profited nicely through a bonus and incentive stock option plan. She confers with her accountant each year to determine how many options she should exercise without triggering taxes.

A has watched her net worth increase dramatically in recent years. However, she has grown increasingly concerned that a considerable amount of her financial security is tied to the performance of the company. Although she is not aware of any immediate problems with the company, she is enough of a realist to know that some of the biggest and best-run companies have undergone significant reversals. Consequently, A is considering several strategies that would enable her to diversify.

Selling some of her stock is a possibility, but that would entail some significant capital gains tax consequences. Selling short against the box and margin accounts are other possibilities, but they are risky. Coupled with her visibility as an insider, her dilemma is indeed a difficult one.

A then learns about a strategy that would enable her to sell some of her stock without paying capital gains tax. The strategy, which involves the use of a NIMCRUT, offers several significant benefits: (1) A would receive an income tax deduction for each contribution she makes to the trust; (2) she would be able to avoid capital gains tax when she sold the stock; (3) she would have the right to receive income from the trust during her lifetime; (4) as trustee of the trust, she could manage the trust to produce income when she needs it or to grow tax-free if she wants to defer income; and

(*continues*)

EXAMPLE 12.21 (*CONTINUED*)

(5) she could make a significant gift to the charitable organizations with which she is involved. This is a particularly compelling benefit to A, not only because of her personal interest in these charitable organizations but also because of her position within the company. She realizes that this kind of program, if promoted within the company, could be coordinated with an external public relations campaign to make a significant impact in the community where the company does business.

With the assistance of a charitable gift planner and her lawyer, A develops the following plan: (1) she authorizes the establishment of a NIMCRUT, with herself as the trustee; (2) she continues to exercise her stock options systematically; (3) after holding the stock for at least one year, she will contribute to the trust $100,000 of stock per year for 10 years (generating approximately $240,000 in income tax deductions); (4) as trustee, she will sell the stock and report the sale as a beneficial owner; (5) she will select an investment objective so that the assets will compound tax-free for 10 years (at which time she will begin receiving income from the trust); (6) if the trust's assets are invested at an 8 percent return, the account balance when A becomes 65 would be $1.5 million; (7) if the unitrust amount payable was set at 8 percent, she would receive a lifetime income of $120,000 per year; (8) she will make annual contributions of $16,200 for 11 years to a wealth replacement trust, designed to provide a benefit to her children to replace the value of her charitable gifts (they will receive $1 million free of income and estate taxes from her estate); (9) and, at the death of A, the principal in the NIMCRUT (the $1.5 million plus undistributed earnings) will be paid to the designated charities.

EXAMPLE 12.22

H and W, both aged 61, own a company. When they started, H was the sales, marketing, and public relations departments; W was the receptionist, controller, and customer service department. Years later, they employ 8 individuals and the business has annual revenue of $4.4 million. Their combined salaries are $290,000. Recently, as H and W began thinking about retirement, they were approached by a business broker who thought the business could be sold for as much as $3 million.

They began reviewing the numbers. They set the sales price at $2.5 million (to be more realistic), on the assumption that the assets were worth $1.5 million and a consulting contract (with an agreement not to compete) would have a value of $1 million. The corporate tax on the sale of the assets, however, would be about $500,000. Thus, they would have $2 million of income, with corresponding income tax liability of about $700,000.

Under this approach, H and W would end up with $1.3 million. This, when invested, would produce only about $100,000 per year—far short of the $290,000 to which they had become accustomed. They agreed that they needed income of at least $150,000 to be comfortable. Thus, it seemed that after two lifetimes of building the business, H and W could not afford to sell it.

However, a charitable gift planner showed H and W a way out of this dilemma. The strategy involved use of a CRT. H and W had never considered themselves in a position to make a major charitable gift, but nonetheless liked the idea—as long as their three children would not be deprived of a reasonable inheritance. The plan had these objectives: (1) sell the business with a minimum of tax; (2) generate income of at least $150,000 annually; (3) maintain at least $500,000 in liquid assets; (4) provide a substantial inheritance for their children; and (5) leave a major gift to one or more charitable organizations.

H and W agreed to the following plan, as devised by the charitable gift planner and their lawyer: (1) they will transfer their stock in the company to a CRUT (thereby receiving an income tax charitable contribution deduction of approximately $225,000, which will be used to offset part of their taxable income in the year of sale); (2) the trustees of the trust (H and W) will negotiate sale of the stock for $1.5 million; (3) the purchaser will pay $1 million pursuant to a covenant not to compete and a consulting

contract, so that H and W will incur about $250,000 in income tax (when the income tax deduction is considered), leaving $750,000 to invest; (4) the investment of the $750,000 will produce $60,000 in annual income; (5) the trustees will invest the $1.5 million (the proceeds from the sale of the stock) in income-producing assets; (6) the trust will pay H and W 8 percent of the value of the trust each year (expected to be $120,000); (7) they will allocate $25,000 per year for 11 years to a wealth replacement trust, which will generate an inheritance; (8) when H and W die, the wealth replacement trust will provide to their heirs $150,000 free of income and estate taxes; and (9) when they die, the assets remaining in the CRUT ($1.5 million plus undistributed earnings) will be paid to the charitable organizations that are the remainder interest beneficiaries of the trust.[a]

[a] The illustrations in Examples 12.21 and 12.22 were provided courtesy of Lane Planning Co., Bethesda, Maryland.

Example 12.23

H is 50 years of age and has a successful business; last year, his personal income was $130,000. W is 49 and has a degree in special education. She is no longer employed, although she does volunteer work with handicapped children. Their only child, C, is in her final year of medical school.

H has a pension plan, but it is overfunded; he cannot make any further contributions to this plan. He had intended to contribute $25,000 each year to the plan until he retired at age 65. H is looking for an alternative retirement planning tool.

H and W create a CRUT with a payout rate of 6 percent. They plan to contribute $25,000 each year to the trust for the next 15 years. H and W will be the income beneficiaries of the trust. They want to provide an inheritance for C, so they are allocating nearly $5,000 each year to pay the premiums on an asset replacement policy outside the trust. Additionally, they plan to allocate 25 percent of their contributions to the trust to pay for life insurance inside the trust. This will help assure that their financial objectives will be met regardless of what happens to either of them.

For contributions totaling $375,000, H and W can set aside a substantial retirement nest egg on a tax-favored basis, leave a substantial inheritance to C, and make a meaningful contribution to their favorite charitable causes. They will also have the benefit of tax deductions exceeding $90,000 for their annual contributions.

Assuming that H and W both live to their life expectancies, they will receive $1,125,775 in income from the trust. The life insurance policy inside the trust assures that their financial retirement goals will be met. The asset replacement trust will leave C more than $424,000, which will pass to her outside of her parents' estate. Assuming that H dies first, the death proceeds from this policy could also provide additional income benefits to W. In addition to these advantages, H and W receive immediate recognition for creating a gift of more than $1 million that will pass to the charities of their choice after their deaths.

H and W are pleased with the benefits they have gained from their charitable remainder trust. They have multiplied the value of the dollars they are investing in their retirement, provided for their daughter, and made a large gift to several of the organizations for which W does volunteer work.[a]

[a] The illustration in Example 12.23 was provided by Renaissance, Inc., Carmel, Indiana.

Example 12.24

C and M, both aged 72, have owned and operated a dairy farm for more than 40 years. Both raised on farms, they inherited land and acquired much more over the years. Their operation has been more profitable than most, but in recent years, they have begun to reduce the size of their herd and scale back overall operations. They always enjoyed their way of life, but recently have wished to be free from the constant demands of running the farm so they can pursue other interests (such as visiting their children and grandchildren). They also want to give more time to their church, in which they have been very active.

(*continues*)

EXAMPLE 12.24 (*CONTINUED*)

C and M have four children and nine grandchildren; none of them has any interest in working the farm. The family is interested in keeping the house and some of the prime acreage, but C and M realize that the majority of the property will have to be sold either in their lifetime or during their children's lifetimes.

During good years, C and M were able to save a substantial amount of money. Between their interest income, social security payments, and rent from some of their land, they have been reasonably comfortable. Now, however, they feel the need to increase their income. To this end, they have considered selling some of the land, worth about $250,000, but the resulting capital gain tax (about $72,000) has precluded that approach. Although the after-tax proceeds of about $172,000 would generate more than $14,000 per year in additional income, the thought of all that money lost to taxes is unacceptable to them.

One day, they attend a financial planning seminar sponsored by their church. There they learn about CRTs and ways to utilize this type of trust and avoid the capital gains tax. Later, they meet with the financial planner and identify the following objectives: (1) sell the land and avoid capital gains tax; (2) generate maximum income with moderate risk by managed investment of the proceeds; (3) leave major gifts to their church and some other favorite charitable organizations; and (4) replace the value of the land as an inheritance for their children.

The plan ultimately adopted (developed by additional consultation with a lawyer and an accountant) consists of the following steps: (1) C and M will establish a CRT, with themselves as the trustees; (2) they will contribute land valued at $250,000 to the trust; (3) a special independent trustee, appointed by them, will oversee the selling of the land; (4) because the trust will be tax-exempt, the entire before-tax proceeds will be invested; (5) for making this contribution, C and M will receive an income tax deduction of approximately $31,000; (6) they will also receive income from the trust of about $20,000 for each year for the remainder of their lives; (7) they will use $8,600 of this income for 10 years to fund a wealth replacement trust for their children; (8) when C and M both die, the assets remaining in the trust will pass to their church and some other charitable organizations; and (9) at the death of the second of them to die, the wealth replacement trust will provide about $250,000 to their children, free of income and estate taxes.[a]

[a] The illustration in Example 12.24 was provided by Lane Planning Co., Bethesda, Maryland.

§ 12.12 CALCULATION OF CHARITABLE DEDUCTION

The amount of the charitable contribution deduction for a gift to charity by means of a CRT essentially is equal to the value (as of the appropriate valuation date) of the remainder interest in the trust property.[435] The value of the remainder interest, then, is equal to the fair market value of the property placed in trust, less the value of the income interest.

If, however, the probability that the charitable organization will receive the remainder interest is negligible, the charitable deduction will not be allowed.[436] In one instance, when the likelihood that the remainder interest beneficiary would receive the interest was not in excess of 5 percent, the IRS disallowed the charitable contribution deduction.[437]

[435] IRC § 664(e); Reg. §§ 1.664-2(c); 1.664-4(d), (e); 1.7520-1(a)(3); 20.2031-7(d)(2)(i). The deduction is, of course, also subject to other rules governing the extent of the charitable deduction, such as the percentage limitations in the case of the income tax charitable contribution deduction. See ch. 7.

[436] Reg. § 1.170A-1(e).

[437] Rev. Rul. 77-374, 1977-2 C.B. 329.

The rules as to valuation of a remainder interest in a CRT vary, depending on whether the trust is a CRAT or a CRUT. The process by which this type of remainder interest is valued is discussed elsewhere.[438]

(a) Charitable Remainder Annuity Trusts

The fair market value of a remainder interest in a CRAT is its *present value*.[439] For purposes of the charitable contribution deductions, the fair market value of the remainder interest in a CRAT is the net fair market value—as of the appropriate valuation date—of the property placed in the trust, less the present value of the annuity income interest.[440] Simply stated, the value of the remainder interest is equal to the value of the property transferred to the trust less the value of the annuity interest.

Thus, valuation of a remainder interest in a CRAT requires identification of a *valuation date*. The rules for determining this date dependent on the type of charitable contribution deduction involved.

In the case of a gift involving an *income tax* charitable contribution deduction or a *gift tax* charitable contribution deduction, the term *valuation date* means, in general, the date on which the property is transferred to the trust by the donor.[441]

The present value of an annuity interest is determined basically by two factors: mortality tables promulgated by the IRS and an interest rate that is set by the Department of the Treasury each month.[442]

In an instance of a gift involving an *estate tax* charitable contribution deduction, the valuation date generally is the date of death. In the estate tax context, however, an *alternative valuation date* may be elected by the decedent's estate,[443] in which case the valuation date is the alternative valuation date. If the alternative valuation date is elected, and the decedent's estate also elects to use the interest rate component for one of the two months preceding the alternative valuation date,[444] the month selected containing that date is the one used to determine the interest rate and mortality tables.[445]

The present value of an annuity is computed using rules in the estate tax regulations.[446] If the interest to be valued is the right of a person to receive an annuity that is payable, at the end of each year, for a term of years or one life, the present value of that interest is ascertained by multiplying the amount that is annually payable by the appropriate annuity actuarial factor. That factor is the one that corresponds to the applicable interest rate and the annuity period.[447]

As noted, this annuity actuarial factor assumes that the annuity is paid annually. If, however, the annuity is payable at the *end* of semiannual, quarterly, monthly, or weekly periods, the product obtained by multiplying the annuity

[438] See ch. 11.
[439] Reg. § 20.2031-7(a), (d)(2)(i).
[440] Reg. § 1.664-2(c).
[441] *Id*. The valuation date is not determined by the date on which the trust was created.
[442] IRC § 7520(a). See ch. 11.
[443] IRC § 2032.
[444] See § 8.3(c).
[445] Reg. § 1.664-2(c).
[446] Reg. § 20.2031-7(d).
[447] Reg. § 20.2031-7(d)(6)(iv)(A).

factor by the annual annuity amount must be multiplied by an adjustment factor.[448] Likewise, an adjustment must be made if the annuity is payable at the beginning of one of these periods.[449] This adjustment is required to adjust (lower) the charitable deduction in light of the more frequent annuity payments.

EXAMPLE 12.25

A, an individual age 65, makes a contribution of $100,000 to a CRAT. The gift is made in November 2009 (in that month, the Treasury Department's interest rate[a] was 3.2 percent). The annuity amount, paid annually and at the end of each year, is $5,000. The income interest is for A's life. The annuity factor is 12.389. The present value of the annuity interest is $61,945. The value of the remainder interest (and thus the resulting charitable contribution deduction) is $38,055.[b]

[a] See § 12(d), note 367, and Appendix J.
[b] The illustration in Example 12.25 was provided by Lisa McLaughlin, Polsinelli Shughart PC, Clayton, Missouri.

Other tables are used to compute the value of a remainder interest in the case of an annuity amount determined on the basis of multiple lives.[450]

EXAMPLE 12.26

B, an individual age 70, and C, an individual age 68, make a contribution of $100,000 to a CRAT. The gift is made in November 2009. The annuity amount, paid annually and at the end of each year, is $5,000. The income interest is for the joint lives of B and C, then to the survivor. The two-life annuity factor is 13.7914. The present value of the annuity interest is $68,957. The value of the remainder interest (and thus the resulting charitable contribution deduction) is $31,043.

EXAMPLE 12.27

D, an individual, makes a contribution of $100,000 to a CRAT. The gift is made in November 2009. The annuity amount, paid annually and at the end of each year, is $6,000. The income interest is for a 20-year term. The annuity factor is 14.6061. The present value of the annuity interest is $87,636. The value of the remainder interest (and thus the resulting charitable contribution deduction) is $12,363.40.[a]

[a] The illustrations in Examples 12.26 and 12.27 were provided by Lisa McLaughlin, Polsinelli Shughart PC, Clayton, Missouri.

(b) Charitable Remainder Unitrusts

The fair market value of a remainder interest in a CRUT is its *present value*.[451] This is the case for purposes of the charitable contribution deduction.[452] The rules as to determining the valuation date are the same as those for CRATs.[453]

---

[448] Reg. § 20.2031-7(d)(6)(iv)(B).
[449] Reg. § 20.2031-7(d)(6)(iv)(C).
[450] See § 11.2.
[451] Reg. §§ 1.170A-6(b)(2); 20.2031-7(a), (d)(2)(i), (e)(1).
[452] Reg. § 1.664-4(a), (d), (e).
[453] See § 12.11(a), text accompanied by *supra* notes 443–445.

This present value is computed on the basis of life contingencies determined as to each life (if any) involved, the appropriate monthly interest rate,[454] and the assumption that the unitrust amount is distributed in accordance with the payout sequence described in the governing instrument of the trust.[455] If the governing instrument does not prescribe when the distribution is made during the period for which the payment is to be made, the distribution is considered payable on the first day of the period for which the payment is made.[456]

These rules require determination of an *adjusted payout rate*.[457] There are rules for when the unitrust payment period is for a term of years[458] and for when it is for the life of an individual.[459]

The regulations also state the process for requesting a ruling from the IRS that supplies an actuarial factor in the CRUT context.[460] Any claim for a charitable contribution deduction on any return for the value of a remainder interest in a CRUT must be supported by a full statement attached to the appropriate tax return showing the computation of the present value of the interest.[461]

Other tables are used to compute the value of a remainder interest in cases of a unitrust interest determined on the basis of multiple lives.[462]

EXAMPLE 12.28

E, an individual age 70, makes a contribution of $100,000 to a SCRUT. The gift is made in November 2009. The unitrust amount, paid annually, is based on 5 percent. The valuation date precedes the first payout by 12 months. The unitrust interest is for E's life. The payout sequence factor is 0.968922. The adjusted payout rate is 4.845 percent. The (interpolated) life remainder factor is 0.53805. The value of the remainder interest (and thus the resulting charitable contribution deduction) is $53,805.

EXAMPLE 12.29

F, an individual age 75, and G, an individual age 70, make a contribution of $100,000 to a SCRUT. The gift is made in November 2009. The unitrust amount, paid annually, jointly for life, then to the survivor, is based on 6 percent. The valuation date is at the beginning of the year. The payout sequence factor is 0.968992. The adjusted payout rate is 5.814 percent. The life remainder factor is 0.39485. The value of the remainder interest (and thus the resulting charitable contribution deduction) is $39,485.[a]

[a] The illustrations in Examples 12.28 and 12.29 were provided by Lisa McLaughlin, Polsinelli Shughart PC, Clayton, Missouri.

---

[454] That is, the IRC § 7520 rate. See ch. 11.
[455] Reg. § 1.664-4(a).
[456] *Id.* This presumption was in the tax regulations when they were issued in proposed form and attracted comments. In its explanation accompanying the regulations in final form, the IRS observed that "[u]nitrusts have traditionally been regarded as providing for distributions at the beginning of each period unless the governing instrument provides to the contrary" and that this "presumption has been reflected in [the] unitrust factors prescribed in the regulations . . . since the enactment of" the CRUT rules. This observation was made in rationalizing why the presumption was continued in the final regulations.
[457] Reg. § 1.664-4(e)(3).
[458] Reg. § 1.664-4(e)(4).
[459] Reg. § 1.664-4(e)(5).
[460] Reg. § 1.664-4(b).
[461] Reg. § 1.664-4(c).
[462] See § 11.2.

(c) Qualified Contingencies

If a trust would, but for a qualified contingency, meet the requirements to be a CRAT or CRUT, it is treated as a CRT.[463] For purposes of determining the amount of a charitable contribution in this context (or the actuarial value of any interest), a qualified contingency is not taken into account.[464] That is, in the CRT setting, the value of the charitable remainder interest is calculated without regard to the qualified contingency.

A *qualified contingency* is a trust provision stating that, on the happening of a contingency, the annuity interest payments or the unitrust interest payments will terminate not later than the payments would otherwise terminate under the trust.[465]

Example 12.30

This is an example of a qualified contingency. A CRT is to pay to X, during X's life, a qualifying unitrust amount. On the death of X, if Y survives X, the unitrust amount is to be divided into equal shares. One share is to be paid to Y during Y's life. The other share is to be paid in equal portions to A, B, and C, or the survivors of them, during Y's lifetime. The termination of the unitrust payments at the death of Y is a qualified contingency.[a]

[a] Priv. Ltr. Rul. 200414011.

[463] IRC § 664(f)(1).
[464] IRC § 664(f)(2).
[465] IRC § 664(f)(3).

CHAPTER THIRTEEN

Pooled Income Funds

§ 13.1 **Definitions** 526
§ 13.2 **Qualifying Pooled Income Funds** 527
(a) Remainder Interests 527
(b) Life Income Interests 527
(c) Commingling 528
(d) Prohibition as to Exempt Securities 529
(e) Maintenance 529
(f) Prohibitions as to Trustees 530
(g) Income of Beneficiaries 530
(h) Termination of Life Income Interest 531
§ 13.3 **Allocation of Income** 531
(a) Units of Participation 532
(b) Partial Allocation of Income to Charity 533
§ 13.4 **Recognition of Gain or Loss on Transfers** 535
§ 13.5 **Mandatory Provisions** 535
§ 13.6 **Private Foundation Rules** 536
§ 13.7 **Pass-Through of Depreciation** 536
§ 13.8 **Tax Status of Fund and Beneficiaries** 538
§ 13.9 **Multiorganization Pooled Income Funds** 538
(a) National Organizations with Affiliates 539
(b) Pooled Income Funds of Community Trusts 540
(c) Other Circumstances 541
§ 13.10 **Comparison with Charitable Remainder Trusts** 541
§ 13.11 **Charitable Contribution Deduction** 542

The federal tax law provides for a form of planned giving that utilizes a split-interest trust called a pooled income fund.[1] Basically, a *pooled income fund* is a vehicle by which money or property is split into two types of interests: one or more *income interests* and one or more *remainder interests*. The remainder interest usually is destined for one charitable organization, while the income interests are retained by or created for noncharitable beneficiaries.[2] In the normal course of events, the gift of the remainder interest gives rise to a federal tax deduction.[3] This chapter focuses on the income tax deduction; the use of pooled income funds in the estate and gift tax context is discussed elsewhere.[4]

[1] The concepts of planned giving and split-interest trusts are discussed in ch. 5. That chapter also contains a general description of pooled income funds.
[2] IRC § 642(c)(5).
[3] IRC § 170(f)(2)(A). See § 9.23.
[4] See ch. 8.

§ 13.1 DEFINITIONS

The rules concerning qualified pooled income funds employ a variety of definitions, which include the following:

- The term *income* has the same meaning as it does under general income tax rules.[5]
- The term *donor* includes a decedent who makes a testamentary transfer of property to a pooled income fund.[6]
- The term *governing instrument* means either the governing plan under which the pooled income fund is established and administered or the instrument of transfer, as the context requires.[7]
- The term *public charity* means certain charitable organizations that are not private foundations because they are institutions such as churches, universities, colleges, and hospitals, or are certain publicly supported charities.[8] To be a public charity for these purposes, an organization need only be described in one of the applicable provisions of the federal tax law,[9] even though it has been classified as another type of public charity.[10] Nonetheless, not all charitable organizations that are generically termed *public charities* qualify as such under these rules.
- The term *fair market value*, when used with respect to property, means its value in excess of the indebtedness or charges against the property.[11]
- The term *determination date* means each day within the tax year of a pooled income fund on which a valuation is made of the property in the fund. The property in the fund must be valued on the first day of the tax year of the fund and on at least three other days within the tax year. The period between any two consecutive determination dates within a tax year may not be greater than three calendar months. In the case of a tax year of less than 12 months, the property in the fund must be valued on the first day of that tax year and on such other days within the year as occur at successive intervals of no greater than three calendar months. When a valuation date falls on a Saturday, Sunday, or legal holiday,[12] the valuation may be made on either the next preceding day that is not a Saturday, Sunday, or legal holiday or the next succeeding day that is not a Saturday, Sunday, or legal

[5] Reg. § 1.642(c)-5(a)(5)(i). The term *income* is generally defined in IRC § 643(b). See §§ 13.8, 10.13.
[6] Reg. § 1.642(c)-5(a)(5)(ii).
[7] Reg. § 1.642(c)-5(a)(5)(iii).
[8] Reg. § 1.642(c)-5(a)(5)(iv).
[9] IRC § 170(b)(1)(A)(i)–(vi).
[10] Reg. § 1.642(c)-5(a)(5)(iv). For example, a charitable organization may not be a private foundation by reason of the fact that it is classified as a publicly supported charity under IRC § 509(a)(2), and yet also satisfy the public support test of IRC § 509(a)(1). Because of this, the organization is one that is *described* in IRC § 170 (b)(1)(A)(vi) and thus qualifies as a public charity under these rules. By contrast, if the organization satisfied only the IRC § 509(a)(2) public support test, and not the IRC § 509(a)(1) public support test, it would not be a public charity under this definition (unless it otherwise qualified), because IRC § 509(a)(2) is referenced in IRC § 170(b)(1)(A)(viii), which is outside the scope of the tax law provisions defining public charities in this context. In general, see § 3.4.
[11] Reg. § 1.642(c)-5(a)(5)(v).
[12] The term *legal holiday* is defined in IRC § 7503.

holiday, as long as this next preceding day or next succeeding day is consistently used when the valuation date falls on a Saturday, Sunday, or legal holiday.[13]

§ 13.2 QUALIFYING POOLED INCOME FUNDS

To qualify under these rules, a pooled income fund must satisfy the following requirements.

(a) Remainder Interests

Each donor to a pooled income fund must transfer property (which can be or include money) to the fund and contribute an irrevocable remainder interest in the property to or for the use of a qualified public charity,[14] retaining for himself or herself, or creating for another beneficiary or beneficiaries, a life income interest in the transferred property.[15] A contingent remainder interest is not treated as an irrevocable remainder interest.[16]

(b) Life Income Interests

Each donor to a pooled income fund must retain for himself or herself, for life, an income interest in the property transferred to the fund, or create an income interest in the property for the life of one or more beneficiaries, each of whom must be living at the time of the transfer of the property to the fund by the donor.[17] The phrase *one or more beneficiaries* includes those members of a named class who are alive and can be ascertained at the time of the transfer of the property to the fund. If more than one beneficiary of the income interest is designated, the beneficiaries may enjoy their shares of income from the fund concurrently, consecutively, or both concurrently and consecutively.[18]

These income interest beneficiaries must be individuals. An income interest beneficiary of a pooled income fund cannot be a pet animal, even when the measuring period of the income interest is the lifetime of the animal.[19]

It is not required that a donor to a pooled income fund be an individual. The law allows a donor, by means of a pooled income fund gift, to create an income interest in gift property for the life of one or more beneficiaries.[20] Thus, a donor to a pooled income fund may be a person other than an individual, such as a corporation.[21] When the donor is not an individual, however, it cannot retain an income interest in its favor (since it lacks a natural life), nor can it retain a power

---

[13] Reg. § 1.642(c)-5(a)(5)(vi).
[14] See § 13.1, text accompanied by *supra* note 10.
[15] IRC § 642(c)(5)(A); Reg. § 1.642(c)-5(b)(1).
[16] Reg. § 1.642(c)-5(b)(1).
[17] IRC § 642(c)(5)(A); Reg § 1.642(c)-5(b)(2). An interest in a pooled income fund bequeathed to a surviving spouse qualifies for qualified terminable interest property treatment. See § 8.3(b)(ii). *See* also Priv. Ltr. Rul. 9406013.
[18] Reg. § 1.642(c)-5(b)(2).
[19] Rev. Rul. 78-105, 1978-1 C.B. 295 (so held in the case of a charitable remainder trust (see ch. 12); presumably, the holding is the same for pooled income funds).
[20] See § 13.2(a), text accompanied by *supra* note 15.
[21] Rev. Rul. 85-69, 1985-1 C.B. 183.

exercisable only by will to revoke or terminate the income interest of a designated beneficiary.

The measuring period of an income interest for an income beneficiary of a pooled income fund must be the life of the beneficiary. That is, an individual beneficiary of an income interest may not receive an income interest when the duration of the enjoyment of the income interest is measured by the lifetime of another individual.[22] This is the case even when the other individual is also a beneficiary of an income interest established by the same gift. A provision in the governing instrument of a pooled income fund authorizing the creation of this type of an interest would prevent the fund from qualifying as a pooled income fund.[23]

The donor may retain the power exercisable only by will to revoke or terminate the income interest of any designated beneficiary other than the public charity. The governing instrument must specify at the time of the transfer the particular beneficiary or beneficiaries to whom the income is payable, and the share of income distributable to each person so specified.[24]

The public charity to or for the use of which the remainder interest is contributed may also be designated one of the beneficiaries of an income interest. The donor need not retain or create a life interest in all of the income from the property transferred to the fund, provided that any income not payable under the terms of the governing instrument to an income beneficiary is contributed to, and within the tax year in which it is received is paid to, the same public charity to or for the use of which the remainder interest is contributed. A charitable contribution deduction is not, however, allowed to the donor for the value of the income interest of the public charity or for the amount of any such income paid to the organization.[25]

(c) Commingling

The property transferred to a pooled income fund by each donor must be commingled with, and invested or reinvested with, other property transferred to the fund by other donors in satisfaction of the above requirements.[26] For this reason, property contributed to charity by means of a pooled income fund generally is confined to cash and publicly traded securities. The governing instrument of the pooled income fund must contain a provision reflecting this requirement.[27]

The public charity to or for the use of which the remainder interest is contributed may maintain[28] more than one pooled income fund, provided that each fund is maintained by the organization and is not a device to permit a group of donors to create a fund that may be subject to their manipulation.[29]

The fund must not include property transferred under arrangements other than those specified in these rules.[30] For example, if a contribution to a pooled

[22] Rev. Rul. 79-81, 1979-1 C.B. 220.
[23] *Id.*
[24] Reg. § 1.642(c)-5(b)(2).
[25] *Id.*
[26] IRC § 642(c)(5)(B); Reg. § 1.642(c)-5(b)(3).
[27] Reg. § 1.642(c)-5(b)(3).
[28] See § 13.2(e).
[29] Reg. § 1.642(c)-5(b)(3).
[30] IRC § 642(c)(5)(D); Reg. § 1.642(c)-5(b)(3).

income fund is made subject to a provision that the income interest of the designated beneficiary is to be measured by the life of another individual, that contribution would be a transfer in violation of this requirement.[31]

A fund will not be disqualified as a pooled income fund under these rules, however, because any portion of its properties is invested or reinvested jointly with other properties, not a part of the pooled income fund, which are held by, or for the use of, the public charity that maintains the fund. An example of this practice, which is frequently used to "seed" a pooled income fund, is transferring securities from the general endowment fund of the public charity to or for the use of which the remainder interest is contributed. When this type of joint investment or reinvestment of properties occurs, records must be maintained that sufficiently identify the portion of the total fund that is owned by the pooled income fund and the income earned by, and attributable to, that portion. This type of joint investment or reinvestment of properties is not treated as an association or partnership for federal tax purposes.[32]

A bank that serves as trustee of more than one pooled income fund may maintain a common trust fund[33] for the collective investment and reinvestment of moneys of the funds.[34]

(d) Prohibition as to Exempt Securities

The property transferred to a pooled income fund by a donor must not include any securities the income from which is exempt from federal income tax, and the fund must not invest in this type of security.[35] The governing instrument of the fund must contain specific prohibitions against accepting or investing in these securities.[36]

(e) Maintenance

A qualifying pooled income fund must be maintained by the same public charity to or for the use of which the irrevocable remainder interest is contributed.[37] This requirement of maintenance is satisfied when the public charity exercises control, directly or indirectly, over the fund. For example, this requirement of control is ordinarily met when the public charity has the power to remove the trustee or trustees of the fund and designate a new trustee or trustees.[38]

A national organization that carries out its purposes through local organizations, chapters, or auxiliary bodies with which it has an identity of aims and purposes may maintain a pooled income fund (otherwise satisfying the requirements

[31] Rev. Rul. 79-81, 1979-1 C.B. 220.
[32] Reg. § 1.642(c)-5(b)(3).
[33] These common trust funds are the subject of IRC § 584.
[34] Reg. § 1.642(c)-5(b)(3).
[35] IRC § 642(c)(5)(C); Reg. § 1.642(c)-5(b)(4). This prohibition is chiefly aimed at tax-exempt municipal bonds, the income from which is exempt from federal income taxation by IRC § 103.
[36] Reg. § 1.642(c)-5(b)(4).
[37] IRC § 642(c)(5)(E); Reg. § 1.642(c)-5(b)(5). It is because of this requirement that the pooled income funds of different public charities cannot be merged, although pooled income funds maintained by the same public charity may be merged. See, e.g., Priv. Ltr. Rul. 9642020. *Cf.* text accompanied by *infra* note 41.
[38] Reg. § 1.642(c)-5(b)(5).

of these rules) in which one or more local organizations, chapters, or auxiliary bodies that are public charities have been named as recipients of the remainder interests. For example, a national church body may maintain a pooled income fund when donors have transferred property to the fund and contributed an irrevocable remainder interest in it to or for the use of various local churches or educational institutions of the body. The fact that the local organizations or chapters are separately incorporated is immaterial.[39]

A national organization may wish to maintain a pooled income fund for the benefit of local or other charitable organizations but not meet the foregoing criteria. In this circumstance, a donor could recommend (but not direct) that an amount equal to the remainder interest amount associated with the gift be paid by the remainder interest beneficiary over to the other charitable organization, following the death of the income beneficiary or beneficiaries.

The public charity that maintains a pooled income fund may directly pay the costs of managing and administering the fund, without endangering the qualification of the fund.[40] The transfer of charitable remainder interests in a pooled income fund from one eligible public charity to another will not adversely affect the qualification of the fund.[41]

(f) Prohibitions as to Trustees

A pooled income fund may not have, and its governing instrument must prohibit the fund from having, as a trustee a donor to the fund or a beneficiary (other than the public charity to or for the use of which the remainder interest is contributed) of an income interest in any property transferred to the fund.[42] Thus, if a donor or beneficiary (other than the public charity) directly or indirectly has general responsibilities with respect to the fund that are ordinarily exercised by a trustee, the fund does not qualify under these rules. The fact that a donor of property to the fund, or a beneficiary of the fund, is a trustee, officer, director, or other official of the public charity to or for the use of which the remainder interest is contributed ordinarily will not prevent the fund from meeting these requirements.[43]

(g) Income of Beneficiaries

Each beneficiary of a pooled income fund entitled to income in any tax year of the fund must receive the income in an amount determined by the rate of return earned by the fund for that tax year with respect to his or her income interest, compounded as provided below.[44] The governing instrument of the fund must direct the trustee to distribute income currently or within the first 65 days following the close of the tax year in which the income is earned. Any such payment made after the close of the tax year must be treated as paid on the last day of the tax year. A statement must be attached to the return of the pooled income fund

[39] *Id*. See § 13.11.
[40] Priv. Ltr. Rul. 9311018.
[41] E.g., Priv. Ltr. Rul. 200329031.
[42] IRC § 642(c)(5)(E); Reg. § 1.642(c)-5(b)(6).
[43] Reg. § 1.642(c)-5(b)(6).
[44] IRC § 642(c)(5)(F); Reg. § 1.642(c)-5(b)(7). See § 13.3.

indicating the date and amount of these payments after the close of the tax year. The beneficiary must include in his or her gross income all amounts properly paid, credited, or required to be distributed to the beneficiary during the tax year or years of the fund ending within or with his or her tax year. The governing instrument of the fund must provide that the income interest of any designated beneficiary must either terminate with the last regular payment made before the death of the beneficiary or be prorated to the date of his or her death.[45]

(h) Termination of Life Income Interest

Upon termination of the income interest retained or created by any donor, the trustee of the pooled income fund must sever from the fund an amount equal to the value of the remainder interest in the property upon which the income interest is based. The value of the remainder interest for this purpose may be either

- its value as of the determination date next succeeding the termination of the income interest, or
- its value as of the date on which the last regular payment was made before the death of the beneficiary, if the income interest is terminated on the payment date.[46]

In one instance, the governing instrument of a pooled income fund provided that the income interest of each income beneficiary would terminate with the income payment immediately preceding the beneficiary's death. The valuation dates selected were January 1, April 1, July 1, and October 1. The payment dates were March 15, June 15, September 15, and December 15. A beneficiary of an income interest died on May 15. The property to be severed from the fund was valued as of July 1, as that was the valuation date immediately following the date of death (May 15). The determination date that next succeeded the termination on March 15 of the income interest was April 1. The last regular payment prior to the death of the beneficiary was made on March 15. The IRS held that the fund did not qualify as a pooled income fund because the property was neither valued as of the determination date next succeeding the termination of the income interest nor valued as of the date on which the last regular payment was made before the death of the beneficiary.[47]

The amount so severed from the fund must either be paid to, or retained for the use of, the designated public charity, as provided in the governing instrument.[48]

§ 13.3 ALLOCATION OF INCOME

Every income interest retained or created in property transferred to a pooled income fund must be assigned a proportionate share of the annual income earned

[45] Reg. § 1.642(c)-5(b)(7).
[46] *Id.*
[47] Rev. Rul. 76-196, 1976-1 C.B. 178.
[48] Reg. § 1.642(c)-5(b)(8).

by the fund. The share or unit of participation must be based on the fair market value of the property on the date of transfer.[49]

(a) Units of Participation

On each transfer of property by a donor to a pooled income fund, one or more units of participation in the fund must be assigned to the beneficiary or beneficiaries of the income interest retained or created in the property. The number of units of participation must be equal to the number obtained by dividing the fair market value of the property by the fair market value of a unit in the fund at the time of the transfer.[50] This is known as the *unit plan*.

Under the unit plan, the fair market value of a unit in a pooled income fund at the time of the transfer must be determined by dividing the fair market value of all property in the fund at that time by the number of units then in the fund. The initial fair market value of a unit in a pooled income fund is the fair market value of the property transferred to the fund, divided by the number of units assigned to the income interest in that property. The value of each unit of participation will fluctuate with each new transfer of property to the fund, in relation to the appreciation or depreciation in the fair market value of the property in the fund, but all units in the fund will always have equal value.[51]

Under the unit plan, the share of income allocated to each unit of participation must be determined by dividing the income of the fund for the tax year by the outstanding number of units in the fund at the end of the year, except that, consistent with the rate of return requirements,[52] income must be allocated to units outstanding during only part of the year by taking into consideration the period of time for which the units were outstanding. For this purpose, the actual income of the part of the tax year, or a prorated portion of the annual income, may be used, after making such adjustments as are reasonably necessary to reflect fluctuations during the year to the fair market value of the property in the fund.[53]

The governing instrument of a pooled income fund may provide any other reasonable method not described under the unit plan rules for assigning units of participation in the fund and allocating income to the units, as long as it reaches a result reasonably consistent with the unit plan rules.[54]

If a transfer of property to a pooled income fund by a donor occurs on a date other than a determination date, the number of units of participation assigned to the income interest in the property may be determined by using the fair market value of the property in the fund on the determination date immediately preceding the date of transfer (determined without regard to the property so transferred)—subject, however, to appropriate adjustments on the next succeeding determination date. These adjustments may be made by any reasonable method,

---

[49] Reg. § 1.642(c)-5(c)(1).
[50] Reg. § 1.642(c)-5(c)(2)(i)(a).
[51] Reg. § 1.642(c)-5(c)(2)(i)(b).
[52] See § 13.2(g).
[53] Reg. § 1.642(c)-5(c)(2)(i)(c). If one pooled income fund is combined with another pooled income fund and then terminated, each income beneficiary of the terminating fund is allocated units of participation in the surviving fund, computed by dividing the fair market value of the beneficiary's units in the terminating fund by the fair market value of the beneficiary's units in the surviving fund on the date on which the funds are combined. Priv. Ltr. Rul. 9332033.
[54] Reg. § 1.642(c)-5(c)(2)(ii).

including the use of a method whereby the fair market value of the property in the fund at the time of the transfer is deemed to be the average of the fair market values of the property in the fund on the determination dates immediately preceding and succeeding the date of transfer. For purposes of determining this average, any property transferred to the fund between the preceding and succeeding dates, or on the succeeding date, must be excluded.[55] The application of this rule may be illustrated by the following example.

EXAMPLE 13.1

The determination dates of a pooled income fund are the first day of each calendar month. On April 1, 2010, the fair market value of the property in the fund was $100,000, at which time 1,000 units of participation were outstanding with a value of $100 each. On April 15, 2010, B transferred property with a fair market value of $50,000 to the fund, retaining for himself for life an income interest in the property. No other property was transferred to the fund after April 1, 2010. On May 1, 2010, the fair market value of the property in the fund, including the property transferred by B, was $160,000. The average of the fair market values of the property in the fund (excluding the property transferred by B) on April 1 and May 1, 2010, was $105,000 ($100,000 + [$160,000 − $50,000] ÷ 2). Accordingly, the fair market value of a unit of participation in the fund on April 15, 2010, at the time of B's transfer, may be deemed to be $105 ($105,000/1,000 units), and B was assigned 476.19 units of participation in the fund ($50,000/$105).[a]

[a] *Id.*

(b) Partial Allocation of Income to Charity

Notwithstanding the above rules concerning units of participation, the governing instrument of a pooled income fund may provide that a unit of participation is entitled to share in the income of a fund in a lesser amount than would otherwise be determined under those rules, provided that the income otherwise allocable to the unit under the rules is paid within the tax year in which it is received to the public charity to or for the use of which the remainder interest is contributed under the governing instrument of the fund.[56] Application of the foregoing rule may be illustrated by Examples 13.2, 13.3, and 13.4.

EXAMPLE 13.2

On July 1, 2010, A and B transferred separate properties with a fair market value of $20,000 and $10,000, respectively, to a newly created pooled income fund that is maintained by Y University, a public charity. Y University uses as its tax year the fiscal year ending June 30. A and B each retain for themselves for life an income interest in the property, the remainder interest being contributed to Y University. The pooled income fund assigned an initial value of $100 to each unit of participation in the fund, and (under the governing instruments) A received 200 units and B received 100 units. On October 1, 2010, which is a determination date, C transferred property to the fund with a fair market value of $12,000, retaining for herself for life an income interest in the property and contributing the remainder interest to Y University. The fair market value of the property in the fund at the time of C's transfer was $36,000. The fair market value of A's and B's units at the time of the transfer was $120 each ($36,000/300). By reason of her transfer of property, C was assigned 100 units of participation in the fund ($12,000/$120).[a]

[a] Reg. § 1.642(c)-5(c)(4), Example (1).

[55] Reg. § 1.642(c)-5(c)(2)(iii).
[56] Reg. § 1.642(c)-5(c)(3).

EXAMPLE 13.3

The pooled income fund in Example 13.2 earned $2,005 for its tax year ending June 30, 2010. There were no further contributions of property to the fund in that year. $300 was earned in the first quarter ending September 30, 2010. Therefore, the fund earned $1 per unit for the first quarter ($300 ÷ 300 units outstanding) and $5.75 per unit for the remainder of the tax year ([$2,600 − $300] ÷ 400 units outstanding). The fund distributed its income for the year based on its actual earnings per quarter. The income had to have been distributed as follows:

Beneficiary		Share of Income
A	$1,350	([200 × $1] + [200 × $5.75])
B	675	([100 × $1] + [100 × $5.75])
C	575	(100 × $5.75)[a]

[a] Reg. § 1.642(c)-5(c)(4), Example (2).

EXAMPLE 13.4

On July 1, 2010, A and B transferred separate properties with a fair market value of $10,000 and $20,000, respectively, to a newly created pooled income fund maintained by X Hospital, a public charity. X Hospital uses as its tax year the fiscal year ending June 30. A and B each retained in themselves an income interest for life in the property, the remainder interest being contributed to X Hospital. The governing instrument provides that each unit of participation in the fund shall have a value of not more than its initial fair market value; the instrument also provides that the income allocable to appreciation in the fair market value of each unit (to the extent in excess of its initial fair market value) at the end of each quarter of the fiscal year is to be distributed currently to X Hospital. On October 1, 2005, which was a determination date, C contributed to the fund property with a fair market value of $60,000 and retained in herself an income interest for life in the property, the remainder interest being contributed to X Hospital. The initial fair market value of the units assigned to A, B, and C was $100. A, B, and C's units of participation are as follows:

Beneficiary		Units of Participation
A	100	($10,000 ÷ $100)
B	200	($20,000 ÷ $100)
C	600	($60,000 ÷ $100)

The fair market value of the property in the fund at the time of C's contribution was $40,000. The fair market value of the property in the fund was $100,000 on December 31, 2010. The income of the fund for the second quarter ending December 31, 2010, was $2,000. The income was shared by the income beneficiaries and X Hospital as follows:

Beneficiary	Allocation of Income
A, B, and C	90% ($90,000 ÷ $100,000)
X Hospital	10% ($10,000 ÷ $100,000)

For the quarter ending December 31, 2010, each unit of participation was allocated $2 (90 % × $2,000 ÷ 900) of the income earned for that quarter. A, B, C, and X Hospital shared in the income as follows:

Beneficiary	Share of Income	
A	$200	(100 × $2)
B	400	(200 × $2)
C	1,200	(600 × $2)
X Hospital	200	(10 % × $2,000)[a]

[a] Reg. § 1.642(c)-5(c)(4), Example (3).

§ 13.4 RECOGNITION OF GAIN OR LOSS ON TRANSFERS

No gain or loss is recognized to a donor as a result of the transfer of property to a pooled income fund.[57] The basis of the fund and its holding period with respect to property transferred to the fund by a donor are determined pursuant to the general rules concerning the basis of property acquired by gift and transferred in trust.[58] If, however, a donor transfers property to a pooled income fund and, in addition to creating or retaining a life income interest in the fund, receives property from the fund, or transfers to the fund property that is subject to an indebtedness, this rule does not apply to the gain realized by reason of the receipt of the property or the amount of the indebtedness (whether or not assumed by the pooled income fund). Such gain is required to be treated as an amount realized on the transfer.[59]

§ 13.5 MANDATORY PROVISIONS

As references throughout the foregoing portions of this chapter indicate, a variety of provisions must appear in a pooled income fund instrument, as a condition for qualification of the fund under the applicable federal tax rules. Many of these mandatory provisions are required by the tax regulations. The IRS published sample provisions for inclusion in a pooled income fund declaration of trust and instrument of transfer.[60] Subsequently, the IRS published sample forms of a declaration of trust and instruments of transfer that meet the requirements for a qualified pooled income fund.[61]

Concurrently with the publication of this prototype of a qualifying pooled income fund, the IRS announced that it ordinarily would no longer issue rulings as to whether a transfer to a pooled income fund qualifies for a charitable deduction or whether a pooled income fund is a qualified one.[62] Those who follow these sample provisions are assured that the IRS will recognize the fund as meeting the pooled income fund requirements, as long as the fund operates in a manner consistent with the terms of the trust instrument and is a valid trust under local law. The sample provisions are not intended, however, to preclude other permissible provisions in the governing instrument. Provisions that vary from the prototype language will not adversely affect the qualification of a fund as a pooled income fund if the provisions are consistent with the legal requirements applicable to pooled income funds. Consequently, despite this general non-ruling policy, when a pooled income fund document contains provisions that differ from the sample provisions, the IRS will rule as to whether the differing provisions disqualify the trust.[63]

---

[57] Reg. § 1.642(c)-(5)(a)(3).
[58] *Id*. These rules are the subject of IRC §§ 1015(b) and 1223(2).
[59] Reg. § 1.642(c)-5(a)(3). See § 9.19 for a discussion of the bargain sale rules.
[60] Rev. Rul. 82-38, 1982-1 C.B. 96; Rev. Rul. 85-57, 1985-1 C.B. 182.
[61] Rev. Proc. 88-53, 1988-2 C.B. 712. See Appendix F.
[62] Rev. Proc. 88-54, 1988-2 C.B. 715, amplifying Rev. Proc. 88-3, 1988-1 C.B. 579. This announcement applied to all ruling requests received in the National Office of the IRS after November 28, 1988. This non-ruling position of the IRS is also reflected in Rev. Proc. 2009-3, 2009-1 C.B. 107, § 4.01(14), (35), (44), (48). Prior to 1988, the IRS issued rulings as to the qualification of pooled income funds. E.g., Priv. Ltr. Rul. 8601041.
[63] E.g., Priv. Ltr. Rul. 9311018.

The following provisions have been held not to adversely affect the qualification of a fund as a pooled income fund:

- A requirement that donors impose an obligation on their estates to pay death taxes from sources other than the pooled income fund
- A provision enabling a donor to retain either a primary or a secondary income interest in a ''two lives consecutively'' form of arrangement[64]
- The trustee is authorized to invest in any kind of property, other than securities that produce tax-exempt income, interests in real estate investment trusts, depreciable real or personal property, depletable assets, or property that would in any way result in denial of any charitable contribution deduction to which donors to the fund may otherwise be entitled
- In computing the fair market value of the fund's assets, all accrued assets and liabilities will be taken into account; the amount of any income earned by the fund but not yet distributed on a distribution date will be excluded from the fund's fair market value
- The following items must be allocated to principal: gains from the sale, exchange, redemption, or other distribution of any investment; stock dividends; capital gain dividends of regulated investment companies; liquidating distributions; amounts received from the sale of options that are not exercised by the optionee; and any other dividends or distributions not deemed taxable as income under the federal tax law[65]

The IRS also published additional pooled income fund language concerning the establishment of depreciation reserve funds.[66]

§ 13.6 PRIVATE FOUNDATION RULES

Because pooled income funds are split-interest trusts,[67] they are subject to at least some of the prohibitions that are imposed on private foundations, most particularly the rules concerning self-dealing[68] and taxable expenditures.[69] Although reference to the other private foundation rules may not be necessary,[70] it is common practice to include references in the pooled income fund declaration of trust to the other private foundation restrictions, such as distribution and the prohibitions on excess business holdings[71] and jeopardizing investments.[72]

§ 13.7 PASS-THROUGH OF DEPRECIATION

In private letter rulings, the IRS recognized that the tax deduction for depreciation can flow through a pooled income fund to the income beneficiaries of the

---

[64] Priv. Ltr. Rul. 9412004.
[65] Priv. Ltr. Rul. 9642037.
[66] Rev. Rul. 90-103, 1990-2 C.B. 159.
[67] IRC § 4947(a)(2); Reg. § 53.4947-1(c)(1)(ii). See *Private Foundations* § 3.7.
[68] IRC § 4941. See *Private Foundations* ch. 5.
[69] IRC § 4945. See *Private Foundations* ch. 9.
[70] Reg. § 1.642(c)-5(a)(6).
[71] IRC §§ 4943, 4944. See *Private Foundations* chs. 7, 8.
[72] IRC § 4944. See *Private Foundations* ch. 8.

fund in determining their federal income tax liability.[73] The benefits arising from this circumstance were, however, initially curbed when the IRS required application of the tax-exempt entity rules in certain of these circumstances, which had the effect of reducing the allowable depreciation deduction.[74] These circumstances arise when the property that is the (or a) medium of investment of the pooled income fund is located on the premises of the charitable organization that maintains the fund or is otherwise available to those who are served by the charitable organization. This is because of the provision of the tax-exempt entity rules that includes within the definition of a *lease* the grant of the *right to use* property, thereby causing the grant of a right to use property to be a *disqualified lease*.[75]

Thereafter, however, the IRS ruled that a pooled income fund, to qualify under these rules, must have adequate language concerning a depreciation reserve fund.[76] Specifically, the IRS held that:

- If a trustee of a trust that otherwise qualifies as a pooled income fund is not required by the governing instrument of the trust or state law to establish a depreciation reserve fund with respect to any depreciable property held by the trust, the trust does not meet the requirements for a pooled income fund under these rules
- If a trustee of a trust that otherwise qualifies as a pooled income fund is required by the governing instrument of the trust to establish a depreciation reserve fund with respect to any depreciable property held by the trust, but the depreciation to be added to the reserve is not required to be determined in accordance with generally accepted accounting principles (GAAP), the trust does not meet the requirements for a pooled income fund under these rules

The IRS explained the rationale for these requirements as follows:

> [T]he purpose of establishing a depreciation reserve for a pooled income fund is the preservation of the value of the property which will pass to the charitable remainderman. This can be accomplished only by a method that systematically allocates the cost of a capital asset to the years in which the asset is expected to produce income. . . . It is . . . appropriate for a pooled income fund to use a GAAP standard in calculating depreciation, since a GAAP method ensures that the cost of the asset will be allocated systematically over its useful life.[77]

Thus, if the trustee of an otherwise qualifying pooled income fund is not prohibited by state law from accepting or investing in depreciable or depletable property, the governing instrument of the fund must provide either that the trustee shall establish a depletion or depreciation reserve in accordance with GAAP or that the trustee shall not accept or invest in any depreciable or depletable assets.[78]

---

[73] E.g., Priv. Ltr. Rul. 8616020.
[74] The tax-exempt entity leasing rules are the subject of *Tax-Exempt Organizations* § 27.14.
[75] Reg. § 1.168(j)-IT, Q-5, A-5.
[76] Rev. Rul. 90-103, 1990-2 C.B. 159, amplifying Rev. Rul. 82-38, 1982-1 C.B. 96.
[77] Rev. Rul. 90-103, 1990-2 C.B. 159, at 160.
[78] E.g., Priv. Ltr. Rul. 9436035.

§ 13.8 TAX STATUS OF FUND AND BENEFICIARIES

A qualified pooled income fund is not treated as an association for tax purposes,[79] nor does such a fund have to be a trust under local law.[80] Generally, a pooled income fund and its income interest beneficiaries are subject to federal income taxation.[81] In actuality, however, a pooled income fund usually is not taxable, because it receives a distribution deduction for amounts paid out to income interest beneficiaries[82] and a set-aside deduction for the remainder interests permanently set aside for the charitable beneficiary.[83] As to this second point, more specifically, a pooled income fund receives a charitable deduction for any amount of net long-term capital gain that, pursuant to the terms of the governing instrument, is permanently set aside for charitable purposes.[84] A pooled income fund is taxed on any net short-term capital gain that is not required to be distributed to the income beneficiaries pursuant to the terms of the governing instrument and applicable state law.

Traditionally, long-term capital gain, when permanently set aside, qualified for the income tax charitable contribution deduction available to pooled income funds. Pursuant to tax regulations issued in 2003, however, no amount of net long-term capital gain may be considered permanently set aside for charitable purposes if, under the terms of the governing instrument of the fund and local law, the trustee has the power (whether or not exercised) to satisfy the income beneficiaries' right to income by the payment of (1) an amount equal to a fixed percentage of the fair market value of the fund assets or (2) any amount that takes into account unrealized appreciation in the value of the fund assets.

Also, no amount of net long-term capital gain may be considered permanently set aside for charitable purposes to the extent the trustee distributes proceeds from the sale or exchange of the fund assets as income.[85]

§ 13.9 MULTIORGANIZATION POOLED INCOME FUNDS

The conventional pooled income fund is established and maintained by one charitable organization. The organization uses the fund as a fundraising vehicle: the gifts flow to the fund and thereafter the remainder interest portion in the gifts is transferred to that charitable organization.

In some situations, however, a pooled income fund is established in circumstances in which more than one charitable organization is the ultimate beneficiary of the remainder interest in property transferred to the fund. There has been some

---

[79] Reg. § 1.642(c)-5(a)(2). The definition of an *association*, for tax purposes, is the subject of IRC § 7701(a)(3). In general, Lochray, "Pooled Income Funds and the Depreciable Property Requirements," 3 *J. Tax. Exempt Orgs.* 31 (Fall 1991); Huffaker, Pooled Income Funds and Depreciation Reserves," 74 *J. Tax.* 238 (April 1991).

[80] Reg. § 1.642(c)-5(a)(2).

[81] *Id.* This taxation is under IRC, pt. 1, subch. J, ch. 1, although the provisions of subpart E containing the grantor trust rules (see § 3.7) do not apply to pooled income funds (*id.*). Generally, the tax on pooled income funds is pursuant to IRC § 641.

[82] IRC § 661.

[83] IRC § 642(c).

[84] IRC § 642(c)(3).

[85] Reg. § 1.642(c)-2(c).

confusion and controversy over the extent to which there can be multiple charitable beneficiaries of a pooled income fund.

(a) National Organizations with Affiliates

It is common for a national charitable organization to have local charitable organizations (such as state chapters) affiliated with it. The local organizations are generally under the supervision and control of the national organization; these entities have an identity of aims and purposes.

An issue presented to the IRS was whether a national organization such as this can establish a pooled income fund that it will maintain for itself and for those of the local organizations that expressly consent to participate in the fund.[86] The declaration of trust and instruments of transfer (collectively, the *governing instrument*) meet all the other requirements of the law, so the fund will qualify as a pooled income fund if the maintenance requirement is satisfied.[87] Under the terms of the governing instrument of this fund, a donor can designate that the remainder interest in the gift be transferred either to the national charitable organization or to one of the participating local charitable organizations. The governing instrument also provides that a designated local organization may not sever its interest in the fund prior to the death of the named income beneficiary. The governing instrument further provides that, if the designated local organization is no longer affiliated with the national organization when the remainder interest is to be transferred, the remainder interest will be transferred to the national organization or to another affiliated local organization selected by the national organization.

The tax law requirements for a pooled income fund include the rule that the fund must be maintained "by the organization to which the remainder interest is contributed" and of which no donor or income interest beneficiary is a trustee.[88] This requirement of maintenance is satisfied when the public charity exercises control, directly or indirectly, over the fund.[89] These requirements also provide that a national organization that carries out its purposes through local organizations (such as chapters) with which it has an identity of aims and purposes may maintain a pooled income fund in which one or more local organizations that are public charities have been named as recipients of the remainder interests.[90] For example, a national church body may maintain a pooled income fund when donors have transferred property to the fund and contributed an irrevocable remainder interest in it to, or for the use of, various local churches or educational institutions of the body. All the facts and circumstances are to be examined to determine whether a national organization and its local organizations meet this standard; the fact that the local organizations are incorporated is immaterial for

[86] It is assumed for purposes of this analysis that the national organization and each of the participating local organizations is the type of organization that is qualified to maintain a pooled income fund (that is, an organization described in at least one of the provisions of IRC § 170(b)(1)(A)(i)–(vi)). See § 13.1, text accompanied by *supra* notes 8–10).

[87] That is, the qualification of the fund turned on compliance with IRC § 642(c)(5)(E). See § 13.2(e).

[88] IRC § 642(c)(5)(E).

[89] Reg. § 1.642(c)-5(b)(5).

[90] *Id*. See § 13.2(e), text accompanied by *supra* note 39.

this purpose.[91] The IRS concluded that this maintenance requirement ensures "that the charitable organization [that maintains a pooled income fund] would look out for its own best interests by not manipulating the investments and by preserving the value of the remainder."[92]

Reviewing these facts, the IRS ruled that the various provisions in the governing instruments of the pooled income fund ensure that there will always be an identity of aims and interests between the national organization and any local organization that actually receives a remainder interest in the fund. The IRS concluded that the maintenance requirement would be achieved in these circumstances because of the "close relationship" between the national organization and its local organizations.[93] Thus, this pooled income fund was held to qualify under the federal tax law requirements.

(b) Pooled Income Funds of Community Trusts

The IRS also reviewed the situation in which a pooled income fund is maintained by a community trust[94] and either

1. the donor permits the community trust to determine the charitable organizations that will benefit from the remainder interest, or
2. the donor may designate the specific charitable organization for whose benefit the community trust will use the remainder interest.

In this connection, the IRS reviewed two situations.[95]

In the first of these situations, a community trust proposes to establish a pooled income fund that it will maintain. Under the terms of the governing instrument of the fund, donors will contribute to the trust an irrevocable remainder interest in the property that the donors transfer to the fund and the community trust will have full discretion to determine how to use the remainder interests to further its charitable purposes.

The IRS noted that, in this situation, although the community trust may elect to use some or all of the remainder interest for the benefit of other charitable organizations, the trust is given full dominion and control over the remainder interest. Therefore, the donor is treated as contributing the remainder interest to the trust

[91] Reg. § 1.642(c)-5(b)(5).

[92] Rev. Rul. 92-107, 1992-2 C.B. 120.

[93] *Id*. at 121.

[94] A community trust (or community foundation) is a publicly supported charity that is described in Reg. § 1.170A-9(e)(10). See *Private Foundations* § 15.4(d). A group of funds is treated as a single community trust if the funds operate under a common name, have a common governing instrument, prepare common reports, and are under the direction of a common governing board that has the power to modify any restriction on distributions from any of the funds, if in the sole judgment of the governing body the restriction becomes unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served. Reg. § 1.170A-9(e)(11). A fund created by gift, bequest, or other transfer that is not subject to any material restriction or condition can be treated as a component part of the single entity. Reg. § 1.170A-9(e)(11)(ii). A fund held by a community trust and designated by the donor to pay its income annually to a specific public charity is not subject to a material restriction and therefore may qualify as a component part of the community trust. Reg. § 1.507-1(a)(8)(v).

[95] Again, there are two underlying assumptions: (1) each of the potential beneficiary organizations qualifies as a public charity eligible to maintain a pooled income fund (see § 13.9(a), *supra* note 90), and (2) the pooled income fund would otherwise qualify under the tax law requirements, so that the only issue is with respect to the maintenance requirement (see § 13.9(a), *supra* note 91).

and, because the trust will maintain the fund, the pooled income fund maintenance requirement is satisfied.[96]

In the second situation, the governing instrument of the pooled income fund allows a donor, in the instrument of transfer, either to request or require that the community trust place the proceeds from the remainder interest in one of its designated funds that is a component part of the trust, for the benefit of one or more charitable organizations. (As noted, these component funds are treated as a single entity.[97]) The IRS held that even though the donor in this situation will either request or require that the remainder interest pass in this fashion, the donor will be regarded as contributing the remainder interest to the trust. Because the community trust is considered as maintaining the pooled income fund, the fund is held to qualify under these rules.[98] (The IRS's position in connection with this second situation is a reversal of an earlier position, holding that a donor in that circumstance would be treated as having made a contribution of the remainder interest, not to the community trust, but rather to the charitable organization designated by the donor. Because that charitable organization did not maintain the pooled income fund, it was the IRS's view that the fund would fail to meet the tax law requirements.[99])

(c) Other Circumstances

There may be other circumstances in which a multiorganization pooled income fund (or something approximating it) may be established. For example, there might be a national organization with chapters or local organizations that are loosely affiliated, but bear other designations and are not under the general supervision and control of the national organization. Or, there might be a national organization of which the local organizations are merely members, so that there is no general supervision and control and perhaps not the requisite affiliation. The question thus arises of whether the national organization can maintain a qualified pooled income fund for itself and either of these categories of local organizations. Presumably, a pooled income fund established for the benefit of the local organizations would not qualify, because of an absence of the requisite affiliation.

Therefore, a national organization in these circumstances would be best advised to maintain a pooled income fund for itself, allowing donors to recommend the local organization to which the remainder interest in the gift should be transferred by the national organization, rather than allowing donors to designate a local organization beneficiary.

§ 13.10 COMPARISON WITH CHARITABLE REMAINDER TRUSTS

The vehicle used most commonly in planned giving transactions is the charitable remainder trust.[100] There are some important distinctions between charitable remainder trusts and pooled income funds that warrant highlighting.

---

[96] Rev. Rul. 96-38, 1996-2 C.B. 44.
[97] See *infra* note 98.
[98] Rev. Rul. 96-38, 1996-2 C.B. 44.
[99] Rev. Rul. 92-108, 1992-2 C.B. 121, revoked by Rev. Rul. 93-8, 1993-1 C.B. 125, so that the IRS could subject the matter to "further study." Notice 93-9, 1993-1 C.B. 297.
[100] See ch. 12.

First, the remainder interest beneficiary of a charitable remainder trust can be any type of charitable organization.[101] The remainder interest beneficiary of a charitable remainder trust can be any type of public charity or a private foundation.[102] By contrast, the remainder interest beneficiary of a pooled income fund must be a public charity—and can only be particular types of public charities.[103]

Second, the income interest created by a charitable remainder trust must be either an annuity amount or a unitrust amount, both subject to a minimum payout requirement.[104] The income interest created by a pooled income fund is the pro rata share of the earnings of the fund, whatever they may be.[105]

Third, the income interest term of a charitable remainder trust can be measured by one or more lifetimes or a term of years not to exceed 20 years.[106] By contrast, the income interest term created by a pooled income fund must be for the life of the income beneficiary.[107]

Fourth, a pooled income fund cannot receive or invest in tax-exempt securities.[108] There is no comparable limitation in the case of a charitable remainder trust. Indeed, there is almost no restriction on the type of property that can be transferred to a charitable remainder trust. By contrast, the type of property that is transferred to a pooled income fund must be of a nature to satisfy the commingling requirement[109]—most frequently, money or marketable securities.

Fifth, a pooled income fund must be maintained by the charitable organization that is the holder of the remainder interests contributed.[110] There is no comparable limitation in the case of a charitable remainder trust.

§ 13.11 CHARITABLE CONTRIBUTION DEDUCTION

A charitable contribution deduction is allowed for a transfer of property to a pooled income fund.[111]

In the case of a charitable contribution by means of a pooled income fund, the charitable deduction is equal to the value of the remainder interest. The value of the remainder interest is equal to the fair market value of the property less the value of the income interest.[112]

Thus, the fair market value of a remainder interest in property transferred to a pooled income fund is its present value.[113] The present value of a remainder interest at the time of the transfer of property to the pooled income fund is

[101] The term *charitable* is used in this context to mean an organization that is tax-exempt under IRC § 501(a) by reason of being described in IRC § 501(c)(3). See § 3.3.

[102] See § 3.4.

[103] See § 13.1, text accompanied by *supra* notes 8–10.

[104] See §§ 12.2, 12.3.

[105] See § 13.2(b), *supra* notes 17–25.

[106] See §§ 13.5 and 13.6.

[107] See § 13.2(b), text accompanied by *supra* notes 22 and 23.

[108] See § 13.2(d).

[109] See § 13.2(c).

[110] See § 13.2(e).

[111] IRC § 170(f)(2)(A); Reg. § 1.642(c)-5(a)(4).

[112] The process by which this type of remainder interest is valued is the subject of ch. 11. For purposes of determining the present value of income interests in a pooled income fund, the first tax year of the fund is the year in which the fund first receives assets. Rev. Rul. 85-20, 1985-1 C.B. 183.

[113] Reg. §§ 20.2031-7(d)(2), 1.170A-6(b)(2), 1.642(c)-6(a)(1), (d), (e)(1).

determined by computing the present value (at the time of the transfer) of the life income interest and subtracting that value from the fair market value of the transferred property on the valuation date.[114] The present value of a remainder interest in property transferred to a pooled income fund is computed on the basis of (1) the appropriate life contingencies[115] and (2) the discount at a rate of interest, computed annually, equal to the highest yearly rate of return[116] of the pooled income fund for the three years immediately preceding its year in which the transfer of property to the fund is made.[117]

If a pooled income fund has been in existence less than three years immediately preceding the year in which the transfer is made to the fund (termed a *new* pooled income fund), the highest rate of return is deemed to be the interest rate (rounded to the nearest two-tenths of a percent) that is 1 percent less than the highest annual average of the monthly rates[118] for the three calendar years immediately preceding the calendar year in which the transfer to the pooled income fund is made.[119] The deemed rate of return for transfers to a new pooled income fund is recomputed each calendar year, using the monthly rates for the three-year period immediately preceding the calendar year in which each transfer to the fund is made; this rate must be used until the fund has been in existence for three years and can compute its highest rate of return for the three years immediately preceding the year in which the transfer of property to the fund is made.[120]

The regulations set forth the process for requesting a ruling from the IRS supplying an actuarial factor in the pooled income fund context.[121] Any claim for a charitable deduction on any return for the value of the remainder interest in property transferred to a pooled income fund must be supported by a statement attached to the appropriate tax return and showing the computation of the present value of the interest.[122]

---

[114] Reg. § 1.642(c)-6(a)(2). Generally, the *valuation date* is the date on which property is transferred to the fund by a donor. *Id*.

[115] Reg. § 20.2031-7(d)(6) (Table 80CNSMT).

[116] The yearly rate of return generally is computed as provided in Reg. § 1.642(c)-6(c). In the case of a merger of two pooled income funds (see § 13.2(e), note 37), the rate of return used to ascertain the value of income interests in property transferred to the surviving fund should, the IRS ruled,

> be determined as if both funds had been combined for all of the taxable years in which the funds are actually combined and for the three preceding taxable years. Thus, for each such year, the percentage is determined by dividing the income earned by both [f]unds by an amount equal to (i) the average fair market value for the year of the property in both [f]unds less (ii) the corrective term adjustment for both [f]unds.

Priv. Ltr. Rul. 9642020.

[117] Reg. § 1.642(c)-6(e)(2).

[118] That is, the IRC § 7520 rates.

[119] Reg. § 1.642(c)-6(e)(3). In 1989, the IRS announced a method for determining the deemed yearly rate of return for new pooled income funds. Notice 89-60, 1989-1 C.B. 700. This method defined the *deemed rate* as the highest annual average IRC § 7520 interest rate for the preceding three years, reduced by one percentage point. Regulations proposed in 1992 would have defined the deemed rate as the highest annual average IRC § 7520 interest rate for the preceding three years, multiplied by 90 percent. Although both methods produced the same result for each of the years since the enactment of IRC § 7520, commentators indicated a strong preference for the method promulgated in 1989 because the computation is simpler than the one proposed in 1992. The IRS went along with these comments: the final regulations adopted the 1989 method.

[120] Reg. § 1.642(c)-6(e)(3). The IRS publishes the deemed rates of return for transfers to new pooled income funds. A cumulative list of these rates for transfers to pooled income funds is in Appendix I.

[121] Reg. § 1.642(c)-6(b).

[122] Reg. § 1.642(c)-6(a)(3). For further reading about pooled income funds, see Appendix K.

EXAMPLE 13.5

X, an individual age 66, makes a contribution of $50,000 to a pooled income fund. The gift is made in November 2009 (in that month, the Treasury Department's interest rate[a] was 4.8 percent). The highest rate of return experienced by the fund in the most recent three years was 7 percent. (Thus, the estate annual return to X is $3,500.) The life estimate factor is 0.50138. The remainder interest is $24,931. X's charitable deduction for this gift is $25,069 (50.138% of $50,000).[b]

[a] See *supra* note 121 and Appendix H.

[b] This illustration is adapted from material provided by Lisa McLaughlin, Polsinelli Shughart PC, Clayton, Missouri.

C H A P T E R F O U R T E E N

Charitable Gift Annuities

§ 14.1 **Contract as Vehicle Form** 545

§ 14.2 **Tax Treatment to Donor** 546

§ 14.3 **Deferred Payment Gift Annuities** 547

(a) Deferred Payment Gift Annuities in General 547

(b) Tuition Annuity Programs 547

§ 14.4 **Estate and Gift Tax Consequences** 548

§ 14.5 **Unrelated Business Income Implications** 548

§ 14.6 **Unrelated Debt-Financed Income Implications** 549

§ 14.7 **Contrast with Other Planned Gift Methods** 550

§ 14.8 **Gift Annuities and Antitrust Laws** 550

§ 14.9 **Gift Annuities and Securities Laws** 552

§ 14.10 **Charitable Contribution Deduction** 552

A form of planned gift vehicle is the *charitable gift annuity*,[1] created by means of an agreement between a donor and a charitable organization, rather than by means of a split-interest trust.[2] The income interest is reflected in an annuity obligation of the donee charitable organization. Once the requirement to pay the annuity has expired, the remaining property becomes that of the charitable organization involved. A federal income tax deduction is generally available for the value of the remainder interest created by the contract.

§ 14.1 CONTRACT AS VEHICLE FORM

Unlike the charitable remainder trust, the pooled income fund, and the charitable lead trust,[3] the charitable gift annuity is not based on use of a split-interest trust. Rather, the annuity is reflected in an agreement between the donor and charitable donee, whereby the donor agrees to make a gift of money and/or property and the donee agrees, in return, to provide the donor (and/or someone else) with an annuity. Again,[4] an *annuity* is an amount of money, fixed by contract between the

[1] The concepts of planned giving are discussed in ch. 5. That chapter also contains a general description of charitable gift annuities in § 5.6.

[2] The concept of the split-interest trust is discussed in § 5.3.

[3] See chs. 12, 13, 16, respectively.

[4] See § 12.2(a).

person paying the annuity and the person receiving it (or the person purchasing the annuity), that is paid annually, either in one sum or in installments (such as semi-annually or quarterly). The charitable gift annuity is nonetheless a planned giving method that is based on the concept of split interests—an income interest and a remainder interest—though not, as noted, established through a trust.

In fact, the donor, in the process of creating a charitable gift annuity, is engaging in two transactions, albeit with one payment: the purchase of an annuity and the making of a charitable gift. It is the latter that gives rise to the charitable deduction. One sum (money and/or property) is transferred; the amount in excess of that necessary to purchase the annuity is the charitable gift portion of the transaction. There is generally a federal income tax charitable contribution deduction for the value of the remainder interest created in this manner.[5]

As discussed,[6] this annuity is for one or two lives. The amount of the annuity is fixed as part of the gift annuity contract. Also as discussed,[7] a portion of each annuity payment is excludable from income.

§ 14.2 TAX TREATMENT TO DONOR

A portion of the annuity paid is tax-free, being a return of capital. This amount is a function of the donor's life expectancy, obtained by calculating the *expected return multiple*.[8] The tax-free portion of the annuity payment is determined by ascertaining the *exclusion ratio*, which is an amount equal to the investment in the contract (the amount initially paid for the annuity) divided by the expected return.

The balance of the annuity payment is ordinary income, which is subject to income taxation.[9] All of the annuity becomes taxable once the capital element is returned.

When appreciated securities are given, there will be—in addition to the foregoing consequences—capital gain on the appreciation attributable to the value of the annuity. It is because of this feature of this type of transaction that the charitable gift annuity transfer constitutes a *bargain sale*.[10] Thus, the basis in the gift property must be allocated between the gift portion and the sale (annuity) portion of the transfer.

The manner in which capital gain is recognized in this setting depends on the language in the annuity agreement. If the donor is the annuitant, the capital gain can be recognized ratably over the individual's life expectancy. More specifically, the capital gain can be recognized ratably in this context when

- the annuity is
  - nonassignable, or
  - assignable but only to the charitable organization involved, and

---

[5] Reg. § 1.170A-1(d)(1).
[6] See § 14.6.
[7] See § 14.2.
[8] Reg. § 1.1011-2(c).
[9] IRC § 72; Reg. § 1.1011-2(c).
[10] See § 9.19.

- one of the following is the case:
  - the transferor is the only annuitant, or
  - the transferor and a designated survivor annuitant or annuitants are the only annuitants.[11]

In other circumstances, the gain must be recognized in the year of the charitable gift annuity transaction.

EXAMPLE 14.1

An individual, aged 72, purchased a charitable gift annuity using appreciated property with a value of $10,000: the annuity is $800 annually for life (8 percent return). The basis in the property is $5,000. The charitable contribution deduction arising from this gift is $4,888. The annual annuity is taxable as follows: ordinary income of $447.46, capital gain (recognized ratably) of $176.27, and tax-free income of $176.27.[a]

[a] This example is adapted from material provided by the Children's Mercy Hospitals and Clinics, Kansas City, MO.

§ 14.3 DEFERRED PAYMENT GIFT ANNUITIES

(a) Deferred Payment Gift Annuities in General

Frequently, the annuity payment period begins with the creation of the annuity payment obligation. With the charitable gift annuity planned giving transaction, however, initiation of the payment period can be postponed to a future date. The term usually used in this connection is *deferred* (rather than *postponed*), so this type of arrangement is called the *deferred payment* charitable gift annuity.

The timing of receipt of the annuity can be deferred to lower-income years (such as retirement years) to reduce income taxation of the annuity, with the gift element of the transaction deductible in higher-income years.

EXAMPLE 14.2

An individual, aged 50, entered into a deferred payment charitable gift annuity contract, with the income payments to begin at age 65. The individual transferred $10,000 at the time of execution of the contract. The charitable organization agreed to pay an annual annuity of $1,220 for life beginning at age 65. This individual obtained a charitable contribution deduction in the year of the transaction of $6,700. The tax-free element of the annuity will be $121.[a]

[a] *Id.*

(b) Tuition Annuity Programs

One contemporary use of the deferred payment charitable gift annuity is as part of a *tuition annuity program*. The organization that offers this program is a tax-exempt college, school, or university; a donor designates the recipient of the annuity and may designate an alternative annuitant. As usual, the annuitant is

[11] Reg. §§ 1.1011-2(a)(4)(ii), 1.1011-2(c), Example (8).

entitled to the annuity for life; however, the annuitant has the right to sell or assign his or her annuity to the organization or to a third party in return for a lump-sum payment or installment payments over several years.[12] It is contemplated that a designated recipient of the annuity will use the funds to attend the institution that is the remainder interest beneficiary under the contract, but this is not required. The annuitant will be able to use the funds for any purpose. Donors in this situation usually make these contributions for the benefit of a child or grandchild.

The timing of any conversion is important. If the annuitant sells the annuity and converts the annuity into a lump sum before the starting date of the annuity, the amount that is taxed is the difference between the amount received and the investment in the contract. If the conversion occurs after the starting date, all of the proceeds are taxable.

If this type of deferred payment gift annuity is funded with appreciated property, the ability to pay the capital gain ratably is not available, because the criteria for this tax feature are not met.[13]

The IRS has privately ruled that deferred payment charitable gift annuities issued in connection with a tuition payment plan do not create any *acquisition indebtedness*.[14] The increase generated from investment of the proceeds is not debt-financed income and thus is not taxable as unrelated business income.[15] The IRS has yet to rule specifically on the matter of the availability of the charitable contribution deduction for these arrangements.

§ 14.4 ESTATE AND GIFT TAX CONSEQUENCES

When a donor names another individual as the annuitant, the donor is making a gift to that other individual. The amount of this gift is the value of the annuity.[16] When the spouse of the donor is the only annuitant, the gift is sheltered from the federal gift tax by the gift tax marital deduction.[17]

When another individual is the annuitant under a charitable gift annuity arrangement, and the donor dies within three years of the date of the transaction, any gift tax paid because of the gift must be included in the donor's estate.[18]

§ 14.5 UNRELATED BUSINESS INCOME IMPLICATIONS

An otherwise tax-exempt charitable organization[19] will lose or be denied tax exemption if a substantial part of its activities consists of the provision of commercial-type insurance.[20] Otherwise, the activity of providing commercial-type

[12] If the annuity contract is purchased by the educational institution, it may pay only for the fair market value of the contract; a greater payment amount may constitute a form of private inurement or private benefit. See *Tax-Exempt Organizations* ch. 20.
[13] See § 14.2, text accompanied by *supra* note 11.
[14] See § 14.6.
[15] Priv. Ltr. Rul. 9042043.
[16] IRC § 2503(a).
[17] IRC § 2523(a), (b)(1).
[18] IRC § 2035(c).
[19] That is, an organization described in IRC § 501(c)(3).
[20] IRC § 501(m).

insurance is treated as the conduct of an unrelated trade or business[21] and taxed under the rules pertaining to taxable insurance companies.[22]

The term *commercial-type insurance* generally means any insurance of a type provided by commercial insurance companies.[23]

For this purpose, the issuance of annuity contracts is considered the provision of insurance.[24] These rules do not apply to a charitable gift annuity, however, when:

- a portion of the amount paid in connection with issuance of the annuity is allowable as a charitable deduction for federal income or estate tax purposes, and
- the annuity is described in the special rule for annuities in the law concerning unrelated debt-financed income[25] (determined as if any amount paid in money in connection with the issuance of the annuity were property).[26]

§ 14.6 UNRELATED DEBT-FINANCED INCOME IMPLICATIONS

A form of income that can be taxable to charitable and other types of tax-exempt organizations is *unrelated debt-financed income*. Basically, this is a form of unrelated income, which is investment income that is traceable in one way or another to borrowed funds.[27]

In computing a tax-exempt organization's unrelated business taxable income, there must be included with respect to each debt-financed property that is unrelated to the organization's exempt function—as an item of gross income derived from an unrelated trade or business—an amount of income from the property, subject to tax in the proportion in which the property is financed by the debt.[28] The term *debt-financed property* means (with certain exceptions) all property held to produce income and with respect to which there is an acquisition indebtedness at any time during the tax year (or during the preceding 12 months, if the property was disposed of during the year).[29]

Acquisition indebtedness, with respect to debt-financed property, means the unpaid amount of (1) the indebtedness incurred by the tax-exempt organization in acquiring or improving the property; (2) the indebtedness incurred before any acquisition or improvement of the property if the indebtedness would not have been incurred but for the acquisition or improvement; and (3) the indebtedness incurred after the acquisition or improvement of the property if the indebtedness would not have been incurred but for the acquisition or improvement and the incurrence of the indebtedness was reasonably foreseeable at the time of the acquisition or improvement.[30]

[21] See § 3.5.
[22] IRC subch. L.
[23] See *Tax-Exempt Organizations* §§ 24.11, 27.12(b).
[24] IRC § 501(m)(4).
[25] See §14.6, text accompanied by *supra* note 33.
[26] IRC § 501(m)(3)(E), (m)(5).
[27] IRC § 514. See *Tax-Exempt Organizations* § 24.12.
[28] IRC §§ 514(a)(1), 512(b)(4).
[29] IRC § 514(b)(1).
[30] IRC § 514(c)(1).

There are several exceptions to the scope of the definition of the term *acquisition indebtedness*. One of these exceptions is that the term does not include an obligation to pay an annuity that is

- the sole consideration issued in exchange for property if, at the time of the exchange, the value of the annuity is less than 90 percent of the value of the property received in the exchange,
- payable over the life of one individual who is living at the time the annuity is issued, or over the lives of two individuals living at that time, and
- payable under a contract that does not guarantee a minimum amount of payments or specify a maximum amount of payments and does not provide for any adjustment of the amount of the annuity payments by reference to the income received from the transferred property or any other property.[31]

Consequently, charitable gift annuity contracts that are properly written adhere to these elements, to avoid adverse tax consequences to the issuing charity. That is, if the criteria are not met, the increase generated from the investment of the proceeds will be a form of unrelated debt-financed income subject to tax as unrelated business income.

§ 14.7 CONTRAST WITH OTHER PLANNED GIFT METHODS

Because the arrangement creating a charitable gift annuity is a contract between donor and donee, all of the assets of the charitable organization are subject to the liability for ongoing payment of the annuities. (By contrast, with most planned giving techniques, the resources for payment of income are confined to those in a split-interest trust.) That is why some states impose a requirement that charities establish a reserve for the payment of gift annuities, and why many charitable organizations are reluctant to embark upon a gift annuity program. However, charitable organizations that are reluctant to commit to the ongoing payment of annuities can eliminate the risk by reinsuring them.

As a consequence of the unrelated debt-financed income rules,[32] the term of an income interest in a charitable gift annuity arrangement is one or two lifetimes. This is similar to the rules in the case of pooled income funds.[33] By contrast, income interests resulting from the creation of a charitable remainder trust can be for a term of years.[34]

With the charitable gift annuity, the gift portion of the transaction is immediately available for use by recipient charitable organization.

§ 14.8 GIFT ANNUITIES AND ANTITRUST LAWS

The antitrust laws were amended in 1995 to make it clear that charitable organizations using the same annuity rate in the issuance of charitable gift annuities are

[31] IRC § 514(c)(5).
[32] See § 14.6.
[33] See § 13.2(b).
[34] See §§ 12.2(f), 12.3(f).

not violating the antitrust laws.[35] Specifically, agreeing to use, or using, the same annuity rate for the purpose of issuing one or more charitable gift annuities is not unlawful under any of the antitrust laws. This exemption extends to both federal and state law. The protection is not confined to charities: it extends to lawyers, accountants, actuaries, consultants, and others retained or employed by a charitable organization when assisting in the issuance of a charitable gift annuity or the setting of charitable annuity rates.

Moreover, this antitrust exemption also sweeps within its ambit the act of publishing suggested annuity rates. Thus, organizations—most notably, the American Council on Gift Annuities—are not in violation of the antitrust laws because they publish actuarial tables or annuity rates for use in issuing gift annuities.

This legislation defines *charitable gift annuity* by cross-reference to the federal tax law definition of the term.[36] A state can override this legislation with its antitrust laws. To do this, the state must have, by December 7, 1998, enacted a law expressly providing that the antitrust exemption does not apply with respect to the otherwise protected conduct.[37]

The report of the House Committee on the Judiciary accompanying this legislation[38] contains a discussion of the applicability of the antitrust laws to charitable organizations: essentially, these laws apply when an organization is engaged in a ''commercial transaction'' with a ''public service aspect.'' The committee was not certain whether charitable gift annuities involve these types of transactions or are ''pure charity.'' In any event, the committee concluded that giving by means of these annuities is ''legitimate,'' particularly since the IRS ''approves and regulates'' these instruments.[39]

---

[35] 15 U.S.C. § 37 *et seq*. This legislation was enacted as the Charitable Gift Annuity Antitrust Relief Act of 1995 (109 Stat. 687; Pub. L. No. 104-63, 104th Cong., 1st Sess. (1995)). A short-term purpose of the statute was to end litigation, which involved an allegation that the use of the same annuity rate by various charitable organizations constitutes price-fixing and thus is a violation of the antitrust laws. *Ritchie v. American Council on Gift Annuities*, Civ. No. 7:94-CV-128-X (N.D. Tex.). Nonetheless, this litigation persisted; see § 5.9, note 31. In a second effort to derail this litigation, Congress passed the Charitable Donation Antitrust Immunity Act of 1997 (111 Stat. 241; Pub. L. No. 105-26, 105th Cong., 1st Sess. (1997)). Nonetheless, this litigation has been concluded. *Ritchie v. American Council on Gift Annuities*, 943 F. Supp. 685 (N.D. Tex. 1996), *appeal dismissed sub nom. Ozee v. American Council on Gift Annuities*, 110 F.3d 1082 (5th Cir.), *reh'g denied*, 116 F.3d 1479 (5th Cir.), *cert. granted & judgment vacated, American Bible Soc'y v. Ritchie*, 522 U.S. 1011 (1997), *on remand sub nom. Ozee v. American Council on Gift Annuities*, 143 F.3d 937 (5th Cir. 1998), *cert. denied*, *American Bible Soc'y v. Ritchie*, 526 U.S. 1064 (1999). See also *Ozee v. American Council on Gift Annuities*, 110 F.3d 1082 (5th Cir.), *cert. granted & judgment vacated*, *American Council on Gift Annuities v. Ritchie*, 522 U.S. 1011 (1997); *Ozee v. American Council on Gift Annuities*, 888 F. Supp. 1318 (N.D. Tex. 1995); *Ritchie v. American Council on Gift Annuities*, 1996 WL 743343 (N.D. Tex. 1996). In general, McCue, III, & Luther, "Gift Annuities: Texas Class Action Suit Threatens Charities," 134 *Trusts & Estates* (no. 6) 46 (June 1995).

[36] See §§ 14.5, 14.6.

[37] A state law in effect on the date of enactment of this relief legislation (December 8, 1995) does not qualify under this override rule because it cannot expressly reference the provisions of the Charitable Gift Annuity Antitrust Relief Act of 1995.

[38] H. Rep. No. 104-336, 104th Cong., 1st Sess. (1995).

[39] *Id*. at 3. In connection with the litigation referenced in note 37, the committee observed: "Allowing litigants to use the antitrust laws as an impediment to these beneficial activities should not be countenanced where, as here, there is no detriment associated with the conduct. It is particularly difficult to see what anticompetitive effect the supposed setting of prices has in a context where the decision to give is motivated not by price but by interest in and commitment to a charitable mission." *Id*.

§ 14.9 GIFT ANNUITIES AND SECURITIES LAWS

As discussed, there is a broad exemption from the securities laws for various planned giving vehicles.[40] This exemption, however, is not unlimited. For example, the exclusion from the definition of *investment company* under the Investment Company Act of 1940 is not available where a representative of a charitable organization receives commission-type compensation in connection with contribution made to the organization.[41] This rule was applied in holding that compensated individuals involved in the solicitation of charitable gift annuities were not exempt from the broker-dealer registration provisions of the Securities Exchange Act of 1934.[42]

§ 14.10 CHARITABLE CONTRIBUTION DEDUCTION

As with the annuity paid out of a charitable remainder annuity trust,[43] the annuity resulting from the creation of a charitable gift annuity arrangement is a fixed amount paid at regular intervals. The amount paid depends on the age of the beneficiary, determined at the time the contribution is made.

As noted, the amount that generates the charitable deduction is basically the amount equal to the fair market value of the money and/or property transferred, reduced by the value of the income interest. The annuity is usually calculated using a rate of return set by the American Council on Gift Annuities.[44]

---

[40] See § 5.9.

[41] 15 U.S.C. § 78c(e)(2).

[42] *Warfield v. Bestgen* (9th Cir., Nos. 07-15586, 16377 (June 24, 2009)), *aff'g*, 453 F. Supp. 2d 1118 (D. Ariz. 2006).

[43] See § 12.2(a).

[44] The legality of these rates was the subject of litigation and legislation (see § 14.8). The current rates took effect on February 1, 2009, with the recommended rates lowered by .4 percent to .7 percent at each age.

For further reading about charitable gift annuities, see Appendix K. In general, Friedman, "Charitable Gift Annuities Can Be the Best Way to Help Both Charities and Donors," 7 *J. Tax. Exempt Orgs.* (no. 1) 24 (July/Aug. 1996); Berry, "Federal Tax and State Regulation of Charitable Gift Annuities," 3 *J. Tax. Exempt Orgs.* 15 (Summer 1991).

CHAPTER FIFTEEN

Other Gifts of Remainder Interests

§ 15.1 Overview **553**

§ 15.2 Contributions of Remainder Interests in Personal Residence or Farm **554**

(a) Personal Residence 554

(b) Farm 556

§ 15.3 Undivided Portions of Entire Interests in Property **557**

(a) General Rules 557

(b) Gifts of Certain Fractional Interests 562

Previously, this text discussed the principle of the federal income tax law underlying planned giving which is based on the concept of partial interests.[1] The charitable contribution deduction (if one is available) is for the gift of a remainder interest or an income interest.

§ 15.1 OVERVIEW

The law is specific as to the circumstances in which a charitable deduction arises, particularly when the charitable gift is made using a trust. Basically, there is no federal income tax charitable contribution deduction unless the gift meets one of a variety of stringent tests.[2] Related to this point is the rule of law that a charitable contribution consisting of a transfer of a future interest in tangible personal property is treated as made only when all intervening interests in, and rights to the actual possession or enjoyment of, the property have expired or are held by persons other than the donor or those related to the donor.[3]

Otherwise, there are few situations in which a federal income tax charitable contribution deduction is available for a gift of a partial interest. (The rules in this regard are essentially the same in the gift and estate tax setting.[4]) One exception is the special set of rules concerning certain gifts of works of art, as distinct from the copyrights in them, which can lead to an estate and gift tax charitable deduction.[5]

[1] See ch. 5.
[2] IRC § 170(f)(3)(A). See § 9.22.
[3] IRC § 170(a)(3). See § 9.21.
[4] See ch. 8.
[5] IRC §§ 2055(e)(4), 2522(c)(3). See § 9.1.

Indeed, there are only three of these situations:

1. Qualified conservation contributions[6]
2. Contributions of remainder interests in a personal residence or farm[7]
3. Contributions of an undivided portion of the donor's entire interest in the property[8]

§ 15.2 CONTRIBUTIONS OF REMAINDER INTERESTS IN PERSONAL RESIDENCE OR FARM

A federal income tax charitable contribution deduction may arise from a gift of a remainder interest in a personal residence or farm, even though the gift is not made in trust and is irrevocable.[9] This deduction is based on the value of the remainder interest.[10] In determining this value, depreciation (computed on the straight-line method) and depletion of the property may be taken into account.[11] If the property is contributed subject to a mortgage, the transfer must be treated as a bargain sale.[12]

(a) Personal Residence

A *personal residence* is a property that is used by its owner as a personal residence; it does not have to be the owner's principal residence.[13] For example, a vacation home would likely qualify under this definition.[14] Indeed, there is no restriction on the form a personal residence may take. All that is required for something to qualify as a personal residence is that it contain facilities for cooking, sleeping, and sanitation.[15]

The term *personal residence* also includes stock owned by a donor as a tenant-stockholder in a cooperative housing corporation,[16] if the dwelling that the donor is entitled to occupy as a stockholder is used by the donor as his or her personal residence.[17]

In general, a personal residence does not include household furnishings that are not fixtures.[18] Thus, there is no charitable deduction for a contribution of a remainder interest in household furnishings contained in a decedent's personal residence at the time of death.[19]

In this context, the charitable remainder interest must be in the residence itself and not simply in the proceeds to be derived from sale of the residence at a

[6] IRC § 170(f)(3)(B)(iii). See § 9.7.
[7] IRC § 170(f)(3)(B)(i). See § 15.2.
[8] IRC § 170(f)(3)(B)(ii). See § 15.3.
[9] IRC § 170(f)(3)(B)(i); Reg. § 1.170A-7(b)(3), (4).
[10] IRC § 170(f)(3)(B)(i); Reg. § 1.170A-7(b)(3), (4).
[11] IRC § 170(f)(4); Reg. § 1.170A-12(b)(2).
[12] E.g., Priv. Ltr. Rul. 9329017. The bargain sale rules are the subject of § 9.19.
[13] Reg. § 1.170A-7(b)(3).
[14] *Id.*
[15] Rev. Rul. 74-241, 1974-1 C.B. 68. The IRS held that a yacht which "contains all of the amenities found in a house" qualified as a personal residence. Priv. Ltr. Rul. 8015017.
[16] IRC § 216(b)(1), (2).
[17] Reg. § 1.170A-7(b)(3).
[18] E.g., Reg. § 1.1034-1(c)(3).
[19] Rev. Rul. 76-165, 1976-1 C.B. 279.

future date.[20] The IRS so held in the setting of a contribution of a remainder interest in a decedent's personal residence bequeathed to charity, under a will which provided that the property was to be sold upon the life tenant's death and the entire proceeds of the sale to be paid to a charitable organization.[21] A charitable deduction will, however, be allowed for the value of a remainder interest in a personal residence when the residence is to be sold and the proceeds distributed to a charitable organization, as long as local law permits the charity to elect distribution of the residence itself.[22] The charitable deduction will be allowed, because a gift of a remainder interest in a personal residence is given to charity and to an individual as tenants in common, for the value of the interest received by the charity.[23] The deduction will also be allowed, notwithstanding the fact that the applicable law (known as a *mortmain act*) requires the charitable recipient to dispose of the property within 10 years of the date of acquisition.[24] In the last of these situations, the IRS noted that the "circumstance does not lend itself to abuse" because the charitable organization is receiving the . . . [property] in its original form and can sell the property for itself in the way that is most advantageous and most likely to realize the full value of the property."[25]

As noted, this type of remainder interest gift cannot be made by means of a trust. (The nontrust contribution to a charitable organization of a remainder interest in a personal residence, with retention of an estate in the property for life or for a term of years, is not considered a transfer in trust.[26])

A court had the opportunity to review this matter in some detail (albeit in the context of the federal estate tax charitable deduction), and construed the provision as meaning that the remainder interest, to result in a charitable deduction, cannot pass through a trust.[27] An individual created a trust in his will by which a life estate was created in two personal residences for the benefit of his sister, with the remainder interest destined for charitable organizations. The court traced the legislative history of the general rule requiring gifts of this nature to be in a qualifying trust and the rule creating an exception for nontrust gifts of remainder interests in personal residences. It found that the trust did not conform to the requirements of a charitable remainder trust (in part because of authority granted to the trustee). The charitable remainder trust rules were created "to eliminate possible abuses in the administration of trusts which might operate to deprive the charity of the future remainder interest" for which there has been a charitable deduction.[28] The court added that "[t]his concern is no less present with respect to personal residences which first pass through a trust not approved" by the general rules.[29] The court wrote that, "[u]nlike an outright gift of a remainder interest in a residence where the charity is guaranteed the eventual deed upon the

[20] Rev. Rul. 76-543, 1976-2 C.B. 287, *amplified by* Rev. Rul. 77-169, 1977-1 C.B. 286.
[21] Rev. Rul. 77-169, 1977-1 C.B. 286.
[22] Rev. Rul. 83-158, 1983-2 C.B. 159, distinguishing Rev. Rul. 77-169, 1977-1 C.B. 286; Rev. Rul. 76-543, 1976-2 C.B. 287. Also *Estate of Blackford v. Commissioner*, 77 T.C. 1246 (1981).
[23] Rev. Rul. 87-37, 1987-1 C.B. 295.
[24] Rev. Rul. 84-97, 1984-2 C.B. 196.
[25] *Id.* at 197.
[26] Reg. § 1.170A-7(b)(3).
[27] *Ellis First Nat'l Bank v. United States*, 550 F.2d 9 (Ct. Cl. 1977).
[28] *Id.* at 16.
[29] *Id.*

termination of the life estate, a remainder interest which passes through a trust and is subject to the trustee's exercise of discretionary powers, is not certain to be realized by the charity.''[30] The court found that the ''potential for abuse [was] dramatically evident'' in the trust involved in the case[31] and upheld the tax regulations, thus making it clear that, to qualify for charitable deductions, these gifts cannot be in trust.

The IRS ruled that a charitable deduction is not allowable for a gift of a remainder interest in a decedent's personal residence passing to charity upon the death of the decedent's child for whom the residence was held in a testamentary trust, valid under local law, that was neither a charitable remainder annuity trust, a charitable remainder unitrust, nor a pooled income fund.[32]

Also, as noted, this type of gift must be irrevocable. Thus, the IRS ruled that a charitable deduction was not allowable for the gift of a remainder interest in a personal residence to a charitable organization when the donors placed a condition on the gift requiring the donee to sell its remainder interest and receive cash in lieu of it if the donors decided to sell the residence before they died.[33] Indeed, a contingency of any type is likely to eliminate the deduction, such as a provision that the property in the remainder interest will pass to another individual instead of a charitable organization under certain circumstances.[34]

The charitable organization must be given the right to possession, dominion, and control of the property.[35] The deduction is not defeated simply because the charitable organization that is the donee fails to take actual possession of the property.[36]

(b) Farm

A *farm* is any land used by the donor or a tenant of the donor for the production of crops, fruits, or other agricultural products or for the sustenance of livestock.[37] A farm includes the improvements on it.[38] The term *livestock* includes cattle, hogs, horses, mules, donkeys, sheep, goats, captive fur-bearing animals, chickens, turkeys, pigeons, and other poultry.[39] The words *any land* does not mean the entire farm acreage owned and used by the donor or his or her tenant for the production of crops or the sustenance of livestock; it can include any portion of farm acreage so used.[40] It can be property that is subject to a conservation easement.[41]

---

[30] *Id.*
[31] *Id.*
[32] Rev. Rul. 76-357, 1976-2 C.B. 285. See also *Estate of Cassidy v. Commissioner*, 49 T.C.M. (CCH) 580 (1985).
[33] Rev. Rul. 77-305, 1977-2 C.B. 72.
[34] Rev. Rul. 85-23, 1985-1 C.B. 327.
[35] Reg. § 1.170A-7(b)(1)(i).
[36] *Winokur v. Commissioner*, 90 T.C. 733 (1988).
[37] Reg. § 1.170A-7(b)(4).
[38] *Id.*
[39] *Id.*
[40] Rev. Rul. 78-303, 1978-2 C.B. 122.
[41] Priv. Ltr. Rul. 8202137.

As noted, this type of gift, to be deductible, cannot be made in trust.[42] A contribution not in trust to a charitable organization of a remainder interest in a farm, with retention of an estate in the farm for life or for a term of years, would give rise to a charitable deduction for the value of the remainder interest not transferred in trust.

The various points of law concerning the charitable contribution deduction for gifts of remainder interests in personal residences[43] should also apply in the setting of gifts of remainder interests in farms.

§ 15.3 UNDIVIDED PORTIONS OF ENTIRE INTERESTS IN PROPERTY

In general, a charitable contribution deduction is not allowable for a contribution of a partial interest in property, such as an income interest, a remainder interest, or the right to use property.[44] A gift of an undivided portion of a donor's entire interest in property generally is not treated as a nondeductible gift of a partial interest in property.

(a) General Rules

A federal income tax charitable contribution deduction is available for a gift of an undivided portion of the donor's entire interest in an item of property.[45] This type of deduction is available only when the gift is not in trust.[46]

An undivided portion of a donor's entire interest in property must

- consist of a fraction or percentage of each and every substantial interest or right owned by the donor in the property, and
- extend over the entire term of the donor's interest in the property and in other property into which the property may be converted.[47]

A charitable deduction is allowable under these rules if the charitable organization is given the right, as a tenant in common with the donor, to possession, dominion, and control of the property for a portion of each year appropriate to its interest in the property.

EXAMPLE 15.1

In 2009, B was given a life estate in an office building for the life of A. B had no other interest in the office building. B was allowed an income tax charitable deduction for his contribution in 2010 to charity of a one-half interest in the life estate in a transfer not made in trust. The contribution by B was a contribution of an undivided portion of his entire interest in the property.[a]

[a] *Id.*

[42] Of course, if the trust qualifies (such as a qualified charitable remainder trust; see ch. 12), a deduction for the remainder interest would be available. If the trust does not qualify, once again there would not be a charitable deduction. See, e.g., Priv. Ltr. Rul. 8110016.
[43] See § 15.2(a).
[44] See §§ 9.18, 9.23.
[45] IRC § 170(f)(3)(B)(ii); Reg. § 1.170A-7(b)(1)(i).
[46] Reg. § 1.170A-7(b)(1)(i).
[47] *Id.*

EXAMPLE 15.2

In 2009, C was given the remainder interest in a trust created under the will of her father. C had no other interest in the trust. C was allowed an income tax charitable contribution deduction for her contribution in 2010 to charity of a 20 percent interest in the remainder interest in a transfer not made in trust. This contribution by C was considered a contribution of an undivided portion of her entire interest in the property.[a]

[a] *Id.*

Also, an income tax charitable contribution is allowed

- if a person owns 100 acres of land and makes a contribution of 50 acres to a charitable organization,[48] or
- for a contribution of property to a charitable organization when the organization is given the right, as a tenant in common with the donor, to possession, dominion, and control of the property for a portion of each year appropriate to its interest in the property.[49]

A charitable contribution in perpetuity of an interest in property not in trust, when the donor transfers some specific rights and retains other substantial rights, is not considered a contribution of an undivided portion of the donor's interest in property under this rule.[50] Thus, for example, a charitable deduction was not allowed for the value of an immediate and perpetual gift (not in trust) of an interest in original historic motion picture films to a charitable organization when the donor retained the exclusive right to make reproductions of the films and to exploit the reproductions commercially.[51] Likewise, a charitable deduction was not allowed for the contribution of an overriding royalty interest or a net profits interest to a charitable organization by the owner of a working interest under an oil and gas lease, because the owner carved out and contributed only a portion of the interest.[52]

In one instance, a person contributed to a tax-exempt university a license to use a patent, retaining the right to license the patent to others. The IRS ruled that this license was similar to the partial interest in motion picture films referenced above, in that it did not constitute a fraction or percentage of each and every substantial interest or right that the person owned in the property. The agency held that a charitable contribution deduction was not allowable in this instance.[53]

The standard concerning conditional gifts[54] applies in this context in determining whether a remote possibility of divestment will trigger the partial interest restrictions.[55]

Despite the constraints, this body of law allows creative tax and charitable planning, as indicated in the following examples.

[48] *Id.*
[49] *Id.*
[50] *Id.*
[51] *Id.*
[52] Rev. Rul. 88-37, 1988-1 C.B. 97.
[53] Rev. Rul. 2003-28, 2003-1 C.B 594.
[54] See § 10.4.
[55] Reg. § 1.170A-7(a)(3).

- An individual transferred an undivided two-fifths interest in land to a charitable organization and retained an undivided three-fifths interest in the property. At the time of this transfer, this individual intended to make a gift to the same charitable organization of the retained interest. However, the individual leased the retained interest to the charitable organization at a fair rental value, with an option in the donee to purchase the retained interest. The lease provided that if, during its term, the individual made further gifts to the charitable organization of all or part of the three-fifths interest, the rent payable under the lease would be proportionately reduced. The IRS ruled that there was a charitable contribution deduction for the fair market value of the undivided two-fifths interest in the property contributed to the organization and that contributions of all or a part of the retained three-fifths interest in the property to the charitable organization would also give rise to a charitable deduction.[56]
- An individual owned approximately 30 acres of improved real property. This individual planned to retain all rights to approximately two acres of the property. The individual planned to make a series of contributions to a charitable organization of undivided interests as tenant in common in the balance of the acreage. Under each deed conveying an undivided interest, the charitable organization would have the right to possession, dominion, and control of the approximately 28 acres for a portion of each year appropriate to the interest conveyed. To enable the charitable organization to use the entire 30 acres for the entirety of the first year in which the individual conveyed the 28 acres, the individual planned to grant to the charitable organization a one-year lease of the retained undivided interest in the 28 acres and the two acres not subject to any undivided interest in the charity. The lease required the charity to pay all expenses for upkeep, maintenance, and repair, and any taxes and assessments levied upon the 30 acres. The charitable organization was also required to bear the expense of any improvements it made on the 30 acres, without regard as to whether the improvements were made to the two acres or the 28 acres. The IRS ruled that the fair market value of the undivided interests conveyed to the charitable organization would be deductible as charitable contributions in the years made (and that the amounts equal to any expenses paid or incurred, or any improvements made, by the charitable organization with respect to the 30 acres during the one-year lease term would be items of gross income to this individual).[57]
- An individual had an extensive collection of paintings and sculptures that were kept in the individual's home. A museum (a public charity[58]) wanted to acquire the entire collection at one time but could not because of a lack of exhibit space and money, so the parties agreed that the museum would

[56] Rev. Rul. 58-261, 1958-1 C.B. 143.

[57] Priv. Ltr. Rul. 8204220.

[58] See § 3.4(a). This distinction is noted because, if the museum were a private foundation, the ensuing charitable deductions would have to be confined to allocable portions of the donor's basis in the property. See § 4.5. Also, no reduction in the deduction was required because the donated property was used by the charitable donee for purposes related to its tax exemption. See § 4.6.

acquire the collection by means of a series of bargain sales.[59] Under the terms of the agreement, the museum paid a total of $8x for the collection, an amount that was substantially less than the fair market value of the collection. The initial payment was $2x. The remaining $6x was payable in equal installments of $1x over the six successive years following the year in which the initial payment was made. After making a payment, the museum acquired an undivided ownership interest in each and every item contained in the collection. The amount of undivided interest acquired by the museum was computed as follows: the percentage of ownership interest, less the total amount paid by the museum, divided by $8x. Because of the space difficulties, the collection was displayed at this individual's personal residence. During those years, the museum and the general public had access to the collection for at least the portion of the year as was determined by multiplying 365 days by the museum's undivided ownership interest. The museum had the right to have the days of access spread evenly throughout the year, by calendar quarter. The museum also had the right, prior to acquisition of full ownership of the collection, to removal of it to its facilities for the number of access days then available to the museum. When the museum acquired full ownership of the collection, it had the right to the sole possession and custody of it. The IRS ruled that, to the extent each transfer to the museum of a percentage of an undivided ownership interest was made for an amount less than the fair market value of the interest, the difference between the fair market value of the interest and that amount was deductible as a charitable gift.[60]

- A donor enters into an agreement with a tax-exempt, charitable museum for the purpose of establishing there an art collection to be known as the A and B Collection (Collection). The Collection will consist of (1) specified X and related works of art (X Works); (2) works of art by Y (Y Works), in which some fractional interests previously were donated to the museum by the donor and her late husband; (3) other works of art previously donated by the donor to the museum (Other Works); and (4) a fractional interest in a work by Z previously given to the museum by the donor. In furtherance of the donor's purpose in establishing the Collection, she has been loaning art works to the museum and will be making other gifts of art. The loaned works are accompanied by certain conditions, such as continuous display of the works, periodic changes in gallery or installment design if requested by the donor (Display Control Rights) subject to a ''good museum practice'' standard, and final editorial control over publicity concerning the Collection. The agreement contains an arbitration device to ensure that unresolved questions will not lead to breach of the conditions. The museum is deemed to be in compliance with all of these gift conditions unless and until it receives a gift condition failure notice from the donor or, after her death, any of her children. Similar conditions apply to the gifted works; the museum must comply with these to retain the X Works and to receive the donor's

[59] Bargain sales are the subject of § 9.19.

[60] Priv. Ltr. Rul. 8333019. A similar transaction, without the bargain sale feature, is involved in Priv. Ltr. Rul. 8535019.

remaining interests in the Collection. The gift conditions apply during the donor's lifetime and during the period ending with the death of the last of her children; thereafter, only provisions of the agreement concerning matters such as insurance and scholarly access will remain. If a breach of the gift obligations occurs and is not timely cured, all of the museum's rights in the X Works terminate and the property reverts to the donor or to her estate; there is no right of reversion as to the Y Works or the Other Works. The IRS ruled that the donor and her successors in interest, in retaining the Display Control Rights and the reversionary rights, have interests that are not ''substantial,'' in that they are ''largely fiduciary powers to be exercised in furtherance of the charitable purposes'' of the museum.[61] The IRS relied on the good museum practice standard and the arbitration device to conclude that the possibility that the works of art will revert to the donor or her estate is so remote as to be negligible.[62] The IRS thus concluded that any gift that the donor made during her lifetime of an undivided fractional interest in any work of the Collection accepted by the museum subject to the terms and conditions of the agreement will be deductible as a charitable gift.

- An individual entered into an agreement under which he contributed the long-term capital gains of selected futures contracts from his personal accounts at a brokerage house and retained for himself the short-term capital gains. For the most part, the selected contracts were sold on the same day that the gift was made and the portions of the proceeds representing the long-term gains were transferred to an account of a charitable organization at the same brokerage house. The donor chose the futures contracts to be donated according to the funding needs of the charity and the amount of unrealized long-term capital gains inherent in the contracts. The IRS took the position that there was no deductible charitable gift because the transfer was a contribution of a nonqualified partial interest in property.[63] A court ruled, however, that the contribution was of an undivided portion of the donor's entire interest in the futures contracts, and that he had donated only the portion of the contracts representing long-term capital gain.[64]
- A surviving spouse is the trustee and beneficiary of a marital trust, which pays him income for his life. A court order is to be obtained by which this trust will be divided into two marital trusts. An election[65] will be made to treat all of the property in the two trusts as qualified terminable interest property. This individual will transfer his income interest in one of these two trusts to a charitable organization, with the trust thereupon terminating so that the property in it will be distributed outright to the charity. The IRS ruled that this individual will contribute an undivided portion of his entire interest in the marital trust for charitable purposes.[66]

---

[61] Priv. Ltr. Rul. 9303007 (revoking and replacing Priv. Ltr. Rul. 9152036).
[62] See § 10.4(b).
[63] See § 9.20.
[64] *Greene v. United States*, 864 F. Supp. 407 (S.D.N.Y. 1995). This case and its progeny are discussed in greater detail in §§ 3.1(g), 4.8, 9.11.
[65] IRC § 2056(b)(7).
[66] Priv. Ltr. Rul. 200122025.

- A married couple each owned an undivided one-half interest in certain works of art. They established an art collection at a public charity consisting of these and other previously contributed art works. They proposed to enter into a gift and loan agreement pursuant to which they would transfer less than their entire interest in any work of art not previously transferred to the charitable organization, provided that the fractional interest transferred was at least a one-twelfth interest. Although these donors retained certain insubstantial rights in the interests that could be transferred (such as approval rights for the gallery design and the installation design), they did not retain any ownership reversion rights. If an uncured breach were to occur, the gifted works would not revert to the donors; the ownership rights would be transferred to another public charity. The IRS ruled that a gift of a fractional interest in any work of the collection accepted by the donee subject to this gift and loan agreement would qualify as a gift of an undivided portion of the donor's entire interest in the work.[67]

(b) Gifts of Certain Fractional Interests

The value of a donor's charitable contribution deduction for the initial contribution of a fractional interest in an item of tangible personal property (or collection of such items)[68] is determined, in part, on the fair market value of the property at the time of the contribution of the fractional interest[69] and whether the use of the property will be related to the charitable donee's exempt purposes.[70]

Additional rules apply, however, in instances of gifts of fractional interests to charitable organizations after August 17, 2006.[71] For example, for purposes of determining the deductible amount of each additional contribution[72] of an interest (whether or not a fractional interest) in the same item of property, the fair market value of the item is the lesser of (1) the value used for purposes of determining the charitable deduction for the initial fractional contribution[73] or (2) the fair market value of the item at the time of the subsequent contribution.[74]

Recapture of this income tax charitable deduction[75] can occur in two circumstances. First, if a donor makes an initial fractional contribution and thereafter fails to contribute all of the donor's remaining interest in the property to the same charitable donee before the earlier of 10 years from the initial fractional contribution or the donor's death, the donor's charitable deduction(s) for all previous contribution(s) of interests in the item must be recaptured, plus interest.[76] If the

[67] Priv. Ltr. Rul. 200223013.
[68] E.g., § 9.1(b).
[69] See §§ 4.2, 10.1.
[70] See § 4.6.
[71] These rules also apply for estate tax purposes (see § 8.3(b), text accompanied by note 118) and gift tax purposes (see § 8.2(k), text accompanied by note 67).
[72] IRC § 170(o)(4)(A).
[73] IRC § 170(o)(4)(B).
[74] IRC § 170(o)(2).
[75] The term *recapture* is not defined in this context; the manner of this recapture has been made discretionary with the IRS.
[76] IRC § 170(o)(3)(A)(i).

donee of the initial contribution is no longer in existence as of that time, the donor's remaining interest may be contributed to another charitable entity.

Second, if the charitable donee of a fractional interest in an item of tangible personal property fails to take substantial physical possession of the item during the above-described period or fails to use the property for an exempt use during the above-described period, the donor's charitable income tax deduction(s) for all previous contribution(s) of interests in the item must be recaptured, plus interest.[77] In either of these circumstances, where there is a recapture, an additional tax is imposed in an amount equal to 10 percent of the amount recaptured.[78]

An income tax charitable contribution deduction is not allowed for a contribution of a fractional interest in an item of tangible personal property unless, immediately before the contribution, all interests in the item are owned by the donor or by the donor and the donee charitable organization.[79] The IRS is authorized to make exceptions to this rule in cases where all persons who hold an interest in an item make proportional contributions of undivided interests in their respective shares of each item to the donee organization.[80]

EXAMPLE 15.3

A owns an undivided 40 percent interest in a painting; B owns an undivided 60 percent interest in the same painting. The IRS may determine that A may take a deduction for a charitable contribution of less than the entire interest in the painting held by A, if both A and B make proportional contributions of undivided fractional interests in their respective shares of the painting to the same donee organization. For example, A contributes 50 percent of A's interest and B contributes 50 percent of B's interest.

[77] IRC § 170(o)(3)(A)(ii).
[78] IRC § 170(o)(3)(B).
[79] IRC § 170(o)(1)(A).
[80] IRC § 170(o)(1)(B). These new rules are causing a struggle as a matter of tax policy. The rules as to charitable gifts of fractional interests are inconsistent with the general prohibition on partial interest gifts; under prior law, there was the troublesome matter of artwork remaining in the donors' possession for lengthy periods of time. Conversely, the fractional gift approach often is the only way for museums to acquire major works of art. This conundrum is explored in a letter from the Association of Art Museum Directors to members of the U.S. Senate (reproduced in Bureau of National Affairs, *Daily Tax Report*, Aug. 4, 2006) and in Kahn, "Museums Fear Tax Law Changes on Some Donations," *New York Times*, Sept. 13, 2006, at B1.

CHAPTER SIXTEEN

Charitable Lead Trusts

§ 16.1 **General Rules** 565
§ 16.2 **Income Interest** 566
§ 16.3 **Income Tax Charitable Deduction** 567
§ 16.4 **Tax Treatment of Charitable Lead Trusts** 568
§ 16.5 **Testamentary Use of Charitable Lead Trusts** 570
§ 16.6 **Percentage Limitation Rules** 570
§ 16.7 **Private Foundation Rules** 571
§ 16.8 **Anti-Abuse Rule Concerning Income Interests** 572
(a) Abuse 572
(b) Anti-Abuse Rule in General 573
(c) Effective Date 573
(d) Reformations 574
§ 16.9 **Charitable Income Trusts** 574
§ 16.10 **Comparison with Charitable Remainder Trusts** 575
§ 16.11 **Valuing Charitable Deduction** 575

The federal tax law provides for a form of planned giving that utilizes a split-interest trust called a charitable lead trust.[1] In general, a *charitable lead trust* is a vehicle by which money or property is split into two interests: one or more income interests and one or more remainder interests. The *income interest* is to be paid over to one or more charitable organizations, while the *remainder interest* is destined for one or more noncharitable beneficiaries. (This type of planned giving is so named because the income interest created for charitable objectives precedes—or ''leads''—the remainder interest.)

The forms of planned giving discussed in the foregoing three chapters have this common element: The donor transfers to a charitable organization the remainder interest in the money or property involved, with one or more noncharitable beneficiaries retaining the income interest. The reverse may occur, however—and that is the essence of the charitable lead trust.

§ 16.1 GENERAL RULES

A charitable lead trust is a vehicle by which property transferred to it is apportioned into an income interest and a remainder interest. Like the charitable

[1] The concepts of planned giving and split-interest trusts are discussed in ch. 5. That chapter also contains a general description of charitable lead trusts.

remainder trust and the pooled income fund,[2] it is a split-interest trust. Pursuant to a charitable lead trust, an income interest in property is contributed to a charitable organization, either for a term of years or for the life of one individual or the lives of more than one individual. The remainder interest in the property is reserved to return, at the expiration of the income interest (the *lead period*), to the donor or some other noncharitable beneficiary or beneficiaries; often the property passes from one generation (the donor's) to another.

The charitable lead trust can be used to accelerate a series of charitable contributions, that would otherwise be made annually, into one year, with a corresponding single-year deduction for the ''bunched'' amount of charitable gifts.

In some circumstances, a charitable deduction is available for the transfer of an income interest in property to a charitable organization. There are stringent limitations, however, on the deductible amount of charitable contributions of these income interests.

A charitable lead trust can be funded by a donor or donors during lifetime, as well as by means of transfers from an estate.

The charitable lead trust is frequently used to transfer property from one member of a family to another, usually from one generation to the next. For example, a father may establish a charitable lead trust, providing income from the trust to a charitable organization for a term of years, with the trust corpus to pass thereafter to his daughter. This type of transfer may be subject to a gift tax, but the actual tax cost of the gift is substantially reduced because of the reduction in the amount transferred to the ultimate beneficiary by the value of the income interest contributed to a charitable organization. If a charitable lead trust is used to shift property to a generation other than the immediate next one, the transfer may be subject to the generation-skipping transfer tax.[3]

§ 16.2 INCOME INTEREST

The income interest created for a charitable organization by means of a charitable lead trust is defined in one of two ways. The income interest may be stated as a guaranteed annuity or as an annual payment equal to a fixed percentage of the fair market value of the trust property, valued annually.[4] These interests have the same names as in the charitable remainder trust context; the first of these interests is an *annuity interest* and the other is a *unitrust interest*.[5] Thus, there can be a charitable lead annuity trust or a charitable lead unitrust. The annuity interest or unitrust interest must be received at least annually.[6] As with a charitable remainder

[2] See chs. 12, 13, respectively.

[3] See § 8.5. The IRS issued a revenue procedure containing annotated sample declarations of trust and alternate provisions that meet the requirements for an inter vivos charitable lead annuity trust providing for annuity payments payable to one or more charitable beneficiaries for the annuity period followed by the distribution of trust assets to one or more noncharitable remainder interest beneficiaries (Rev. Proc. 2007-45, 2007-29 I.R. B. 89) and another revenue procedure containing similar provisions for a testamentary charitable lead annuity trust (Rev. Proc. 2007-46, 2007-2 C.B. 102).

[4] IRC § 170(f)(2)(B); Reg. § 1.170A-6(c)(4).

[5] See §§ 12.2(a), 12.3(a).

[6] Reg. § 1.170A-6(c)(2)(i)(A), (ii)(A).

trust, the charitable lead trust annuity interest or unitrust must qualify as one or the other in all respects.[7]

The IRS held (in the gift tax context) that annuity interests that will continue for a term of years or for a period of lives in existence (technically, *in being*), plus a term of years, can qualify as annuity interests.[8] In that case, an individual, A, created a trust and funded it with $250,000. The trust instrument provided that the trustee of the trust must distribute at the end of each tax year an annuity of $20,000 to qualified charitable organizations. The trust was to terminate on the earlier of a period of 30 years after the funding of the trust or 21 years after the death of the last survivor of A's children living on the date when the trust was created, in favor of A's surviving children. When A created the trust, she had three children, aged 53, 60, and 63. The IRS concluded that each of the payment periods was an allowable payment period and that the lesser value of the two could be computed.

The trust must provide for a specified distribution (as noted, at least annually) to one or more income beneficiaries for the life or lives of one or more individuals or for a term of years.[9] These individuals must be alive and ascertainable as of the funding of the trust.[10]

§ 16.3 INCOME TAX CHARITABLE DEDUCTION

A transfer of money or property to a charitable lead trust may or may not result in a current "front-end" income tax charitable contribution deduction for the donor. If certain conditions are met, a charitable deduction will be available for the value of an income interest created by means of a charitable lead trust. These conditions are principally twofold.

First, as noted, the income interest must be in the form of an annuity interest or a unitrust interest.[11] When this is done, the charitable contribution deduction is available for federal income, gift, and estate tax purposes, if other requirements are satisfied.[12] The IRS issues rulings from time to time as to the qualification of charitable lead interests.[13]

Second, for purposes of the income tax charitable deduction, the donor must be treated as the owner of the income interest, pursuant to the grantor trust rules.[14] (This is a federal tax law requirement, with the donor being the grantor.) This latter requirement means that the income as received by the charitable lead trust is taxed to the donor/grantor. As discussed below, this fact makes an income tax deduction for a charitable gift in this context of limited likelihood and use.

---

[7] Reg. § 1.170A-6(c)(2)(i)(B), (ii)(B).

[8] Rev. Rul. 85-49, 1985-1 C.B. 330.

[9] Reg. § 1.170A-6(c)(2)(1)(A), (ii)(A).

[10] *Id.*

[11] See § 16.2.

[12] IRC §§ 170(f)(2)(B), 2055(e)(2)(B), 2522(c)(2)(B). When the trustee of a charitable lead annuity trust has the discretion to commute and prepay the charitable lead annuity interest prior to the expiration of the term of the annuity, the interest does not qualify as a guaranteed annuity interest (under IRC § 2522(c)(2)(B)), because (in part) the charity does not have the right to receive periodic payments over a specified term, and thus there is no gift tax charitable deduction. Rev. Rul. 88-27, 1988-1 C.B. 331. This rationale was held applicable in connection with a charitable lead unitrust and the estate tax deduction. Priv. Ltr. Rul. 9734057.

[13] E.g., Priv. Ltr. Rul. 8736020.

[14] IRC § 170(f)(2)(B); Reg. § 1.170A-6(c)(1). The grantor trust rules are the subject of § 3.7.

A charitable lead trust may be established in such a fashion that there is no income tax charitable contribution deduction for the income interest involved. Under this approach, the trust is written so that the grantor trust rules are inapplicable; this is accomplished by causing the donor not to be considered the owner of the income interest. The tax consequence of such a charitable lead trust is that the donor forgoes a charitable contribution deduction at the front end, but he or she concurrently avoids taxation on the income of the trust for each of the years that the trust is in existence. In this situation, although there is no charitable deduction, there is nonetheless a ''deduction'' in the sense that the income generated by the property involved is outside the stream of taxable income flowing to the donor.

From an income tax standpoint, the facts and circumstances of each case must be evaluated to ascertain whether a charitable lead trust is appropriate for an individual (or family) and, if so, whether the charitable contribution deduction should be used. A person with a year of abnormally high income may find considerable advantage in a charitable lead trust that yields a charitable deduction, as that deduction will be of greatest economic advantage in relation to the higher income taxation, and the trust income subsequently attributable to the donor will be taxable in a relatively lower amount. Conversely, the charitable lead trust without the deduction is sometimes used in support of a charitable organization by an individual when outright contributions by him or her to the organization cannot be fully deductible because of the percentage limitations on annual charitable contribution deductions.

§ 16.4 TAX TREATMENT OF CHARITABLE LEAD TRUSTS

A qualified charitable remainder trust is an entity that generally is exempt from federal income taxation.[15] A charitable lead trust, by contrast, is not exempt from income taxation. Consequently, the tax treatment accorded a charitable lead trust depends on whether the grantor trust rules are applicable.[16]

If the grantor trust rules are applicable, so that the donor is treated as the owner of the trust, the income of the trust will be taxable to the donor and not to the trust.[17] This means that the trust will not have any income tax liability.

If the grantor trust rules are inapplicable, so that the donor is not treated as the owner of the trust, the income of the trust will be taxable to the trust. In this situation, the charitable lead trust is allowed an unlimited charitable deduction for the payments from it, pursuant to the trust agreement, to the charitable organization that is the income beneficiary.[18]

A charitable lead trust is not entitled to an income tax deduction for payments to charitable organizations in excess of the income interest payable under the terms of the trust agreement.[19] Under the facts of a particular case, four individuals established a trust and transferred $15 million to it. The trust qualified as

[15] See § 12.6.
[16] See § 16.3, *supra* note 14.
[17] IRC § 671.
[18] IRC § 642(c)(1).
[19] *Rebecca K. Crown Income Charitable Fund v. Commissioner*, 98 T.C. 276 (1992), *aff'd*, 8 F.3d 571 (7th Cir. 1993).

a charitable lead trust, with provision for specified annuity payments (totaling $975,000 annually) to charities. The lead period was 45 years. The trust agreement enabled the trustees to pay charitable annuities in excess of the $975,000 amount and in advance of the 45-year term if the payments were in commutation of future annuity payments. The trustees did in fact make excess payments to charitable organizations; however, they did not commute any future annuity payments as a result. The trust claimed income tax deductions for these excess payments.[20] The IRS and the court denied the deduction.[21]

The law essentially allows a trust to deduct charitable contributions to the full extent of gross income as long as the transfers are made pursuant to the terms of the governing instrument. Under the trust agreement, if payments in excess of the annual annuity would adversely affect the maximum charitable deduction allowable, the trustees are not supposed to make them, but instead should accumulate the income and add it to principal. The parties quarreled over whether the trust document, in referring to the "maximum charitable deduction," was referencing the income tax charitable deduction or the gift tax charitable deduction. The court decided it was the latter.

The court found that commutation is necessary before it can be said that the amounts in dispute were paid pursuant to the trust agreement. The court construed the term *commutation* to mean a computation in the formal sense contemporaneously with payments to charity in excess of the annual annuity amount. It held that a "definite formula" for a valid commutation must exist.

The court held that because the amounts in question were not transferred in commutation of future annuity payments, the amounts were not transferred pursuant to the terms of the trust, and thus the claimed deduction was not available.

---

[20] IRC § 642(c)(1).

[21] *Rebecca K. Crown Income Charitable Fund v. Commissioner*, 98 T.C. 276 (1992), *aff'd*, 8 F.3d 571 (7th Cir. 1993). This appellate court decision contains an examination of the legislative objective in creating the statutory charitable lead trust rules. It fretted about the discount rate to be used in commuting (accelerating) future payments, construing outcomes when charitable organizations might annually receive less than the stipulated amount in a year despite the requirement that there be (in this case) a guaranteed annuity interest. See § 16.2, text accompanied by note 4. The court was quick to state that no abuse had occurred thus far, but also noted that the "possibility that commutation might be used abusively cannot be considered negligible." 8 F.3d at 575.

Still, this appellate court based its decision on another point, relating to the issue of loss of the gift tax charitable deduction, should the commutation clause be deemed to disqualify the trust. The court held that language in the governing instrument of the trust required the trustees to obtain, before commuting, either a private letter ruling from the IRS or a judicial ruling at an appellate level, establishing the propriety of commutation by a charitable lead trust. The trustees did not do this; the IRS prevailed.

The court conceded that the "propriety of commutation" by a charitable lead trust "must be considered uncertain." 8 F.3d at 576. It noted that the views of the Treasury Department on the point have not yet "crystallized" (*id*.); in an unusual display of judicial deference to the department, the court wrote that "we generalist judges should be loath to lay down the law on the question" until the IRS decides the issue. *Id*. The IRS, in 1982, announced that it would not issue private letter rulings concerning the propriety of commutation by charitable lead trusts until it had completed its study of the matter. *Id*. Thus, wrote the court, when the trust was created (in 1983), "its draftsmen doubtless expected the IRS to move off the dime eventually, and when and if it did give a green light to commutation the trustees would be authorized by the trust instrument to commute." *Id*. It continued: "Until that happened or some equivalent assurance was received, they were bound by the instrument to refrain from gambling on the permissibility of commutation. A mistake could conceivably cost the donors millions [of dollars]. The trustees have a legitimate gripe about the Treasury's delay in resolving the issue of permissibility. But that delay does not entitle them to disregard the terms of the trust instrument." *Id*. In general, Teitell, "Questions Surround Prepayment Clauses of Charitable Trusts," 131 *Trusts & Estates* (no. 7) 56 (July 1992).

(The court sidestepped the question of whether the trustees' ability to accelerate the payment of a charitable lead annuity is consistent with the federal gift tax requirement[22] that the charitable (income) interest be in the form of a guaranteed annuity.)

The court also denied a deduction under the rules by which a trust is allowed a deduction for the payment of income or principal,[23] on the ground that the regulations under that section expressly require that any amounts paid by trusts for charitable purposes can be deductible only under the general rules providing a deduction for payments for a charitable purpose.[24] The court had previously so held,[25] and it refused to reverse its prior position.

The court, however, rejected the government's contention that the trust was liable for additions to tax for substantial understatements.[26] It held that the trust disclosed sufficient information on its tax returns to allow the IRS to identify the issues involved.

§ 16.5 TESTAMENTARY USE OF CHARITABLE LEAD TRUSTS

Like the other forms of planned giving, a charitable lead trust can be used to benefit a charitable organization out of the assets of a decedent's estate. That is, the income interest thereby created for a charitable organization can be transferred as a charitable bequest by means of such a trust.[27] The remainder interest would be reserved for one or more noncharitable beneficiaries, such as the decedent's heirs.

In this situation, a charitable deduction is available to the estate. Again, the deduction is for the present value of the income interest being transferred to a charitable organization.

When a federal estate tax charitable deduction becomes available, there is no need for anyone to recognize the income of the charitable lead trust. That is, there is no application of the equivalent of the grantor trust rules (whereby an individual is considered the owner of the trust) in this context.

§ 16.6 PERCENTAGE LIMITATION RULES

Under the federal tax law, percentage limitations applicable to charitable contributions by individuals can limit the extent of deductibility for charitable gifts in any one year.[28] One set of these limitations applies when the contribution is *for the use of* a charitable organization, rather than to a charitable organization.[29]

A contribution made by means of a charitable lead trust is considered a contribution for the use of the charitable organization that is entitled to the income

[22] IRC § 2522(c)(2)(B). See § 16.3, text accompanied by *supra* note 12.
[23] IRC § 661(a)(2).
[24] IRC § 642(c).
[25] *Estate of O'Conner v. Commissioner*, 69 T.C. 165 (1977).
[26] IRC § 6662. See § 10.10.
[27] The failure to designate specific charitable beneficiaries of a charitable lead unitrust interest does not preclude a gift tax charitable deduction (see § 8.2(k)(ii)) for the interest if the trustee has the power to select charitable beneficiaries. Rev. Rul. 78-101, 1978-1 C.B. 301.
[28] See ch. 7.
[29] See § 10.3.

interest.[30] Thus, in general, a 30 percent limitation applies to such gifts for income tax purposes.[31] When the charitable donee is not a public charitable organization[32] and the subject of the gift is capital gain property, the 20 percent limitation applies.[33] Nonetheless, amounts in excess of these limitations may be carried forward to subsequent years.[34]

§ 16.7 PRIVATE FOUNDATION RULES

As is the case with many types of trusts used in the planned giving context, a charitable lead trust—being a split-interest trust[35]—is treated as a private foundation for certain purposes.[36] In general, the private foundation rules that pertain to a charitable lead trust are those concerning self-dealing,[37] excess business holdings,[38] jeopardizing investments,[39] and taxable expenditures.[40] A charitable lead trust is exempt from the excess business holdings and jeopardizing investments rules, however, when all of the amounts in the trust for which a charitable contribution deduction was allowed (namely, the income interest), and none of the remainder interest, have an aggregate value of no more than 60 percent of the total fair market value of all amounts in the trust.[41]

The IRS applied these rules (in the gift tax setting), in considering a trust under which trust income in excess of the guaranteed annuity payable to charity was to be added to trust corpus for distribution to noncharitable remainder beneficiaries upon expiration of the guaranteed annuity period. All of the excess income, along with any other property held by the trust, could be applied, if necessary, to pay the guaranteed annuity during the term of the annuity, and was not available for any private purpose during the term. In the case considered, because the value of the income interest did not exceed 60 percent of trust corpus, and because the income interest of the trust was devoted solely to charitable purposes, the value of the annuity was held to be deductible even though the trust instrument lacked references to the excess business holdings and jeopardizing investments rules. If the trust, however, had provided that all income earned by the trust in any year in excess of the amount needed for the annuity payment was to be paid currently to the individuals named as remainder interest beneficiaries, the value of the annuity interest would not have been deductible, because (1) the income interest in the trust would not have been devoted solely to charitable purposes; and (2) the trust instrument would not contain references to the excess

[30] Reg. § 1.170A-8(a)(2).
[31] IRC § 170(b)(1)(B).
[32] See § 3.4.
[33] IRC § 170(b)(1)(D).
[34] IRC §§ 170(b)(1)(B), 170(b)(1)(D)(ii). The IRS provided prototype inter vivos charitable lead unitrust forms and prototype testamentary charitable lead trust forms. Rev. Proc. 2008-45, 2008-2 C.B. 224; Rev. Proc. 2008-46, 2008-2 C.B. 238.
[35] IRC § 4947(a)(2); Reg. § 53.4947-1(c)(1)(ii). See *Private Foundations* § 3.7.
[36] The concept of a private foundation is summarized in § 3.4.
[37] IRC § 4941. See *Private Foundations* ch. 5.
[38] IRC § 4943. See *Private Foundations* ch. 7.
[39] IRC § 4944. See *Private Foundations* ch. 8.
[40] IRC § 4945. See *Private Foundations* ch. 9.
[41] IRC § 4947(b)(3).

business holdings and jeopardizing investments rules, even though the value of the charitable interest was less than 60 percent of the trust corpus.[42]

§16.8 ANTI-ABUSE RULE CONCERNING INCOME INTERESTS

In yet another attempt to thwart abuses in the use of charitable split-interest trusts,[43] the IRS issued regulations concerning charitable lead trusts in an effort to shut down the practice of using the lives of seriously ill individuals to move assets and income away from charitable beneficiaries prematurely and to other private beneficiaries instead.[44]

(a) Abuse

Charitable gift planners have been taking advantage of the way in which the term of the charitable income interest, in the case of a charitable lead trust, is defined. With this approach, which was permissible under prior law, an unrelated individual's life was used as the measuring life. There is nothing inherently wrong with that, by itself. This technique, however, involved the selection of an unrelated young individual who was *seriously ill* but not quite *terminally ill.*

This meant that the charitable interest was valued using the standard actuarial factors[45] rather than the special factors.[46] The charitable deduction, then, was based on this individual's normal life expectancy, even though the individual had been carefully selected because he or she likely would not live to an average life expectancy. Thus, on the face of the matter, the amount the charity was expected to receive was based on the longer term (the life expectancy). The charitable deduction, of course, was in turn based on this expectation.

When the seriously ill individual died (prematurely), the amount the charity actually received was significantly less than the amount on which the charitable deduction was based. Therefore, the strategy artificially inflated the charitable deduction. Further, the amount of the actual transfer to the remainder beneficiaries was significantly greater than the amount subject to the gift or estate tax.

These charitable lead trusts were marketed in a package that included the name of a seriously ill individual and access to his or her medical records. A token payment was made to the ill individual whose life was the measuring one. Sometimes, the ill individual was led to believe that a charitable organization interested in the individual's particular interest would receive some benefit from the transaction.

In characterizing this scheme, the IRS wrote in the preamble to these rules in their proposed form—with considerable understatement—that "this kind of adverse selection of an unrelated measuring life to artificially inflate the charitable deduction is contrary to Congressional intent." It was also observed that

[42] Rev. Rul. 88-82, 1988-2 C.B. 336.
[43] See §§ 12.2(c), (i); 12.3(c), (i); 12.4(g).
[44] T.D. 8923. Given their origin and character, these trusts are sometimes referred to as *vulture trusts* or *ghoul trusts*. As the IRS observed: "Similar to the vulture, the promoters of this form of charitable lead trust circle in on mortally ill young people." *Exempt Organizations Continuing Professional Educational Program Textbook for Fiscal Year 2001*, at 103.
[45] See § 11.3.
[46] See § 11.4.

''[m]arketing schemes that exploit the misfortunes of some for the benefit of others are contrary to public policy.''[47]

(b) Anti-Abuse Rule in General

Pursuant to this rule, the permissible term for guaranteed annuity interests and unitrust interests (essentially income interests in deduction-qualifying charitable lead trusts) must be either a specified term of years (no limit) or the life of one or more certain individuals living at the date of the transfer. The only individuals whose lives may be used as measuring ones in this setting are those of the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries be lineal descendants of the individual whose life is the measuring life, or the life of that individual's spouse, if there is less than a 15 percent probability that individuals who are not lineal descendants will receive any trust corpus.[48] (This rule is not applicable to annuity and unitrust interests payable from charitable remainder trusts.)

An interest payable for a specified term of years can qualify as a guaranteed annuity or unitrust interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. This savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives that are selected to maximize, rather than limit, the term of the trust.[49] In the preamble to the final anti-abuse rules, the IRS ''acknowledge[d] that there may be situations in which the grantor, for a valid estate planning objective, may desire to use an individual as a measuring life who does not satisfy the criteria in the regulations'' (e.g., when a remainder beneficiary is dependent on a non-family member for support and the trust corpus is intended to provide that support after the death of the non-family member). The government added, however, that ''in these situations the grantor's objectives can be satisfied through the use of other permissible estate planning techniques.'' This commentary concluded with the observation that when a charitable lead trust is utilized, the IRS believes the final rules ''allow adequate flexibility for achieving legitimate estate planning objectives while providing reasonable safeguards to preclude abusive arrangements.''[50]

(c) Effective Date

The rule applies generally to transfers to *inter vivos* (lifetime) charitable lead trusts made on or after April 4, 2000. If a transfer is made to a trust on or after that date that uses the life of an individual other than a permissible one, the trust may be

[47] 65 *Fed. Reg.* 17,835 (April 5, 2000). In this connection, the IRS quoted a commentator who wrote that "[t]his technique (which is not strictly speaking wealth transfer planning for the terminally ill, but rather wealth transfer planning *using* the terminally ill) falls somewhere between ghoulish and grotesque."

[48] Reg. §§ 1.170A-6(c)(2)(i)(A), (ii)(A) (income tax rule); 20.2055-2(e)(2)(vi)(a), (vii)(a) (estate tax rule); 25.2522(c)-3(c)(2)(vi)(a), (vii)(a) (gift tax rule).

[49] Reg. §§ 1.170A-6(c)(2)(i)(A), (ii)(A) (income tax rule); 20.2055-2(e)(2)(vi)(a), (vii)(a) (estate tax rule); 25.2522(c)-3(c)(2)(vi)(a), (vii)(a) (gift tax rule).

[50] 1041 Fed. Reg. 66 (January 5, 2001).

reformed to satisfy this rule.[51] Also, the rule applies to transfers made pursuant to wills or revocable trusts when the decedent dies on or after that date.[52]

(d) Reformations

The IRS will not disallow the charitable deduction when the charitable interest is payable for the life of an individual other than one permitted under the rule, if the interest is reformed into a lead interest payable for a specified term of years. The term of years must be determined by taking the factor for valuing the annuity or unitrust interest for the named individual's measuring life and identifying the term of years (rounded up to the next whole year) that corresponds to the equivalent term-of-years factor for an annuity or unitrust interest.

In the case of *inter vivos* transfers, a judicial reformation must have been commenced prior to the later of July 3, 2001, or the date prescribed in the rules concerning reformable interests occasioned by judicial proceedings.[53] Any judicial reformation must be accomplished within a reasonable time after it is commenced. A nonjudicial reformation is permitted if effective under state law, provided it is completed by the date on which a judicial reformation must be commenced.[54]

§ 16.9 CHARITABLE INCOME TRUSTS

Broadly comparable to the charitable lead trust is the charitable income trust. Under this type of trust, the charitable organization that is the income interest beneficiary is—literally—only entitled to the income of the trust. (With the usual charitable lead trust, the income beneficiary is to be paid an annuity amount or a unitrust amount, and those amounts must be satisfied out of principal if the trust's income is insufficient to fund the payout(s).) No income, gift, or estate tax deduction is available for this type of gift,[55] because the trust is not one of the two required forms.[56]

The charitable income trust has been used, in the context of gifts made during the donor's lifetime, to:

- Deflect the income of the trust from the income of the donor
- Transfer property to a member of the donor's family with a minimum of tax exposure

---

[51] Reg. §§ 1.170A-6(e) (income tax rule); 25.2522(c)-3(e) (gift tax rule).

[52] Reg. § 20.2055-2(e)(3)(iii). Two exceptions from the application of the rule are provided for transfers pursuant to a will or revocable trust executed on or before April 4, 2000. One exception is for a decedent who dies on or before July 3, 2001, without having republished the will or amended the trust. The other exception is for a decedent who was, on April 4, 2000, under a mental disability regarding changes to the disposition of the decedent's property, and either did not regain competence to dispose of the property before the date of death or died prior to the later of 90 days after the date on which the decedent first regained competence or July 3, 2001, without having republished the will or amended the trust. In general, Grumet & Schnoll-Regun, "'Vulture' Trust Regulations: Hold the Valedictory?," 29 *Exempt Org. Tax Rev.* (no. 1) 51 (July 2000).

[53] IRC § 2055(e)(3)(C)(iii).

[54] Reg. § 20.2055-2(e)(3)(iii).

[55] E.g., Rev. Rul. 77-275, 1977-2 C.B. 346 (no estate tax charitable deduction).

[56] See § 16.2.

§ 16.10 COMPARISON WITH CHARITABLE REMAINDER TRUSTS

An annuity interest or a unitrust interest in property may be created by means of a charitable remainder trust. These interests are subject to minimum amounts that must be payable to the income beneficiaries.[57] An income interest created by a charitable lead trust, however, is not governed by any minimum or maximum payout requirement.[58]

Also, an income interest in property created by means of a charitable remainder trust may be measured by a term of years. The income interest term established by a charitable remainder trust cannot be longer than 20 years.[59] By contrast, federal law contains no restriction on the length of the term during which the income interest is payable to a charitable organization out of a charitable lead trust.[60]

§ 16.11 VALUING CHARITABLE DEDUCTION

The value of any interest for life, or any remainder interest, is determined by using an interest rate (rounded to the nearest two-tenths of 1 percent) equal to 120 percent of the federal midterm rate, used to determine the issue price (value) of certain debt instruments,[61] in effect for the month in which the valuation date falls.[62]

This valuation is made using tables prepared by the IRS[63] charting the most recent mortality experience available.[64] These tables are revised at least once every 10 years to take into account the most recent mortality experience available as of the time of the revision.[65]

If an income, estate, or gift tax charitable contribution deduction is allowable for any part of the property transferred, the individual involved may elect to use the federal midterm rate for either of the two months preceding the month in which the valuation date falls in determining the value.[66] Otherwise, the rate used is the rate in effect in the month of the gift. In the case of transfers of more than one interest in the same property, the person must use the same rate with respect to each interest.[67]

As directed, the IRS has published valuation tables. These tables reflect the use of interest rates ranging from 2.2 percent to 26 percent. The tables used for determining the value of charitable lead annuity trust income interests are in *Actuarial Values: Alpha Volume*,[68] and those for charitable lead unitrust income interests are in *Actuarial Values: Beta Volume*.[69]

---

[57] See §§ 12.2 (b), 12.3 (b).
[58] IRC § 170(f)(2)(B).
[59] See §§ 12.2(f), 12.3(f).
[60] IRC § 170(f)(2)(B). See, e.g., § 16.4, text accompanied by *supra* note 19.
[61] IRC § 1274(d)(1). In general, see ch. 11.
[62] IRC § 7520(a)(2). A chart of these rates appears as Appendix H.
[63] IRC § 7520(a)(1).
[64] IRC § 7520(c)(3).
[65] *Id.*
[66] IRC § 7520(a).
[67] *Id.*
[68] IRS Publication 1457.
[69] IRS Publication 1458. For further reading about charitable lead trusts, see Appendix K. In general, Schumacher, "The Taxation of Charitable Lead Trusts," 9 *J. Tax. Exempt Orgs.* (no. 2) 76 (Sep./Oct. 1997); Schumacher, "How to Design a Charitable Lead Trust," 9 *J. Tax. Exempt Orgs.* (no. 1) 28 (July/Aug. 1997).

CHAPTER SEVENTEEN

Gifts of and Using Life Insurance

§ 17.1 Introduction 577

§ 17.2 Life Insurance Concepts 578
- (a) Basics 578
- (b) Types of Life Insurance 578
- (c) Valuation 580

§ 17.3 Charitable Giving and Insurance 580

§ 17.4 Insurable Interest 585

§ 17.5 Unrelated Debt-Financed Income Considerations 588

§ 17.6 Charitable Split-Dollar Insurance Plans 588
- (a) Plans in General 589
- (b) Charitable Deduction Denial Rules and Penalties 590
- (c) IRS Notice 593

§ 17.7 Applicable Insurance Contract Reporting Requirements 594

Life insurance can be the subject of a charitable gift. It can be considered part of the panoply of planned gifts, although a split-interest trust is not usually involved. A gift of life insurance is a particularly good way for a younger donor to make a major gift to a charitable organization.

§ 17.1 INTRODUCTION

A person may make a gift of life insurance to a charitable organization. Where a federal income tax charitable contribution deduction is desired, the donor must make the charity the owner and beneficiary of the insurance policy.

An individual can contribute a fully paid-up life insurance policy or a single-premium policy to a charitable organization and deduct, for income tax purposes, its replacement value.[1] Alternatively, an individual can acquire a life insurance policy, contribute it to a charitable organization, pay the premiums, and create a charitable contribution deduction for each premium payment made.

For an income tax deduction for a gift of life insurance to be available, the insurance contract must be enforceable. (A contribution by means of a contract that is void or likely to be voidable is a gift of something without value.) For the insurance contract to be enforceable, there must be a form of insurable interest between the insured and the beneficiary.[2]

[1] Reg. § 25.2512-6(a), Example (3). See also *United States v. Ryerson*, 312 U.S. 260 (1941).

[2] See § 17.4.

Charitable giving and life insurance programs often have a tenuous existence. A recent manifestation of that fact is discussed below.[3]

§17.2 LIFE INSURANCE CONCEPTS

Prior to examining the uses of life insurance in the charitable giving context, it is appropriate to briefly summarize the basics of life insurance.

(a) Basics

Life insurance is represented by a contract—known as an *insurance policy*—that involves at least three parties:

- An insured person
- The owner of the insurance policy (usually the purchaser of the policy)
- The insurer (the insurance company that provides the policy)

Another party to this arrangement is the beneficiary of the insurance proceeds. The owner of the insurance policy may be the beneficiary, or the beneficiary may be another person. Also, two or more persons may be the beneficiary of an insurance policy.

If the insured qualifies, and if the requisite consideration for the insurance contract—the *premium*—is paid by the policy owner, the insurance company promises to pay a cash benefit (death benefit) if the insured dies while the policy is in force. Depending on the type of life insurance, a portion of the premium may go into a cash account (and accumulate as cash value). The cash value is available to the policy owner at any time during the insured's lifetime, by canceling (*cashing in*) the insurance policy.

The insured and the owner of the policy may be the same person, or they may be different persons. For example, one may purchase a policy on his or her own life. Alternatively, a spouse may purchase an insurance policy on the other spouse's life. When one spouse purchases a policy on the other spouse's life, the purchasing spouse is the policy owner and the other spouse is the insured.

The distinction between the insured and the policy owner is also important for tax reasons. At one's death, all of one's property is tabulated for the purpose of determining if one's estate must pay estate taxes. Property includes the death benefits from life insurance unless the decedent was merely the insured but not the policy owner. If the decedent was not the policy owner, and if he or she had no rights (for example, to use the cash value or to name the beneficiary), the death benefit paid at death will not be included in the estate for estate tax purposes.

(b) Types of Life Insurance

Broadly speaking, there are two categories of life insurance: term insurance and permanent insurance. Each has many different types. For example, term insurance can be classified as level term, decreasing term, and increasing term.

[3] See § 17.6.

Permanent insurance can be categorized as whole life, variable life, adjustable life, and universal life.

Term insurance is analogous to renting a house. One agrees to pay a regular payment in exchange for the protection afforded by the house. Each year, the landlord raises the rent as expenses increase. No matter how long an individual rents, he or she receives nothing back in the event of a move. With term insurance, in exchange for a ''rent payment'' (premium), the insurance company provides protection (the death benefit). Each year (typically), the rent payment (premium) is increased. If the tenant (policy owner) ''leaves'' (cancels the insurance policy), he or she receives nothing back, no matter how long the premium payments were made.

Permanent insurance is analogous to purchasing a house. The same protection as a rented house is provided, but the monthly payments are (usually) higher. However, the monthly payments are fixed and do not increase. In addition, each month the house is owned, the value may increase (at least over the long term). This value is called *equity*, which can be used during lifetime by borrowing, by using the property as collateral, or by selling the house and receiving the net equity in a lump sum.

Under a permanent insurance contract, one pays the mortgage payments (premiums) in exchange for both protection (death benefit) and equity (cash value). If one dies while insured, the death benefit is paid. If an individual wants to use the cash value while alive, he or she may do so by borrowing or by canceling the policy and taking the cash value. Some policies also allow for withdrawals without borrowing or surrendering. Premium payments are generally fixed during lifetime.

To summarize, term insurance is initially less expensive, offers death protection, and does not build up any cash value during one's lifetime. Permanent insurance is more expensive in the early years, provides the same death benefit, and also builds cash value during lifetime.

One type of permanent insurance is *universal life*. To understand this form of insurance, visualize a bucket with two spigots, one on each side. The insurance owner deposits premium dollars into the bucket, and each month the insurance company turns on one of the spigots and drains off the dollars necessary to pay all of the following: one month's cost of death protection, expense charges, and administrative charges. The spigot is then turned off, and the dollars remaining in the bucket are invested and earn interest. These excess dollars and the interest earned make up the policy's cash value.

As the owner continues to deposit more premium dollars, and as more interest is earned, the cash value becomes larger. At any time, one may cease depositing premium dollars, as long as there are enough dollars in the bucket to pay for the cost of insurance, and the expense and administrative charges. Conversely, if the owner wants the cash value to build faster, he or she may pay more premium dollars.

The cash value can be taken out of the policy during lifetime in three ways. First, some of the money can be borrowed at a rate of interest; if the money is borrowed, it reduces the death benefit by the same amount. The money may be paid back at any time. Second, one can withdraw some of the money without incurring a loan. This method also reduces the death benefit, but it cannot be

paid back without satisfying certain requirements. Third, one can surrender the policy (terminate the insurance) and take all of the cash value. The money available in all three methods may, however, be reduced by a surrender charge, illustrated by the second spigot. In the first 10 to 15 years, the insurance company imposes this charge on a sliding scale and it reduces to zero by the tenth to fifteenth policy year.

Universal life offers additional flexibility in that it allows one to select either of two death benefit options: a level death benefit or an increasing death benefit.

Two other types of insurance contracts have evolved. One is called *survivorship whole life*. It is unique in that it simultaneously insures two or more lives. The second type is group-term life insurance provided by an employer to an employee. An employee may be provided up to $50,000 of this type of insurance without having to recognize taxable income.[4] The cost of any coverage over that amount provided by the employer must be recognized as income.

(c) Valuation

There are three ways in which a life insurance policy can be valued:

1. The replacement value, which is the amount the issuer of the insurance would charge to issue an identical policy to a person of the same age as the insured. This value is usually used in the gift and estate context.[5]
2. The cash surrender value, which is the amount the insurance company is willing to pay if the policy is surrendered. This value has been applied in the income tax context.[6]
3. The potential net death benefit amount, which is the amount the beneficiary would receive if the insured died immediately; this would be the difference between the face amount and any loan(s) outstanding.

Because the potential net death benefit value is relevant only when special circumstances suggest that, because of ill health, the insured's death is imminent, the values usually used are the replacement value and the cash value (or an intermediate amount).

§ 17.3 CHARITABLE GIVING AND INSURANCE

Essentially, there are three situations in which a contribution of life insurance can give rise to a charitable deduction.

In the first situation, an individual may have an existing whole life insurance policy that is fully paid up, or is a single-premium policy, and is not needed for the protection of his or her family. A gift of the policy to a charitable organization would, in general, occasion a charitable deduction in an amount equal to the replacement value of the policy, as noted.[7] A gift of a single-premium whole life

[4] IRC § 79(a).
[5] Reg. §§ 25.2512-6(a), Example (3); 20.2031-8, Example (2).
[6] For example, see § 17.3, text accompanied by *supra* note 9.
[7] This statement assumes that there is an insurable interest between the donor and the donee. See § 17.4.

insurance policy to a charitable organization, when the donor has paid the premium, gives rise to a charitable contribution deduction,[8] with the amount of the deduction equal to the amount of the premium.[9] An exception to this rule is derived from the fact that a disposition of the insurance policy would not be a transaction generating long-term capital gain, so the charitable deduction cannot be greater than the donor's basis in the policy.[10] It was held that, when valuing a paid-up life insurance policy that was contributed to a charitable organization, but was subject to a substantial loan, the proper valuation is the cash surrender value of the policy on the date it was contributed.[11] In so holding, the court was influenced by the fact that no party had any interest in maintaining the life insurance policy as an investment.

Second, an individual may own an insurance policy on which premium payments are still being made. The charitable deduction for a gift of a policy in this instance is an amount equal to the ''interpolated terminal reserve value'' of the policy at the date of the sale, plus the proportionate part of any premium paid by the donor prior to the date of the gift which is applicable to a period subsequent to the date of the gift.[12] As in the prior situation, the deduction in any event cannot exceed an amount equal to the donor's basis in the property. When all other requisite conditions are met, a charitable deduction is available for the remaining premium payments.

In the third of these situations, the insurance policy that is donated is a new one. Thus, there is no charitable deduction for the gift of the policy but, as in the previous circumstance, there is a charitable deduction for the premium payments as made.

If the donor of a life insurance policy retains any incidents of ownership in the policy during lifetime, he or she is not permitted to deduct, for federal income tax purposes, the cost of the premiums as a charitable gift.[13] For example, the IRS ruled that the irrevocable assignment of the cash surrender value of a life insurance policy to a college, with the donor retaining the right to designate the beneficiary and to assign the balance of the policy, whether the policy is paid up and the college is given possession or the policy is not fully paid up and the donor retains possession, constituted a charitable contribution of a partial interest for which a deduction is not allowable.[14] *Incidents of ownership*, in this context, means the right of the insured, or of his or her estate, to the economic benefits of the policy and includes the following:

- Power to change the beneficiary
- Power to surrender the policy
- Power to cancel the policy
- Power to assign the policy

---

[8] Priv. Ltr. Rul. 200209020.
[9] Rev. Rul. 58-372, 1958-2 C.B. 99.
[10] See § 4.4.
[11] *Tuttle v. United States*, 436 F.2d 69 (2d Cir. 1970).
[12] Reg. § 25.2512-6(a); Rev. Rul. 59-195, 1959-1 C.B. 18.
[13] This is because the gift would be of a nondeductible partial interest. See § 9.23.
[14] Rev. Rul. 76-143, 1976-1 C.B. 63.

- Power to revoke an assignment
- Power to pledge the policy for a loan
- Power to obtain from the insurer a loan against the surrender value of the policy[15]
- Reversionary interest in the policy or its proceeds, whether arising by the express terms of the policy or other instrument or by operation of law, but only if the value of the reversionary interest immediately before the death of the decedent exceeded 5 percent of the value of the policy[16]

If the individual has not changed his or her mind on the subject prior to death, the charitable organization will receive the death benefit. This death benefit will be included in the estate for estate tax calculation purposes, but the estate will receive an estate tax charitable deduction for gifts to charitable organizations. Therefore, the death benefit will not create any estate tax burden.

It is not enough, for an income tax charitable deduction, simply to cause a charitable organization to be named as the (or a) beneficiary of a life insurance policy. Full ownership rights in the policy must be conveyed for a charitable deduction to be allowed.

If one gives an amount equal to a premium payment to a charitable organization and authorizes the charity to purchase an insurance policy on the donor's life, the value of the gift is greatly multiplied. The charitable organization can use the annual gifts to purchase an insurance policy having a face value that is greater than the annual amounts combined. In this instance, because the charitable organization is the policy owner and the beneficiary, and the donor is merely the insured, the annual gift is a deductible charitable contribution.

From the charitable organization's point of view, two transactions occur each year. First, premium dollars plus investment earnings are added to the cash value. Second, the cost of insurance, expense charges, and administrative charges are deducted from the cash value. The net cash value is available to the charitable organization if there is a current need for cash. Borrowing or withdrawing cash value will, however, reduce the death benefit and require additional future premium payments to keep the policy in force.

This concept can also be effectively utilized when a donor wishes to make a single large contribution. If the amount given is used to purchase life insurance, a much greater gift is likely to result.

The foregoing discussion focused on the direct use of life insurance in the context of charitable giving. One or more donors make a substantial gift to charity (via the insurance death benefit) with relatively small incremental gifts. The charity benefits in that it can use the policy cash values while the donor is alive, although the major portion of the gift is received at the death of the donor.

There are, however, instances of the indirect use of life insurance in the charitable giving setting. An individual may have a valuable parcel of property that produces very little income and is not important to his or her financial welfare; at the same time, sale of the property might generate a significant capital gains tax

---

[15] These seven examples are listed in Reg. § 20.2042-1(c)(2).
[16] Reg. § 20.2042-1(c)(3).

liability. An illustration of this is a tract of raw land that originally cost very little but has grown substantially in value. Another example is highly appreciated securities that pay little or no dividends. If the individual were to sell such property, he or she would have to pay capital gains tax on the gain (the difference between the original cost and the current fair market value of the property).

If this individual made an outright gift of the property to a public charity, the donor's federal income tax charitable deduction would be based on the fair market value of the property.[17] The capital gains tax would be avoided. In general, regarding this gift, the individual could deduct an amount up to 30 percent of his or her adjusted gross income,[18] with any excess carried forward up to five immediately succeeding years.[19] The tax savings may offset the gift cost; the donor's estate is reduced by the amount of the contribution, so the estate tax burden is reduced.

One major deterrent to a gift of this nature is that the property itself is contributed to charity and is not passed on to the donor's heirs. Life insurance can solve this problem, however, and make it possible for the donor to make a current gift of the property to charity. The individual in this situation can make tax-free gifts (up to $11,000 per year per donee[20]) of part or all of the tax savings. Adult heirs (assuming they have an insurable interest) can purchase life insurance on the donor's life in an amount equal to or greater than the value of the property given to charity. The cost of the insurance is paid by the tax-free gifts they received from the donor.

Two purposes are served by this approach. First, the heirs receive the same (or approximately the same) economic benefit (by means of life insurance) that they would have received if the gift had not been made. Second, neither the property given nor the life insurance purchased on the life of the donor by the heirs will be included in the estate of the donor.

The same result can be achieved by the donor's creation of an irrevocable life insurance trust. The donor makes tax-free gifts of the tax savings to an irrevocable trust for the benefit of his or her heirs. The trust purchases life insurance on the donor with the money received from the donor. At the donor's death, the insurance is paid to the trust free of income or estate taxes, and it replaces the property given to charity by the donor. (The insurance may be includible in the decedent's estate if the death occurs within three years of the transaction.)

The donor, however, may need income from the property during lifetime. This can be accomplished by the creation of a charitable remainder trust.[21] Instead of making an outright gift of property to the charity, the donor transfers the property to a charitable remainder trust. During the donor's lifetime, the donor retains the right to a certain amount of annual income, but at the donor's death the amount remaining in the trust is paid to the charitable organization or organizations that are the remainder interest beneficiaries. The annual amount payable

---

[17] See § 4.2.
[18] See § 7.6.
[19] *Id.*
[20] IRC § 2503(b). See § 8.2(h).
[21] See ch. 12.

to the donor must be either a fixed amount of money[22] or a fixed percentage of the trust assets.[23] Payments can be made to the donor for his or her lifetime or for a term of years. If appropriate, the trust can provide for payments for the donor's lifetime and the lifetime of the donor's spouse.

The donor in this circumstance receives a current income tax deduction for the present value of the future gift of trust assets to the charity. A small annual income payment to the donor (and spouse) during lifetime will result in a larger gift to charity, inasmuch as the trust assets will not be as depleted. As a result, the current income tax charitable deduction will be higher. If larger income payments are desired, the current tax deduction will be lower.

To preserve the assets passing to the donor's heirs, the donor can create an irrevocable life insurance trust, make tax-free gifts of the donor's tax savings to the trust, and allow the trust to insure the donor's life. This use of the survivorship whole life policy is ideal if the charitable remainder trust pays an income to both the donor and his or her spouse.

Perhaps an individual cannot afford to contribute a major asset to charity at the time, yet wants to provide for income to his or her spouse for life and would like to make a major gift to charity. Life insurance can assist an individual in this situation.

First, the individual establishes a charitable remainder unitrust.[24] This trust provides for payment of a fixed percentage of income for the life of the individual and his or her spouse. Second, the trust purchases insurance on the donor's life. The trust pays the insurance premiums from annual gifts that the donor makes to the trust. During the donor's lifetime, there is little if any payment to the donor and spouse, since the trust asset is the life insurance policy on the donor. At the donor's death, the trust receives the death proceeds and pays income to the surviving spouse for his or her lifetime. At the death of the spouse, the trust distributes the remaining assets to the charity or charities that are the remainder interest beneficiaries.

This arrangement benefits the donor in two ways. The spouse receives a guaranteed income and, because a remainder interest is paid to charity, the donor is allowed to deduct a portion of the annual gift of premium payments to the charitable remainder unitrust. In effect, it is a way to purchase life insurance on a partially tax-deductible basis. During lifetime, the donor may be allowed to change the charitable remainder beneficiaries and may revoke the spouse's income interest by a provision to that effect in the donor's will.

Mention was made above of the rule concerning employer-provided group-term life insurance.[25] The point was made that such coverage in excess of $50,000 of insurance gives rise to gross income for the employee recipient. There is, however, an exception to that rule, pertaining to situations in which a charitable organization is named as the beneficiary of any insurance in excess of the $50,000 threshold.[26]

---

[22] See § 12.2(a).
[23] See § 12.3(a).
[24] *Id*.
[25] See § 17.2(b), text accompanied by *supra* note 4.
[26] IRC § 79(b)(2)(B); Reg. § 1.79-2(c)(3).

§ 17.4 INSURABLE INTEREST

A contract of insurance—that is, an insurance policy—is valid (enforceable), only when there is an insurable interest between the insured and the beneficiary. Basically, one person has an *insurable interest* in another person when the person that is the beneficiary of the insurance is better off economically with the insured alive rather than dead. Thus, the concept of insurable interest is that the beneficiary would suffer an economic loss if the insured were to die. (Without putting too fine a point on the subject, the insurable interest doctrine emanated from the common law, to prevent an individual from purchasing insurance on the life of another and then seeing to it that the other person's life was terminated soon thereafter. The law evolved the idea of insurable interest to prevent ''gambling'' on the duration of individuals' lives.) The most common example of a relationship involving insurable interest is the marital relationship; likewise, key individuals are often insured by their companies.

The IRS held that a charitable contribution deduction was not available, for federal income tax purposes, for a donor's payment of premiums for a life insurance policy donated to a charitable organization, when the charity was the sole beneficiary of the policy proceeds.[27] The donor was characterized by the IRS as conceding that the charitable organization involved lacked an insurable interest in the donor's life.

The IRS view in this regard was based upon two doctrines of law. One of these is that the transfer of the policy to the charitable organization was not a transfer of all of the donor's rights associated with it. The IRS characterized the donation as a gift of a partial interest in the policy, not in trust, so a deduction was not available.[28] The interest retained was portrayed as the donor's ability, through a will, to name the heirs who would benefit if the proceeds of the policy were returned to the estate. That is, the IRS relied on the fact that the personal representative of the estate could successfully maintain an action to recover the benefits of the policy and distribute them to others.

The second doctrine of law relied on the IRS was that a deduction for this type of charitable gift will not be disallowed merely because the interest that passes to, or is vested in, the charity may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that the act or event will occur is negligible.[29] In the subject case, the potential for exercise of the rights to be retained by the insurance company and by the personal representative of the estate was found not to be remote. Also, the IRS pointed out that the donor could discontinue payments of the premiums on the insurance, causing the policy to lapse unless the charitable organization paid them.

The facts underlying this ruling involved an individual who had previously made gifts to the charitable organization. This individual intended to apply for a life insurance policy and name the charity as the sole beneficiary of the policy proceeds. Upon receipt of the policy from the insurance company, the individual

[27] Priv. Ltr. Rul. 9110016.
[28] See § 9.23.
[29] See § 10.4.

intended to irrevocably assign the policy to the charity and to continue payment of the insurance policy premiums.

The governing state (New York) insurance law prohibited anyone, without an insurable interest in an insured, from obtaining an insurance policy on the life of another person unless the benefits are to be paid to someone with an insurable interest. As noted, it was conceded that the charitable organization did not have an insurable interest in the donor's life. The intent of the donor to procure the policy and transfer it to the charity, rather than have the charity obtain it directly, was seen as a circumvention of the state law prohibition.

If the transaction was a violation of state law, then, upon the death of the donor, the insurance company might not have had to pay the proceeds of the policy to the charity. Also, if it did, the representative of the estate might have been able to bring a lawsuit to recover the proceeds from the organization and distribute them to other beneficiaries of the estate.

The facts of this ruling involved, as noted, a concession that the charitable organization lacked the requisite insurable interest in the donor. At first thought, it may appear that a charitable organization in these circumstances would benefit more financially with an insured dead than alive—that the charity would be in a preferential position with the insurance proceeds in hand. In many instances, however, this is not so, and a charitable organization will have an insurable interest in the life of a donor of a life insurance policy. For example, the donor may be a valuable volunteer and/or a major donor in other and ongoing respects. There should not always be an assumption that a charitable organization that is the owner (by gift) and beneficiary of a life insurance policy is always better off with that donor deceased.

Some states' statutory law has been amended to invest an insurable interest in charitable organizations that are the owners and beneficiaries of donated insurance policies.[30] Indeed, the state involved in this ruling subsequently amended its law, on a retroactive basis, to provide for an insurable interest in charitable organizations with respect to donors of life insurance policies. Thereafter, the IRS revoked its ruling, noting that the individual was not proceeding with the gift.[31]

A state court held that an ex-spouse had an insurable interest in the life of the other ex-spouse, even though the beneficiary ex-spouse also had a substantial interest in the insured's death.[32] This opinion is of particular applicability in connection with the continuing uncertainty as to whether a charitable organization can have an insurable interest in the life of a contributor of a life insurance policy. In this case, the ex-wife wished to purchase insurance on the life of her ex-husband, who was paying alimony to her, to continue a stream of income to her in the event of his demise. The former husband refused to cooperate, however, fearful that his former wife would soon see to his passing; he indicated that he did not want to be ''worth more dead than alive'' to his former wife. She sued to force him to consent to the purchase of the insurance.

---

[30] See, e.g., Priv. Ltr. Rul. 200209020, in which the IRS noted that, under state law, a charitable donee had an insurable interest in the life of a donor.

[31] Priv. Ltr Rul. 9147040.

[32] *Hopkins v. Hopkins*, 614 A.2d 96 (Md. 1992).

The court found that the ex-wife had an insurable interest in the life of the ex-husband, based on the state's statutory law. The court also decided that, divorce notwithstanding, a former wife who is entitled to alimony has an insurable interest in her former husband's life. The court recognized that the ''primary purpose of the prohibition [on life insurance absent insurable interest] is to prevent wagering on the life of another, . . . although, as other authorities recognize, . . . the prevention of murder is another rationale.''[33] It quoted another court as writing that the rule as to insurable interest stems from the need ''to avoid extending to the beneficiary the temptation to hasten by improper means the time when he [or she] will receive the benefits of the policy.''[34] (The court noted the ''rancorous history'' between the parties, which was cited by the ex-husband as the basis for his position.[35]) The court also found, however, that this ex-wife would have, should she become the beneficiary of the policy, an interest in the ex-husband's death. Instead of finding that that interest obviated any insurable interest, the court recognized a ''conflict of interest.'' That is, the ex-wife was held to have both an interest in the insured's continued life (the insurable interest) and an interest in his death. The court wryly observed, quoting from another court opinion, that ''this conflict might be a fruitful source of crime.''[36] This conflict of interest was held to be resolvable by the consent of the would-be insured. The putative insured was said to be able to ''evaluate the risk to his own interest'' in deciding whether to become an insured.[37] Thus, the case turned on a state statute requiring consent by an insured to the insurance coverage even when the potential beneficiary has an insurable interest in the life of the insured. In the case, the court said that the former husband ''emphatically does not consent'' to this insurance and that he cannot be compelled to consent;[38] the ex-wife thus was unable to obtain the insurance coverage.

This opinion has a substantial bearing on the matter of insurable interest in the setting of charitable giving. As noted, in the instance of an individual who is a valued volunteer and a major annual contributor to a charitable organization, it would seem that the organization has an insurable interest in this individual's life, at least in connection with the gift of a life insurance policy by him or her. Certainly, the charity has an economic interest in the ongoing life of the individual. Being the beneficiary of an insurance policy is not likely to cause someone representing the charity to succumb to the ''temptation to hasten by improper means the time when . . . [the charity] will receive the benefits of the policy.''

There is nearly always an interest for a charitable organization in the death of an individual, particularly when that individual is the insured on a life insurance policy of which the charity is the owner and beneficiary. But one of the important aspects of this opinion is that the court did not find that the interest in the beneficiary's death undercut or eliminated the insurable interest; rather, it found that the interest in death *conflicted* with the insurable interest. Thus, this case is

[33] *Id*. at 98.
[34] *Id*. at 100.
[35] *Id*. at 98.
[36] *Id*. at 100.
[37] *Id*.
[38] *Id*.

authority for the thought that a charity's interest in receiving the proceeds of an insurance policy is not automatically a basis for a finding that there is no insurable interest. As noted, the court found that this conflict of interest can be cured through consent. Obviously, a contributor of an insurance policy to a charity has consented to being an insured when the charity is the beneficiary. Thus, it would seem that if an ex-spouse can have an insurable interest in the life of the other ex-spouse, when the beneficiary ex-spouse also has an economic interest in the demise of the other ex-spouse (that is, when the potential decedent ex-spouse is ''worth more dead than alive''), a charitable organization that is an owner/beneficiary of an insurance policy by gift would have an insurable interest as well.

§ 17.5 UNRELATED DEBT-FINANCED INCOME CONSIDERATIONS

The investment income resulting from life insurance gift programs has been held to be unrelated business income.[39] A court held that loans against the accumulated cash value of life insurance policies constituted indebtedness; therefore, the income derived from reinvestment of the proceeds in marketable securities was treated as income from debt-financed property.[40] The court decided, on the basis of court opinions finding that insurance policy loans are generally regarded as a form of indebtedness and that this type of borrowing has been held sufficient to support a federal income tax interest deduction, that the withdrawals were a form of indebtedness for purposes of the debt-financed income rules.

The court placed great emphasis on the legislative history of the revision of the federal tax law, which disallows a deduction for certain insurance loans.[41] The court wrote, however, that because Congress thus intended to preserve the interest deduction for payments on other types of insurance loans, Congress implicitly considers loans against the accumulated cash value of life insurance policies as indebtedness. The court noted that, at the time, federal tax law[42] allowed a deduction for all interest paid or accrued on indebtedness. Consequently, the court reasoned that if a life insurance loan involves an indebtedness in one tax context, it must be an indebtedness in all tax contexts, including the rules for taxation of unrelated debt-financed income.

Universal life insurance offers (or appears to offer) a solution to this problem. As noted above, cash value may be withdrawn from universal life policies without creating a policy loan. Thus, a charitable organization could withdraw cash value, reinvest it, and avoid the problem of having the property considered debt-financed property that generates unrelated business income.

§ 17.6 CHARITABLE SPLIT-DOLLAR INSURANCE PLANS

A recent addition to the ways in which charitable giving and life insurance interrelate, albeit adversely, is the *charitable split-dollar insurance plan*.

---

[39] *Mose & Garrison Siskin Mem'l Found., Inc. v. United States*, 790 F.2d 480 (6th Cir. 1986).
[40] IRC § 514. See *Tax-Exempt Organizations* § 24.12.
[41] IRC § 264.
[42] IRC § 163(a).

(a) Plans in General

There are several variations of these plans, essentially all of which are now effectively outlawed by the federal tax law,[43] whereby life insurance became the basis for a form of endowment-building investment vehicle for a charitable organization. Under the typical arrangement, one or more contributions of money were made to a charity; the organization used some or all of these funds to purchase premiums in connection with a split-dollar insurance policy. The death benefits were shared between the family members of the insured and the charitable organization.[44] Frequently, this type of arrangement was considered by charities to be a basis for an endowment-building program.

Critics of these plans argued that: (1) there was no true gift (and thus no charitable contribution deduction) by reason of the step transaction doctrine,[45] because the charity was, as a matter of fact, obligated by the donor to purchase the insurance; and (2) the split-dollar arrangement resulted in an unwarranted amount of private benefit.[46]

The IRS described the typical charitable split-dollar insurance transaction[47] as follows. There was a transfer of funds by a taxpayer to a charitable organization, with the ''understanding'' that the charity would use the funds to pay premiums on a cash value life insurance policy that benefited both the charity and the taxpayer's family. Generally, the charity or an irrevocable life insurance trust formed by the taxpayer (or a related person) purchased the insurance policy. The designated beneficiaries of the policy included the charity and the trust. Members of the taxpayer's family (and, perhaps, the taxpayer) were beneficiaries of the trust.

In a ''related transaction,'' the charity entered into a split-dollar agreement with the trust. The agreement specified what portion of the insurance policy premiums was to be paid by the trust and what portion was to be paid by the charity. The agreement stated the extent to which each party could exercise standard policyholder rights, such as the right to borrow against the cash value of the policy, to partially or completely surrender the policy for cash, and to designate beneficiaries for specified portions of the death benefit.

The agreement also specified the manner in which the arrangement could be terminated and the consequences of the termination. Although the terms of these split-dollar agreements varied, a common feature was that, over the life of the split-dollar agreement, the trust had access to a ''disproportionately high percentage'' of the cash surrender value and death benefit under the policy, compared to the percentage of premiums paid by the trust.

As part of the charitable split-dollar insurance transaction, the taxpayer (or a related person) transferred funds to the charity. Although there might have been no legally binding obligation expressly requiring the taxpayer to transfer funds to the charity to assist in making premium payments, or expressly requiring the

---

[43] See § 17.6(b).

[44] An illustration of one of these plans (now banned) is in *Addis v. Commissioner*, 118 T.C. 528 (2002) *aff'd*, 374 F.3d 881 (9th Cir. 2004), *cert. den.*, 543 U.S. 1151 (2005). Also *Weiner v. Commissioner*, 83 T.C.M. (CCH) 1874 (2002), *aff'd*, 102 Fed. Appx. 631 (9th Cir. 2004), *cert. den.*, 543 U.S. 1151 (2005); *Roark v. Commissioner*, 88 T.C.M. (CCH) 517 (2004). See § 21.3(b), text accompanied by notes 61–68.

[45] See § 4.8.

[46] See *Tax-Exempt Organizations* § 20.11.

[47] See § 17.6, summarizing Notice 99-36, 1999-1 C.B. 1284.

charity to use the funds for premium payments, ''both parties understand that this will occur.''

The structure of charitable split-dollar insurance transactions varied. In some cases, a member of the taxpayer's family, a family limited partnership, or another type of intermediary related to the taxpayer was used as an intermediary rather than an irrevocable life insurance trust.

(b) Charitable Deduction Denial Rules and Penalties

The federal tax law denies an income tax charitable contribution deduction for, and imposes excise tax penalties on, transfer associated with the use of charitable split-dollar insurance plans.[48]

General Rules. There is no federal charitable contribution deduction for a transfer to or for the use of a charitable organization, if in connection with the transfer:

- the organization directly or indirectly pays, or has previously paid, any premium on any personal benefit contract with respect to the transferor, or
- there is an understanding or expectation that any person will directly or indirectly pay any premium on this type of a contract with respect to the transferor.[49]

It is intended that an organization be considered as indirectly paying premiums if, for example, another person pays premiums on its behalf.

A *personal benefit contract* with respect to a transferor is any life insurance, annuity, or endowment contract, if any direct or indirect beneficiary under the contract is the transferor, any member of the transferor's family, or any other person (other than a charity) designated by the transferor.[50] For example, this type of beneficiary includes a trust having a direct or indirect beneficiary who is the transferor or any member of the transferor's family, and includes an entity that is controlled by the transferor or any member of the transferor's family. It is intended that a beneficiary under the contract include any beneficiary under any side agreement relating to the contract.

If a person contributes a life insurance contract to a charity and designates one or more charities as the sole beneficiaries under the contract, generally it is not intended that this deduction denial rule apply. If, however, there is an outstanding loan under the contract upon the transfer of the contract, then the person is considered a beneficiary. The fact that a contract also has other direct or indirect beneficiaries (persons who are not the transferor or a family member, or designated by the transferor) does not prevent it from being a personal benefit contract. This is not intended to adversely affect situations in which an organization pays premiums under a legitimate fringe benefit plan for employees.[51]

---

[48] IRC § 170(f)(10). A summary of legislative proposals and various items of legislation leading to this body of law appeared in § 17.6(b) of the second edition of this book.

[49] IRC § 170(f)(10)(A).

[50] IRC § 170(f)(10)(B).

[51] E.g., Priv. Ltr. Rul. 200020060. See § 17.6(c), text accompanied by *infra* note 68.

It would be intended that a person be considered as an indirect beneficiary under a contract if, for example, the person receives or will receive any economic benefit as a result of amounts paid under or with respect to the contract.

For this purpose, the term *charitable organization* means the same as in the federal income tax charitable deduction setting.[52] Thus, it includes *charities* as that term is used in the tax exemption context,[53] but also encompasses entities such as veterans' organizations and certain fraternal groups.[54]

Charitable Gift Annuities. In the case of a charitable gift annuity,[55] if the charitable organization purchases an annuity contract issued by an insurance company to fund its obligation to pay the gift annuity—a practice known as *reinsurance*—a person receiving payments under the annuity arrangement is not treated as an indirect beneficiary as long as:

- the charity possesses all of the incidents of ownership under the annuity contract purchased by the charity,
- the charity is entitled to all the payments under the contract, and
- the timing and amount of payments under the contract are substantially the same as the timing and amount of payments to each person pursuant to the organization's obligation under the charitable gift annuity (as in effect at the time of the transfer to the charity).[56]

A charitable gift annuity obligation may be issued under the laws of a state that requires each beneficiary under the gift annuity to be named as a beneficiary under an annuity contract issued by an insurance company authorized to transact business in that state, in order for the charitable gift annuity to be exempt from insurance regulation by that state. In this situation, the foregoing first two requirements are deemed met as long as:

- the state law requirement was in effect on February 8, 1999 (see below),
- each beneficiary under the charitable gift annuity was a bona fide resident of the state at the time the charitable gift annuity was issued, and
- the only persons entitled to payments under the charitable gift annuity contract are persons entitled to payments as beneficiaries under the obligation on the date the obligation is entered into.[57]

Charitable Remainder Trusts. If a charitable remainder trust[58] holds a life insurance, endowment, or annuity contract issued by an insurance company, a person is not to be treated as an indirect beneficiary under the contract held by the trust solely by reason of being a recipient of income paid by the trust, as long as the trust possesses all of the incidents of ownership under the contract and is entitled to all

[52] IRC § 170(c).
[53] IRC § 501(c)(3).
[54] See § 3.3.
[55] See ch. 14.
[56] IRC § 170(f)(10)(D).
[57] IRC § 170(f)(10)(G).
[58] See ch. 12.

the payments under the contract.[59] No inference should be made as to the applicability of other provisions of the Internal Revenue Code with respect to the acquisition by the trust of a life insurance, endowment, or annuity contract, or the appropriateness of this type of an investment by a charitable remainder trust.

Nothing in this legislation is intended to suggest that a life insurance, endowment, or annuity contract would be a personal benefit contract solely because an individual who is a recipient of income from a charitable remainder trust uses an income payment to purchase a life insurance, endowment, or annuity contract, and a beneficiary under the contract is the recipient, a member of his or her family, or another person he or she designates.

Excise Tax. This legislation imposes an excise tax on a charitable organization that pays the premiums of any life insurance, annuity, or endowment contract in connection with a transfer for which a deduction is not allowable under the above deduction denial rule.[60] The tax equals the amount of the premiums paid by the organization on any life insurance, annuity, or endowment contract. The tax applies even if all of the direct and indirect beneficiaries under the contract (including any related side agreement) are charities.

Payments are treated as made by the organization if they are made by any other person pursuant to an understanding or expectation of payment.[61] The excise tax is to be applied taking into account rules ordinarily applicable to excise taxes in other exempt organizations contexts,[62] such as statute of limitation rules.

Reporting. The legislation requires that the charitable organization annually report the amount of premiums paid during the year that is subject to the excise tax.[63]

Penalties. Penalties applicable to returns[64] apply to returns under this reporting requirement. Returns required under this legislation have to be furnished at such time and in such manner as the IRS requires.

Regulations. The legislation provides for the Treasury to promulgate regulations necessary or appropriate to carry out the purposes of the proposal, including regulations to prevent avoidance of the purpose of the proposal.[65] For example, it is intended that the regulations will prevent avoidance of these purposes by inappropriate or improper reliance on the limited exceptions provided (see above) for certain beneficiaries under bona fide charitable gift annuities and for certain noncharitable recipients of an annuity or unitrust amount paid by a charitable remainder trust.

No Inference. No inference is intended that a charitable contribution deduction was allowed under preexisting law with respect to a charitable split-dollar

[59] IRC § 170(f)(10)(E).
[60] IRC § 170(f)(10)(F)(i).
[61] IRC § 170(f)(10)(E)(ii).
[62] That is, IRC ch. 41 or 42.
[63] See § 24.12.
[64] That is, annual information returns required by IRC § 6033.
[65] IRC § 170(f)(10)(I).

insurance arrangement. The legislation did not change the rules with respect to fraud, or civil or criminal penalties under existing law.

(c) IRS Notice

The IRS issued a notice[66] to ''alert'' taxpayers and charitable organizations about ''certain'' charitable split-dollar insurance transactions that ''purport'' to give rise to federal income and gift tax charitable contribution deductions. The IRS advised these persons that ''these transactions will not produce the tax benefits advertised by their promoters.'' The IRS added that promoters of these transactions, and those participating in them (including charities), ''may be subject to other adverse tax consequences, including penalties.''

The IRS said that, in instances of these transactions, it will apply the *substance-over-form* doctrine. This means that the IRS rejects the contention that the funds transferred to a charity constitute unrestricted gifts, on the ground that no obligation legally binds the charity to make the insurance investment—that is, to pay the policy premiums with the funds. Instead, the IRS presumes a ''mutual understanding'' between the taxpayer, the charity, and any other related intermediary (such as a life insurance trust).

Thus, the IRS will treat such a transaction as one in which the taxpayer obtains an insurance policy, pays premiums with respect to the policy, and transfers some of the rights under that policy to the intermediary entity and the remaining rights to charity. A person in this context is treated as dividing the rights in the insurance policy between the trust and charity. This is cast as a violation of the partial-interest gift rules,[67] causing disallowance of the charitable deduction. (The argument against application of the partial interest rule is that the donor is not a party to the split-dollar arrangement with the charity.)

The IRS stated that this notice applies to any charitable split-dollar insurance transaction, regardless of whether a trust or some other type of related intermediary is used in the transaction.[68]

Here are the potential sanctions—a formidable array, to be sure—proffered by the IRS:

- Challenge to the tax-exempt status of a participating charity on the basis of private inurement
- Challenge to the tax-exempt status of a participating charity on the ground of impermissible private benefit
- Imposition of the intermediate sanctions penalties[69] on a disqualified person who benefits from the split-dollar insurance transaction, and perhaps on the charity's managers

---

[66] Notice 99-36, 1999-1 C.B. 1284.

[67] See § 9.23.

[68] Not every split-dollar life insurance arrangement is encompassed by this notice and IRC § 170(f)(10). For example, the IRS ruled that such an arrangement, involving a private foundation and its chief executive officer, included as part of a comprehensive compensation package for him, did not constitute a transgression of the rules outlawing certain charitable split-dollar insurance plans. Priv. Ltr. Rul. 200020060.

[69] IRC § 4958. See *Tax-Exempt Organizations* ch. 21.

- Like imposition of the private foundation self-dealing rules[70]
- Assessment of the private foundations taxable expenditures penalties[71] on participating foundations, and perhaps on their managers
- Penalties on the charity if it provides substantiation of a charitable contribution[72] in connection with one of these transactions, on the ground that it is aiding and abetting an understatement of tax liability[73]
- Imposition of the accuracy-related penalty[74]
- Imposition of the return-preparer penalty[75]
- Imposition of the promoter penalty[76]
- Imposition of the penalty for aiding and abetting an understatement of tax liability[77] on participants other than charities

Participation in these transactions must be reported by tax-exempt charitable organizations on their annual information returns.[78]

§ 17.7 APPLICABLE INSURANCE CONTRACT REPORTING REQUIREMENTS

Congress perceived an increase in transactions involving the acquisition of life insurance contracts using arrangements in which tax-exempt organizations, primarily charitable entities, and private investors have an interest in the contract.[79] In these instances, the exempt organization has an insurable interest in the insured individuals, perhaps because they are donors.[80] Private investors provide the capital used to fund the purchase of the life insurance contracts, sometimes together with annuity contracts. This dual interest in the contracts is manifested by means of trusts, partnerships, or other arrangements for sharing the rights to the contracts. Both the exempt organizations and the private investors receive money in connection with the investment in the contracts while the life insurance is in force or as the insured individuals die.

For reportable acquisitions occurring after August 17, 2006, and on or before August 18, 2008, an applicable exempt organization that engages in a reportable transaction must file an information return.[81] This return must include the name, address, and taxpayer identification number of the organization and of the issuer of the applicable insurance contract.[82] A *reportable transaction* means the

---

[70] IRC § 4941. See *Private Foundations* ch. 5.
[71] IRC § 4945. See *Private Foundations* ch. 9.
[72] See § 21.3.
[73] IRC § 6701.
[74] IRC § 6662.
[75] IRC § 6694.
[76] IRC § 6700.
[77] IRC § 6701. For further reading about life insurance and charitable giving, see Appendix K.
[78] See § 24.12. In general, Raby & Raby, "What Gets Split with Split-Dollar Life Insurance?," 24 *Exempt Org. Tax Rev*. (no. 1) 37 (April 1999).
[79] E.g., Davis, "Death-Pool Donations," 143 *Trusts and Estates* (No. 5) 55 (2004).
[80] See § 17.4.
[81] IRC § 6050V(a).
[82] IRC § 6050V(c).

acquisition by an applicable exempt organization of a direct or indirect interest in a contract that the exempt organization knows or has reason to know is an applicable insurance contract, if the acquisition is a part of a structured transaction involving a pool of these contracts.[83]

An *applicable insurance contract* is a life insurance, annuity, or endowment contract with respect to which an applicable exempt organization and a person other than an applicable exempt organization have, directly or indirectly, held an interest in the contract (whether or not at the same time).[84] This term does not apply if (1) each person (other than an applicable exempt organization) with a direct or indirect interest in the contract has an insurable interest in the insured individual, independent of any interest of the exempt organization in the contract; (2) the sole interest in the contract of the applicable exempt organization or each person other than the exempt organization is as a named beneficiary; and (3) the sole interest in the contract of each person other than the applicable exempt organization is either (a) as a beneficiary of a trust holding an interest in the contract, but only if the person's designation as a beneficiary was made without consideration and solely on a purely gratuitous basis, or (b) as a trustee who holds an interest in the contract in a fiduciary capacity solely for the benefit of applicable exempt organizations or of persons otherwise meeting one of the first two of these exceptions.[85] An *applicable exempt organization* generally includes charitable organizations, governments or their political subdivisions, and Indian tribal governments.[86]

The Department of the Treasury has been directed to undertake a study on the use by tax-exempt organizations of applicable insurance contracts for the purpose of sharing the benefits of the organizations' insurable interest in insured individuals under these contracts with investors and to determine whether these activities are consistent with exempt purposes.[87] The study may, for example, address whether any of these arrangements are or may be used to improperly shelter income from tax, and whether they should be listed transactions.[88]

[83] IRC § 6050V(d)(1).
[84] IRC § 6050V(d)(2)(A).
[85] IRC § 6050V(d)(2)(B).
[86] IRC § 6050V(d)(3).
[87] Pension Protection Act of 2006 § 1211(c).
[88] See § 2.6.

PART FIVE

International Charitable Giving

CHAPTER EIGHTEEN

International Giving by Individuals during Lifetime

§ 18.1 **Introduction** 599

§ 18.2 **Background** 600

§ 18.3 **Earmarking and Conduit Restrictions** 602

§ 18.4 **Control over Foreign Donees** 605

§ 18.5 **Summary** 608

§ 18.6 **Income Tax Treaties** 608

The charitable impulse is not confined by national borders. Individuals, businesses, private foundations, and other charitable and noncharitable organizations in the United States are increasingly finding the means by which to transfer materials and funds to needy, troubled, and otherwise deserving areas of the world. Although not always as simple as domestic giving, international charitable giving is certainly feasible; increases in such giving are clearly the way of the future, as both individuals and organizations strive to meet large global social, cultural, and environmental needs.

§ 18.1 INTRODUCTION

Some would say that the nations of the world are uniting. Others insist that a process of Balkanization is under way. Few would deny that the frontiers of the world are being redefined.

Attendant to geopolitical changes are internal national restructurings, which are weakening sovereignties that have traditionally financed all social needs. Nearly everyone has been impressed by the deep and critical needs in all sectors of life within, for example, the Central and Eastern European countries. Yet the rise of charitable organizations and the necessity for them is truly an international phenomenon.

This chapter describes the legal requirements underlying the U.S. income tax charitable deduction for gifts to foreign charities made by American individuals. In general, contributions by individuals during lifetime to overseas organizations do not result in an income tax charitable deduction, because of historic policies that restrict deductibility to those charitable activities that essentially relieve (and

reduce) expenditures of U.S. public funds. Nonetheless, in certain situations these international gifts will be deductible if the requisite control over their disbursement to foreign charitable organizations and activities is strictly controlled and managed by U.S.-based charitable entities.

An increase in the mobility of managers of multinational companies and a tendency toward retirement in foreign countries have led to greater foreign property ownership. These facts, coupled with the increase in transborder philanthropic activity by residents and businesses in industrialized countries, have greatly expanded the likelihood that transborder charitable mechanisms will be an important part of estate planning.

The extent to which gifts by bequest to foreign charitable organizations will be deductible under the American estate and gift tax schemes is discussed elsewhere.[1] These tax provisions do not prohibit the use of funds overseas. Gifts to foreign corporations serving charitable purposes and donations to governmental entities that act as trustees in directing the funds to charitable purposes may be deductible.

Also described elsewhere are the methods by which an American company can obtain tax benefits through the practice of overseas corporate giving.[2] Particular attention is given to the utility of a corporate foundation. In this sense, the chapter also discusses the rules and regulations governing overseas activities of American private foundations, inasmuch as corporate grant-making foundations are generally technically classified as private foundations.[3]

§ 18.2 BACKGROUND

Prior to passage of the Revenue Act of 1938, U.S. individual taxpayers were allowed to make deductible contributions to charitable organizations regardless of where the organizations had been created or were located. Corporations did not enjoy this freedom: The Revenue Act of 1936,[4] which first allowed a deduction for corporate charitable contributions, limited that deduction to contributions to organizations established in the United States that used the contributions within the United States.

The rule treating individual contributions was modified by the Revenue Act of 1938. That Act[5] provided that contributions by individuals were deductible only if the recipient was a domestic organization. The House Ways and Means Committee report in this regard[6] declared that the rationale for allowing these deductions was that any loss of tax revenue was seen to be offset by relief of an obligation that otherwise would require public funds. Obviously, gifts to foreign institutions did not produce any of these benefits.

According to this committee report:

> Under the 1936 Act the deduction of charitable contributions by corporations is limited to contributions made to domestic institutions. . . . The bill provides

[1] See ch. 19.
[2] See ch. 20.
[3] A summary of the definition of the term *private foundation* is in § 3.4.
[4] § 102(c).
[5] § 23(o).
[6] H.R. Rep. No. 1860, 75th Cong., 3d Sess. 19–20 (1938).

> that the deduction allowed to taxpayers other than corporations be also restricted to contributions made to domestic institutions. The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare. The United States derives no such benefit from gifts to foreign institutions, and the proposed limitation is consistent with the above theory. If the recipient, however, is a domestic organization the fact that some portion of its funds is used in other countries for charitable and other purposes (such as missionary and educational purposes) will not affect the deductibility of the gift.[7]

The Revenue Act of 1939[8] changed the requirement that a qualifying organization be ''domestic'' to the requirement that it have been ''created or organized in the United States or in any possession thereof.'' In virtually identical form, this requirement was reenacted[9] as part of the Internal Revenue Code of 1954 and carried over to today's Internal Revenue Code of 1986.

Since 1939, the IRS has consistently held that donations by individuals to or for the use of domestic charitable organizations are deductible even though they are entirely used abroad, subject to the conduit and earmarking restrictions discussed below. This long-standing position was stated in a General Counsel Memorandum in 1958. In 1972, the position was expressly incorporated into the tax regulations, which provide as follows:

> A charitable contribution by an individual to or for the use of an organization described in section 170(c) [that is, a charitable organization] may be deductible even though all, or some portion, of the funds of the organization may be used in foreign countries for charitable or educational purposes.[10]

In contrast, gifts given directly to foreign charities are not deductible as charitable contributions because of the requirement that the recipient organization be a domestic entity; that is, a corporation, trust or community chest, fund, or foundation that is established in the United States.[11]

The classification of domestic versus foreign organizations is not necessarily obvious. For example, a court denied a charitable deduction for a direct gift from an American taxpayer to the First Church of Christ, Scientist, in Berne, Switzerland, a Swiss corporation. The organization's claim to U.S. provenance was grounded on the fact that it was an affiliate of The First Church of Christ, Scientist, in Boston, Massachusetts, a Massachusetts corporation. The court reviewed the organizational documents of the Swiss organization and focused on this provision:

> The Mother Church of Christ, Scientist, shall assume no general official control of other churches, and it shall be controlled by none other.
>
> Each Church of Christ, Scientist, shall have its own form of government. No conference of churches shall be held, unless it be when our churches, located in the same State, convene to confer on a statute of said State, or to confer harmoniously on individual unity and action of the churches in said State.

---

[7] *Id*.
[8] § 224.
[9] IRC § 170(c)(2)(A).
[10] Reg. § 1.170A-8(a)(1).
[11] IRC § 170(c)(2)(A).

The court determined that this statement negated the contention that the Mother Church and the Berne branch were inseparable. The Swiss organization was thus held to be legally independent of the American church. Therefore, the individual's contribution to the First Church of Christ, Scientist, Berne (Switzerland), was held not to be deductible.[12]

In another situation, however, the same court decided in favor of the American donor. In this instance, a school had been created in France under French corporation laws and had operated there for many years before incorporating in Delaware. The IRS maintained that the U.S. corporation had no activities and was merely a shell created to attract tax-deductible American contributions. The Tax Court found that the organization was created in the United States by virtue of the Delaware incorporation. Further, the court observed that the organization did not distribute any of its funds to a foreign organization operating a school in France. Rather, the organization itself was found to be operating the Paris school and applied contributions received toward operation of that school. This was sufficient to characterize the entity as a domestic charity for U.S. law purposes, notwithstanding the school's foreign origin. The operational nexus with the U.S. organization, even though essentially technical, was sufficient to distinguish the domestic organization from a mere shell (discussed below).[13]

The second of these two opinions is difficult to reconcile with the earmarking and conduit restrictions discussed below. Application of the teachings of this case to any factual situation would have to be made with caution.[14]

§ 18.3 EARMARKING AND CONDUIT RESTRICTIONS

As discussed above, an American taxpayer who is an individual is not permitted to claim a federal income tax charitable deduction for a gift that flows directly to a foreign charitable organization, because of fundamental policies underlying the charitable deduction framework. Nonetheless, an American individual taxpayer may be permitted to make a contribution to an incorporated American charity that devotes some or all of its funds to overseas activities. The ability to claim the deduction depends on the degree of control exerted by the American charitable organization and the lack of control imposed by the donor in directing that the gift be applied to foreign charitable activities.

Following a basic American tax law principle, deductibility of a contribution does not necessarily depend on its payment to a qualifying organization. If the gift is earmarked for a further destination, it is appropriate to look beyond the immediate recipient (although a qualifying organization) to determine whether the payment is a charitable contribution that will bring an income tax deduction to the donor.

---

[12] *Welti v. Commissioner*, 1 T.C. 905 (1943). Subsequently, a charitable contribution deduction was denied for a gift to a charitable organization in Burma (*ErSelcuk v. Commissioner*, 30 T.C. 962 (1958)); gifts to churches in France (*Herter v. Commissioner*, 20 T.C.M. (CCH) 78 (1961)); a gift to an orphanage in Ecuador (*Tobjy v. Commissioner*, 51 T.C.M. (CCH) 449 (1986)); and a gift to an Islamic mosque in Iran (*Alisobhani v. Commissioner*, 68 T.C.M. (CCH) 1493 (1994)).

[13] *Bilingual Montessori Sch. of Paris, Inc. v. Commissioner*, 75 T.C. 480 (1980).

[14] Further analysis of this body of law is in *Tax-Exempt Organizations* § 28.2(e).

In one instance, a court considered the question of whether amounts paid to a foster home for the care of a named individual were furnished for the use and benefit of the home and hence qualified as deductible charitable contributions. The earmarking in this instance transformed the gift to the foster home into a gift to a particular individual. In the eyes of the court, the ''contributions'' were not to be used in any manner as deemed appropriate by the home, but were for the use of a single individual in whom the ''donor'' felt a keen fatherly and personal interest. The charitable contribution deduction was denied in this circumstance.[15]

The IRS, in applying this principle to transfers of contributions from U.S. sources to foreign organizations, concluded:

> ''A given result at the end of a straight path is not made a different result because reached by following a devious path.'' . . . Moreover, it seems clear that the requirements of . . . [the federal income tax law] would be nullified if contributions inevitably committed to a foreign organization were held to be deductible solely because, in the course of transmittal to a foreign organization, they came to rest momentarily in a qualifying domestic organization. In such case the domestic organization is only nominally the donee; the real donee is the ultimate foreign recipient.[16]

IRS ruling policy permits a U.S. charitable organization to fund a foreign charitable organization and/or individual when

- the domestic organization's purpose can be furthered by granting funds to one or more foreign entities,
- the domestic organization has reviewed and approved of the foreign entity's purposes, and
- the grants are paid from general funds rather than from special funds solicited on behalf of the foreign organization.[17]

Difficulty arises, from the IRS's point of view, when a domestic charity is empowered in such a way that it is no more than an agent of or trustee for a particular foreign organization; has purposes so narrow that its funds can go only to a particular foreign organization; or solicits funds on behalf of a particular foreign organization.

The IRS has analyzed five situations:

1. A foreign organization that caused a domestic organization to be formed to conduct a fundraising campaign in the United States, pay administrative expenses from the collected funds, and remit any balance to the foreign organization.
2. Certain persons in the United States, desirous of furthering the work of a foreign organization, who formed a domestic charitable organization to receive contributions and send them periodically to the foreign organization.
3. A foreign organization and a domestic organization that had previously received a ruling that contributions to it would be deductible as charitable

[15] *Thomason v. Commissioner*, 2 T.C. 441 (1943).
[16] Rev. Rul. 63-252, 1963-2 C.B. 101. In reaching this conclusion, the IRS relied on *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 613 (1938); and *Griffiths v. Helvering*, 308 U.S. 355, 358 (1939).
[17] Rev. Rul. 63-252, 1963-2 C.B. 101.

gifts entered into an agreement under which the domestic organization was to conduct a fundraising campaign on behalf of the foreign organization, representing to prospective contributors that the raised funds would go to the foreign organization.

4. A domestic organization, which conducts a variety of charitable activities in a foreign country, sometimes grants funds to a foreign charitable organization to further the domestic organization's purposes. These grants are made for purposes that the domestic organization has reviewed and approved, and the grants are made from the organization's general funds rather than from a special fund raised on behalf of the foreign organization.
5. A domestic organization that does work in a foreign country forms a subsidiary in that country to facilitate its operation. The subsidiary was formed for purposes of administrative convenience, and the domestic organization controls all facets of its operations. The domestic organization will solicit funds for the specific purpose of carrying out its charitable activities in the foreign country, as it did before forming the foreign subsidiary, but will now transmit the funds directly to the foreign subsidiary.[18]

A common theme in the first three of these cases is that the organizations are charitable organizations nominally created in the United States. They are organized or operated solely to solicit funds on behalf of preexisting foreign entities. The domestic entities are effectively agents or conduit organizations for the foreign beneficiaries. As such, contributions to them are not deductible under U.S. law as charitable gifts. Examples 4 and 5 describe organizations that solicit funds without any express understanding that the donations will be forwarded to foreign entities. They are independent organizations with their own charitable programs. These organizations exercise discretion and control over the funds solicited from U.S. sources. Consequently, gifts to them are deductible. The IRS's view is that the real donees in the first, second, and third of these situations are the foreign organizations; hence, contributions ostensibly to the domestic organization are not deductible under U.S. law. In contrast, the IRS has concluded that contributions to the domestic organizations in the fourth and fifth situations are deductible as charitable gifts because the domestic organizations in these situations actually received and essentially controlled the use of the funds.

The seminal IRS ruling on the point ends with the following language, which draws on the principles enunciated in the case law:

> It is recognized that special earmarking of the use or destination of funds paid to a qualifying charitable organization may deprive the donor of a deduction . . . [citations omitted]. These cases indicate that an inquiry as to the deductibility of a contribution need not stop once it is determined that an amount has been paid to a qualifying organization; if the amount is earmarked[,] then it is appropriate to look beyond the fact that the immediate recipient is a qualifying organization to determine whether the payment constitutes a deductible contribution. Similarly, if an organization is required for other reasons, such as a specific provision in its charter, to turn contributions, or any particular contributions it receives, over to another organization, then in determining whether such contributions are deductible, it is appropriate to determine whether the ultimate recipient of the contribution is a qualifying organization. . . .

[18] *Id.*

> Moreover, it seems clear that the requirements of . . . [the federal tax law] would be nullified if contributions inevitably committed to go to a foreign organization were held to be deductible solely because, in the course of transmittal to the foreign organization, they came to rest momentarily in a qualifying domestic organization. In such cases, the domestic organization is only nominally the donee; the real donee is the ultimate foreign recipient.[19]

Thus, the problem of earmarking that arises when the American donee organization acts as a conduit for the American donor is resolved when the American organization exercises meaningful discretion and control as to the ultimate use of the contributions.

An important test in this regard is who solicited whom: Did the individual taxpayer seek out the recipient organization's cooperation to facilitate application of the funds to a designated project, or did the American donee organization seek the donor's support of a project identified by the organization? When the recipient charitable organization designates the overseas use of the funds, the donor's contribution produces an allowable deduction. The donor may choose from among overseas uses presented as options by the charitable organization. However, when the donor identifies a desired overseas use, and employs the charitable organization as a funding agent or conduit, the gift is not allowed as a charitable deduction to the donor.

The IRS, in its private letter rulings, is attempting to add another criterion in this context, which is that the grantor of funds is expected to undertake some form of expenditure responsibility. (The IRS cannot go too far in this regard, however, in that Congress has imposed expenditure responsibility requirements only on private foundations.[20]) For example, in one of these rulings, the IRS observed that the board of directors of the grantor organization was to ''review'' and ''monitor'' the use of the granted charitable funds.[21] In another private ruling, the IRS wrote of a requirement of ''periodic accounting'' for the monies granted; in this ruling, the IRS found the requisite control, in part because of a monitoring procedure.[22] Monitoring is also mentioned in other private letter rulings.[23] Since this series of private letter rulings began, the IRS has mentioned the control element as the singular factor on only one occasion.[24]

§ 18.4 CONTROL OVER FOREIGN DONEES

The IRS clarified the matter of what constitutes adequate control of the donated funds.[25] This ruling discussed a situation in which a domestic charitable organization solicited contributions in the United States for a specific project of a foreign counterpart organization. The charity's charter provided that, in furtherance of its educational, scientific, and charitable purposes, it had the power to receive and to allocate contributions—within the discretion of the board of directors—to any organization organized and operated exclusively for charitable or educational

---

[19] 1963-2 C.B. at 104.
[20] IRC § 4945(h). See *Private Foundations* § 9.6.
[21] Priv. Ltr. Rul. 8839029.
[22] Priv. Ltr. Rul. 8714050.
[23] See, e.g., Priv. Ltr. Rul. 8408051.
[24] Priv. Ltr. Rul. 8408054.
[25] Rev. Rul. 66-79, 1966-1 C.B. 48.

purposes within the meaning of the U.S. tax law. The board of directors exercised effective review of the project before approving any funding. The board monitored the foreign distributing organization's ongoing adherence to the domestic charity's goals. Notwithstanding that the donations were technically ''earmarked,'' the domestic organization demonstrated that it exercised full control over the donated funds and retained substantial responsibility as to their use. These standards entail more than merely being able to decide whether to contribute and being able to require the foreign recipient to furnish a periodic accounting. In its decision, the IRS referred to an earlier ruling holding that, when gifts to a charitable organization were not earmarked by the donor for a particular individual, the deduction would be allowable if it was established that a gift was intended by the donor for the use of the organization and not actually as a gift to a specific individual for whose benefit the gift would be used by the donee organization.[26] The test, said the IRS, is whether the organization retains full control of the donated funds to ensure that they will be used to carry out the organization's own charitable purposes.

The conclusion in another IRS pronouncement was that, because the trustees of the subject organization were unable to state that all the funds would be used in the United States, they did not have sufficient control and discretion over the use of any contributions made to foreign distributees.[27] The problem in this case was that the domestic organization did not seem to have any formal operating system by which it could control the selection of projects to be funded—they had no means of effective supervision over the use of the funds for a project, nor the ability to withhold or control the funds once committed. In this regard, the IRS concluded that it appeared that the domestic organization was intending to remit the monies to the foreign distributee before even considering possible projects and then discussing with the foreign organization the possible uses of its funds. Thus, the operating procedures and inability of the domestic organization to supervise the use of funds by the foreign organization did not evidence that degree of control and discretion required under the law.[28]

The IRS presented another analysis of the control and accountability requirement.[29] This ruling discussed a domestic charity formed to address the problem of plant and wildlife ecology in a foreign country through programs that included grants to foreign private organizations. The domestic charity maintained control and responsibility over the use of any funds granted to a foreign organization by first making an investigation of the purpose to which the funds were to be directed; by then entering into a written agreement with the recipient organization; and ultimately by making site visits to see that the agreement was being followed. Any foreign organization that received financial assistance from the charitable organization had to be organized and operated in a manner analogous to a U.S. tax-exempt charitable organization and be completely independent of foreign governments. The charitable organization exercised accountability for the

---

[26] Rev. Rul. 62-113, 1962-2 C.B. 10.
[27] Gen. Couns. Mem. 37444.
[28] Reg. § 1.170A-8(a)(1).
[29] Rev. Rul. 75-65, 1975-1 C.B. 79.

funds dispensed to these programs. Accordingly, it was held that contributions to the organization were deductible as charitable gifts.

In yet another illustration of this form of control and accountability, the IRS considered a domestic association that was organized for the relief of poor, distressed, and displaced persons of certain countries. This domestic association was incapable of listing in advance the names of the ultimate recipients of the monies it would turn over to a foreign organization. Even though the foreign organization promised to use the funds for humanitarian purposes, such as furnishing food, clothing, shelter, and medical supplies and services for distressed persons, and even though both the foreign organization and its distributees were required to account for the use of the funds, there was too little discretion and control by the domestic organization to meet these standards.[30]

Conversely, a tax-exempt charitable organization does not jeopardize its exemption by making controlled distributions assuredly in furtherance of its own exempt purposes to organizations that are not themselves tax-exempt as charitable entities. ''We do not believe this [tax-exempt] status of the distributees is a requirement for the distributor's qualifications'' as a charitable organization, the lawyers for the IRS observed.[31] They added: ''It can be readily understood that such status for the foreign distributee is a safeguard for insuring that charitable funds will be expended solely in furtherance of charitable purposes.''

In reaching its conclusion in this particular case, the IRS emphasized that the domestic organization did not know how the funds would be used. This IRS pronouncement further stated that it may not be necessary for a domestic charitable organization to know in advance the precise nature of ultimate distributees to ensure that its qualification as a charitable entity is not jeopardized, if it can establish that its methods of operation include the following types of procedures:

- The domestic charitable organization apprises its agents, at the outset, of the limitations imposed by U.S. law with respect to eligible recipients of its funds, and makes clear to its agents that they are subject to the same limitations in distributing its funds.
- The domestic charitable organization reviews proposed projects in detail, and approves those reasonably calculated to accomplish one or more of its qualified charitable objectives, before turning over any funds to its agents for expenditure for these purposes.
- The domestic charitable organization turns over funds to its agents only as needed for specific projects. This form of expenditure control encourages compliance with the dictates of the domestic organization.
- The domestic charitable organization, or an independent agent selected by it for the purpose, makes periodic audits of programs and requires periodic financial statements by its agents. This continuing review assures that the charitable funds in question are not being misspent.

[30] Gen. Couns. Mem. 35319.
[31] *Id.*

Adoption of these guidelines, as subsequently cited with approval by the IRS,[32] can strengthen the case for the deductibility of contributions as charitable gifts.

§ 18.5 SUMMARY

Although the requirements of the U.S. tax law with respect to tax exemption as a charitable organization[33] and deductibility of charitable gifts[34] are parallel in many respects, they are not identical. In some situations, contributions to or for the use of a foreign organization are not deductible for income tax purposes because the domestic organization requirement[35] is not met. As for a domestic organization that serves as a conduit for a foreign charitable organization, contributions to the domestic organization are no more deductible as charitable gifts than if they had been made directly to the foreign organization.

In most other situations, these two provisions operate in parallel. If a domestic organization transmits its funds to a foreign private organization but retains the required control and discretion over the funds—as detailed in examples 4 and 5 of the IRS ruling discussed earlier[36]—contributions to the domestic organization will be deductible as charitable gifts. Conversely, a domestic organization otherwise qualified as a charitable entity forfeits its qualification for tax-exempt and charitable donee status if it regularly transmits its funds to any organization that is not described in the U.S. rules for charitable organizations, because it then cannot demonstrate that it is operated exclusively for charitable purposes. Further, if the domestic organization fails to exercise discretion and control over the use of funds transmitted to a foreign organization, to assure their use exclusively for purposes that qualify as charitable under U.S. law, those contributions to it will not be deductible.

§ 18.6 INCOME TAX TREATIES

In connection with the international law aspects of the federal income tax, income tax treaties often must be considered, in addition to the principles of U.S. tax law as set forth in the Internal Revenue Code, regulations, rulings, and court opinions. The United States presently is a party to more than 50 income tax treaties, although most of them do not contain provisions relevant to the deductibility of cross-border contributions. Indeed, the U.S. prototype income tax treaty is silent on the subject.[37]

The income tax treaty between the United States and Canada[38] provides that contributions by a citizen or resident of the United States to an organization that

[32] Gen. Couns. Mem. 37444.

[33] Because an organization did not "review and approve the disbursements" and did not "maintain control and discretion over the use of the funds," it was found by the IRS to be a conduit entity; the funds did not flow through to a foreign charity, however, but flowed through to individuals (scholarship recipients). Priv. Ltr. Rul. 200931059.

[34] IRC § 170(c)(2).

[35] IRC § 170(c)(2)(A).

[36] Rev. Rul. 63-252, 1963-2 C.B. 101.

[37] U.S. Model Income Tax Convention of September 20, 1996. This model convention recognizes tax-exempt organizations as entities in the sense that they are entitled to the general benefits of the convention.

[38] Convention Between the U.S. and Canada With Respect to Taxes on Income and on Capital, effective as of January 1, 1985.

is resident in Canada and is generally exempt from Canadian tax are treated as charitable contributions, but only if the organization could qualify in the United States to receive deductible contributions if it were organized in the United States. Generally, the amount of these contributions made deductible by the treaty is limited to the income of the U.S. citizen or resident arising in Canada.[39] The percentage limitations applicable to the deductibility of charitable contributions[40] apply after the limitations established by the treaty. Any amounts treated as charitable contributions that are in excess of amounts deductible in a tax year may generally be carried over and deducted in subsequent tax years.[41]

The income tax treaty between the United States and Mexico[42] has similar rules as to deductibility of charitable contributions. This treaty also contains rules by which charitable organizations in Mexico can be recognized, for U.S. law purposes (including charitable giving), as public charities.[43] The U.S. Department of the Treasury's technical explanation of the treaty includes the following statement: ''The provisions [of the treaty] were considered a desirable way to encourage contributions by U.S. residents to small Mexican charities that would have difficulty in organizing a U.S. entity through which contributions could be directed.'' This explanation added that the treaty ''also enables taxpayers living and operating at the border to support organizations across the border from which they derive benefits,'' and observed that the ''physical proximity of Mexico and the United States provides a unique circumstance for the reciprocal recognition of tax-exempt organizations.''[44]

The United States Senate Committee on Foreign Relations Report of May 21, 1984, on the Tax Convention and Proposed Protocols with Canada, stated:

> The Committee recognizes that the special relationship between the United States and Canada may arguably warrant the treaty's expanded allowance of deductions for contributions to charities of the other country. . . . However, the Committee remains deeply concerned about the granting of deductions to U.S. persons by treaty where the [United States Internal Revenue] Code does not otherwise grant the deductions. . . . The Committee does not believe that treaties are a proper forum for providing deductions not otherwise permitted under domestic law. . . . The Committee wishes to stress that the inclusion of special charitable and convention expense deduction rules in the proposed treaty should not be taken as precedent for future treaty negotiations.

---

[39] In the case of contributions to a college or university at which the U.S. citizen or resident or a member of his or her family is or was enrolled, the limitation to income arising in Canada is not required.

[40] See ch. 7.

[41] These aspects of the income tax treaty with Canada are in Article XXI of the Convention.

[42] Convention and Protocol Between the Government of the U.S. and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, effective as of January 1, 1994.

[43] See § 3.4(a).

[44] These aspects of the income tax treaty with Mexico are in Article 22 of the Convention. The rules as to ''organizing a U.S. entity through which contributions could be directed'' are summarized in § 28.2(e) of *Tax-Exempt Organizations*.

CHAPTER NINETEEN

International Giving by Individuals through Estates

§ 19.1 **Introduction** **611**
§ 19.2 **Estate Tax Rules** **612**
(a) Transfer to Foreign Corporation Serving Charitable Ends 612
(b) Transfer to Foreign Government Serving Public Purposes 613
(c) Transfer to Trustee 614
(d) Testamentary Charitable Remainder Trusts 616
§ 19.3 **Gift Tax Rules** **617**
§ 19.4 **Charitable Giving by Noncitizen Nonresidents** **617**
(a) Estate Tax Rules 617
(b) Gift Tax Rules for Nonresident Noncitizens 618

§ 19.1 INTRODUCTION

The treatment of gifts and bequests under U.S. estate and gift tax provisions[1] does not limit the use of funds overseas. The federal estate tax deduction[2] and the federal gift tax deduction[3] permit bequests and gifts by U.S. residents to foreign organizations for charitable purposes. For estate and gift tax purposes, an individual is considered to be a resident of the United States if that individual maintains his or her domicile in the United States at the time of death or at the time of the gift, whichever is applicable.[4]

The federal estate tax charitable deduction provision is similar to the federal income tax charitable deduction provision[5] in allowing deductions for gifts to U.S. governmental entities but not to foreign governmental units. Unlike the income tax rule, however, the federal estate tax rule permits deductions for bequests to charitable trusts without the requirement that the trusts be domestic organizations.

In the case of a nonresident who is not a U.S. citizen, gifts will be subject to the gift tax if they are not made to a domestic charitable corporation.[6] A gift

[1] In general, see ch. 8.
[2] IRC § 2055(a)(2).
[3] IRC § 2522(a)(2).
[4] Reg. §§ 20.0-2(b)(1); 25.2501-1(b).
[5] IRC § 170(c).
[6] IRC § 2106(a)(2).

made to any charitable trust, community chest, fund, or foundation, by a non-resident who is not a citizen, must be used exclusively within the United States.[7]

§ 19.2 ESTATE TAX RULES

Federal tax law allows an unlimited charitable deduction from the gross estate of a U.S. citizen or resident decedent for transfers to qualifying donees for public, charitable, educational, religious, and other similar purposes.[8] The estate tax provisions do not restrict qualifying donees to domestic charitable organizations. Under certain circumstances, transfers to foreign governments for charitable purposes may be allowed.

(a) Transfer to Foreign Corporation Serving Charitable Ends

An estate tax deduction is allowed for transfers to or for the use of ''any corporation'' organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, or to foster national or international amateur sports competition, and the prevention of cruelty to children or animals.[9]

It is significant to note that this provision of law refers to transfers ''to or for the use of any corporation,'' and does not limit the contemplated transfers to American corporations. The accompanying regulations reflect this provision in referring to ''any corporation or association.''[10]

To qualify as a suitable donee corporation, the foreign organization must meet certain standards. For example, the foreign organization must satisfy the prohibitions against private inurement[11] and political activities.[12] The lobbying restriction applicable to domestic tax-exempt charitable organizations[13] extends to foreign associations as well.[14]

This body of law does not define with precision when an organization will be considered ''organized and operated exclusively for religious, charitable, scientific, literary or educational purposes.'' The statutory language of the estate tax deduction provision is, however, parallel to that of the income tax deduction provision.[15]

Generally, the term *charitable* is construed in its common law sense and includes, among other concepts:

- Relief of the poor and distressed or of the underprivileged
- Advancement of religion
- Advancement of education or science[16]

---

[7] IRC § 2522(b)(2), (3).
[8] IRC § 2055(a). See § 8.3(b)(i).
[9] IRC § 2055(a)(2).
[10] Reg. § 19.2055-1(a)(2).
[11] See *Tax-Exempt Organizations* ch. 20.
[12] *Id*., ch. 23.
[13] *Id*., ch. 21.
[14] IRC § 2055(a)(2).
[15] See §§ 1.1, 3.2.
[16] Reg. § 1.501(c)(3)-1(d)(2).

The concept of what constitutes a foreign charitable corporation was discussed in a court opinion.[17] A charitable deduction had been claimed for a proportional residuary bequest to a governmentally owned Canadian hospital, as a nonprofit organization operated exclusively for the purpose of providing care for the sick and for medical educational facilities. The gift was determined to qualify for an estate tax charitable deduction under the provision that allows a deduction for bequests to charitable corporations.[18] In this case, involving a private hospital that had been turned over to a city, the hospital was found not to be a political subdivision in the sense that it was either a political unit or an integral governmental instrumentality exercising sovereign powers. Rather, the court determined that the hospital was a nonintegral governmental instrumentality, a clear counterpart of a private charitable corporation organized and operated exclusively for charitable purposes.

The IRS, from time to time, issues rulings concerning the qualification of a charitable contribution to a foreign corporation for the federal estate tax charitable deduction.[19] When a decedent is not a resident or citizen of the United States, the estate is subject to a tax on the transfer of the taxable estate that is situated in the United States at the time of death.[20] There is a deduction from the value of the taxable estate for bequests to a corporation organized and operated for charitable purposes; this deduction is limited to transfers to entities created in, and to trustees for use within, the United States.[21] This deduction may not exceed the value of the transferred property required to be included in the gross estate.[22] The statutory law on this subject is not overridden by U.S. tax conventions with other countries.[23]

(b) Transfer to Foreign Government Serving Public Purposes

An estate tax charitable deduction is allowed for transfers to or for the use of the United States, any political subdivision thereof, or the District of Columbia, for exclusively public purposes.[24] Although a transfer to a United States governmental subdivision for its general or public purposes would qualify for the deduction, the same gift to a foreign government would not.

In the facts of one court case, an individual died, having bequeathed his entire estate to the Hammer School District of Vrads Parish in Denmark, "[t]o be used by said school district in any manner it may wish for the betterment of the schools or aid to the students of said district." In determining whether a United States estate tax deduction for the gift was allowable, the court referred to the statutory language.[25] The court specifically chose to determine whether the Danish school district was a political subdivision of a foreign government, not

[17] *Old Colony Trust Co. v. United States*, 438 F.2d 684 (1st Cir. 1971).
[18] IRC § 2055(a)(2).
[19] See, e.g., Tech. Adv. Mem. 199925043.
[20] IRC §§ 2101, 2103.
[21] IRC § 2106(a)(2)(A)(ii).
[22] IRC § 2106(a)(2)(D).
[23] See, e.g., *Silver Estate v. United States*, 120 T.C. 430 (2003) (concerning deductibility of charitable bequests to Canadian charities from estate of individual who was not a resident or citizen of the United States).
[24] IRC § 2055(a)(1).
[25] IRC § 2055(a).

whether it was a corporation. Although the Danish school district was a corporation operated exclusively for educational purposes, the law[26] limits deductible bequests to political subdivisions to those that are subdivisions of the American government. Thus, the court held that this bequest was not deductible for estate tax purposes.[27]

(c) Transfer to Trustee

An estate tax charitable deduction is allowed for ''contributions or gifts to a trustee or trustees . . . to be used by such trustee or trustees . . . exclusively for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals.''[28] The question of whether a bequest to a foreign governmental body, to be used exclusively for charitable purposes, could be deductible as a bequest to a foreign charitable trust has arisen. A growing body of federal case law holds that a bequest to a foreign governmental entity can be instilled with a charitable purpose. In such a case, it would be deductible under the rule concerning bequests to a trustee for charitable purposes.[29]

The two courts that have considered this matter subsequent to this court opinion have expressly rejected the first court's rationale and have adopted another approach to statutory construction.[30] Both cases involved bequests to foreign governmental units. Both courts applied this rule, allowing a deduction for a bequest to a trustee for exclusively charitable purposes. The precedent was therefore set that a transfer to a foreign government, subdivision, or instrumentality may qualify for the estate tax charitable deduction, provided it is restricted exclusively for charitable purposes and the government subdivision acts in a fiduciary capacity.

In another case,[31] the question was whether a clause in the will of an individual constituted a charitable trust and thus qualified as an allowable deduction in the computation of New York state taxes. A controversial paragraph in the decedent's will provided in part as follows:

> I hereby give, devise and bequeath the entire collection of gold and platinum coins left me by my late beloved husband, to the State of Israel, upon condition that the same be kept and exhibited in the State of Israel, in an appropriate museum, that the same be marked and identified to the viewing public as ''The Collection of Dr. Aron A. Kaplun'' and that the State of Israel will undertake to keep said collection in perpetuity, never to be sold or otherwise disposed of. . . .

Obviously, the State of Israel is not a domestic governmental body as defined under the law,[32] nor is it a corporation organized and operating exclusively for charitable purposes as described in the law.[33] Thus, the claimed deduction had to stand under the rule concerning gifts to a trustee for a charitable

[26] IRC § 2055(a)(1).
[27] *Edwards v. Phillips*, 373 F.2d 618 (10th Cir.), *cert. den.*, 389 U.S. 834 (1967).
[28] IRC § 2055(a)(3).
[29] See text accompanied by *supra* note 28.
[30] *Schoellkopf v. United States*, 124 F.2d 982 (2d Cir. 1942).
[31] *Kaplun v. United States*, 436 F.2d 799 (2d Cir. 1970).
[32] IRC § 2055(a)(1).
[33] IRC § 2055(a)(2).

purpose.[34] Whereas the bequest in the earlier case[35] had been given outright to a Danish city school district, the coin collection in this case had been donated to a governmental subdivision to be maintained in trust for the decedent. In drawing a line between what Congress may have intended in limiting an estate tax deduction for gifts made directly to foreign governments and those given ''in trust'' to foreign governments for charitable purposes, the court in this case relied on the reasoning in another court opinion.[36]

In that case, a devise (bequest) had been made to the ''mayor and magistratsraete of Fuerth, Bayern, Germany to be used and expended for the benefit of said City of Fuerth.'' A majority of the court refused to apply the reasoning of the prior court opinion and, although the court disallowed the deduction because the bequest was left to a foreign city outright and not in trust, it noted in its ruling that ''contributions and gifts to foreign cities for exclusively charitable purposes are deductible,'' notwithstanding the political nature of the trustee.[37]

The majority and dissent in this case emphasized that Congress logically could have differentiated between public purposes that could be advanced only under the general estate tax deduction rule[38] and the charitable purposes contemplated under the rule concerning bequests to a charitable trustee.[39] The court wrote:

> It seems to us that the word ''public'' embodies a broader concept, and envisions gifts to domestic government bodies for purposes other than the ordinary philanthropic purposes most people associate with ''charity.'' Consequently, it is our opinion that the use of the word ''public'' shows a Congressional intention to bring within the statutory exemption gifts which could be used for such standard governmental functions as the payment of salaries to policemen and firemen. We think there is a clear indication that Congress considered that many contributions which would benefit domestic municipalities are not charitable, because the exemption permits different and broader uses of a bequest than those which are exclusively for charitable purposes.[40]

In another case, an estate was able to take a charitable deduction for a residuary bequest when the devise was made to a foreign political unit in trust for building a home for the aged.[41]

After these court decisions, the IRS announced that a deduction is allowable under the estate tax rules[42] with respect to a transfer of property to a foreign government or political subdivision thereof for exclusively charitable purposes.[43] The IRS noted the earlier court decision,[44] but looked to the more recent decisions,[45] which had concluded that when the use of property is limited to

---

[34] IRC § 2055(a)(3).
[35] *Edwards v. Phillips*, 373 F.2d 618 (10th Cir.), *cert. den.*, 389 U.S. 834 (1967).
[36] *Continental Ill. Nat'l Bank & Trust Co. v. United States*, 403 F.2d 721 (Ct. Cl. 1968), *cert. den.*, 394 U.S. 973 (1969).
[37] Id., 403 F.2d at 727.
[38] IRC § 2055(a)(1).
[39] IRC § 2055(a)(3).
[40] *Continental Ill. Nat'l Bank & Trust Co. v. United States*, 403 F.2d 721, 724 (Ct. Cl. 1968).
[41] *National Sav. & Trust Co. v. United States*, 436 F.2d 458 (Ct. Cl. 1971).
[42] IRC § 2055.
[43] Rev. Rul. 74-523, 1974-2 C.B. 304.
[44] *Edwards v. Phillips*, 373 F.2d 618 (10th Cir.), *cert. den.*, 389 U.S. 834 (1967).
[45] *Old Colony Trust Co. v. United States*, 438 F.2d 684 (1st Cir. 1971); *Kaplun v. United States*, 436 F.2d 799 (2d Cir. 1970); *National Sav. & Trust Co. v. United States*, 436 F.2d 458 (Ct. Cl. 1971).

exclusively charitable purposes,[46] a gift by bequest to a foreign government body or political subdivision will qualify for a charitable deduction.

The essence of this IRS announcement was the basis of a subsequent court opinion[47] involving the reformation of a provision in a will. The decedent, according to the court, had intended the municipality of Kerasitsa, Greece, rather than his children, to be the ultimate heir of a hospital, built there from proceeds of the sale of his U.S. real estate. The court generally restated the IRS position:

> [The IRS] makes no argument that if we find the remainder interest vested in some entity other than decedent's heirs that the bequest is still outside the bounds of . . . [the federal estate tax charitable deduction]. Petitioner asserts that the decedent intended for the hospital to pass to the village government upon its completion and that this intent establishes the charitable nature of the bequest.[48]

A further demonstration of the utility of the IRS position appears in an IRS private letter ruling.[49] A court attempted to reform a bequest to meet the estate tax law requirements.[50] The IRS determined, however, that for the taxpayer to be able to reform a nonqualifying charitable remainder trust, the beneficiary designated in the will had to be an organization or purpose described or defined in the law of charity.[51] The State of Israel had been named as the beneficiary. The IRS announced: ''If the beneficiary designated in the will had been a . . . [charitable] organization or purpose, the trust established under the decedent's will, as conformed by a probate court order, would have constituted a charitable remainder annuity trust.''[52]

In another instance, an executor of an estate attempted to salvage a bequest of residuary property given in trust to a foreign government. The foreign country acknowledged that the bequest would be used for an agricultural high school in that country. The issue was whether the actual charitable use to which the funds were to be applied would qualify the gift for the deduction when in fact the will had not specifically so directed. The IRS concluded that the ''fact [that the foreign country] has agreed to use its gift for charitable purposes does not convert an otherwise general gift into a charitable gift.''[53]

(d) Testamentary Charitable Remainder Trusts

A charitable organization to or for the use of which the remainder interest passes must meet the requirements for the estate tax deduction[54] as well as the remainder trust rules.[55] Therefore, the charitable entity to which the remainder interest in a charitable remainder annuity trust passes may not be a foreign corporation.[56]

---

[46] IRC §§ 2055(a)(2) and 2055(a)(3).
[47] *Estate of Orphanos v. Commissioner*, 67 T.C. 780 (1977).
[48] *Id*. at 782.
[49] Priv. Ltr. Rul. 7938001.
[50] IRC §§ 2055(a) and 2055(e).
[51] IRC § 2055(a).
[52] The charitable remainder annuity trust rules are the subject of ch. 12.
[53] Tech. Adv. Mem. 8748001.
[54] IRC § 2055(a).
[55] IRC §§ 642(c)(5)(A), 664(d)(1)(C), or 664(d)(2)(C), whichever is applicable.
[56] Reg. § 20.2055-2(e)(2)(v).

§ 19.3 GIFT TAX RULES

The federal tax law allows an unlimited gift tax charitable deduction for gifts to qualifying donees.[57] This deduction is not subject to the percentage limitations applicable to the income tax charitable deduction.[58]

Although a donor may be willing to forgo an income tax charitable deduction in order to benefit a foreign charitable organization, care should be taken to ensure that the donor does not inadvertently make a taxable gift. The rules governing the gift tax charitable deduction are similar to those applicable to the estate tax charitable deduction: A gift tax deduction is not limited to gifts to or for the use of domestic charitable corporations.

§ 19.4 CHARITABLE GIVING BY NONCITIZEN NONRESIDENTS

(a) Estate Tax Rules

When the decedent is a nonresident who is not a citizen of the United States, the federal tax law allows a charitable deduction from the nonresident's U.S. gross estate for transfers to qualifying donees "to or for the use of the United States, any political subdivision thereof, or the District of Columbia" for exclusively public purposes: "charitable, educational, religious and other similar purposes."[59] The deduction is limited to transfers to domestic charitable corporations and transfers to trustees for use in the United States.[60]

Transfers to a foreign government for exclusively charitable purposes do not qualify for the federal estate tax deduction. Transfers to foreign organizations, including foreign governments, exclusively for charitable purposes may be deductible[61] as a transfer to a trustee, provided the funds are restricted to use within the United States.

An individual (a citizen and resident of Ontario, Canada) provided as follows in his will:

> If and when the Michigan College of Mining and Technology, Houghton, Michigan, U.S.A., establishes in Canada to the satisfaction of my Trustees, a charitable foundation corporation or a charitable trust so that monies may be received by it in Canada from my estate and others and the said money spent in Canada without income tax or succession duty levies of any kind, then on that happening, and only then, my Trustees are to pay the remaining twenty-five percent of the net annual income to the said charitable foundation corporation or charitable trust when established.

The bequest was to be used to pay tuition and related expenses of Canadian students at the Michigan college. The court held that the bequest was "to a trustee or trustees . . . to be used within the United States," since the funds were to be expended in the United States.[62] Hence, the decedent's estate was held to be entitled to the claimed deduction for a charitable contribution.[63]

---

[57] IRC § 2522(a). See § 8.2(k)(ii).
[58] See ch. 7.
[59] IRC § 2106(a)(2).
[60] IRC § 2106(a)(2)(A).
[61] IRC § 2106(a)(2)(iii).
[62] *Estate of McAllister v. Commissioner*, 54 T.C. 1407 (1970).
[63] IRC § 2106(a)(2)(A)(iii).

(b) Gift Tax Rules for Nonresident Noncitizens

A gift of real property or tangible personal property situated in the United States, made by a nonresident who is not a citizen, is subject to the federal gift tax.[64] The gift tax charitable deduction provisions that apply to nonresidents who are not citizens parallel the estate tax provisions. A gift tax charitable deduction is allowed for gifts to domestic organizations for charitable purposes and gifts to trustees for charitable purposes within the United States.[65]

[64] IRC § 2522(b).
[65] *Id*.

C H A P T E R T W E N T Y

International Giving by Corporations

§ 20.1 Corporate Gifts to U.S. Charity for Overseas Use **619**

§ 20.2 Gifts of Money from Foreign Affiliate of U.S. Parent to Overseas Charity **620**

§ 20.3 Gift of Goods or Services to Benefit Foreign Charity **621**

§ 20.4 Grants of Funds from U.S. Corporation-Related Foundation to Foreign Charity **622**

(a) Taxable Expenditures 622
(b) Charitable Purpose 623
(c) Expenditure Responsibility 623
(d) Overseas Grantee Categories 625
(e) Grants to Charitable Organizations and Equivalents 626
(f) IRS Simplified Procedure 628
(g) Grants to Other Organizations 629

A dynamic aspect of the global market environment is the extension of corporate philanthropy practiced by American companies doing business abroad. The tax law of the United States imposes certain limitations on overseas charitable giving, depending on the character of the donor and the donee. These constraints are by no means barriers to transborder corporate giving. A U.S. corporation that is planning to conduct philanthropic activities in a foreign country has several methods available for transferring contributions abroad.

§ 20.1 CORPORATE GIFTS TO U.S. CHARITY FOR OVERSEAS USE

A U.S. corporation may deduct up to 10 percent of its pretax net profits[1] for gifts made to U.S. charitable corporations,[2] as charitable contributions,[3] even though the gift may ultimately be used overseas. Certain adjustments to pretax net profits

[1] IRC § 170(b)(2).
[2] That is, corporations that are charitable by reason of IRC § 170(c)(2).
[3] IRC § 170(a)(1).

are required for purposes of this computation.[4] A corporate charitable contribution may be used for overseas purposes if it is made to an organization that is incorporated under American laws and qualified as a charitable entity. In contrast, a gift to an unincorporated trust, chest, fund, or foundation is deductible only if it is to be used within the United States or its possessions.[5] A corporate contribution that is made directly to a tax-exempt organization established under the laws of any foreign country, even if the recipient has charitable status under U.S. law, does not qualify for a charitable deduction.

Because organizations such as the American National Red Cross, the United Way, and the Salvation Army were established and incorporated in the United States, they are frequently used by corporations for facilitating foreign giving objectives. Overseas giving achieved through the mechanism of support of U.S. organizations with charitable status raises no legal or procedural questions not already contemplated in a domestic giving program.

Another category of international agencies that is useful for this purpose are the *private voluntary organizations*, which receive their principal support from the U.S. Agency for International Development. Agencies such as CARE, Save the Children Fund, American Friends Service Committee, Overseas Education Fund, and the Population Council are private voluntary organizations. Typically, these agencies address large problems in developing countries, such as disaster relief and food aid. Because they are qualified as tax-exempt charitable organizations under U.S. law, they are able to receive charitable donations to be applied to their foreign charitable activities.

§ 20.2 GIFTS OF MONEY FROM FOREIGN AFFILIATE OF U.S. PARENT TO OVERSEAS CHARITY

An American corporation can make contributions to foreign charitable (and/or governmental) organizations directly through one or more of its foreign subsidiaries. The company's ability to obtain a tax deduction for the gift depends on the tax laws of the country involved, as well as the company's position with respect to computation of the U.S. foreign tax credit.[6]

In general, corporations may elect to claim a credit against U.S. tax liability for certain foreign taxes they incur. This foreign tax credit is limited to the amount of U.S. tax otherwise payable on foreign-source taxable income. Thus, the foreign tax credit is not available against U.S. tax on U.S.-source taxable income. A shift in the source of net income, from foreign operations to those in the

---

[4] IRC § 170(b)(2)(A)–(D). See §§ 7.18, 7.19.

[5] IRC § 170(c)(2); Rev. Rul. 69-80, 1969-1 C.B. 65. This limitation as to gifts by corporations does not apply in the case of charitable gifts by small business (S) corporations, which are the subject of IRC §§ 1361–1368. Priv. Ltr. Rul. 9703028. The taxable income of an S corporation is generally computed in the same manner as for an individual. IRC § 1363(b)(2). One of the exceptions to this rule is that certain deductions (those referenced in IRC § 703(a)(2)) are not allowed to these corporations; among these deductions is the one for charitable gifts. In determining the tax of a shareholder of an S corporation, each shareholder takes into account the shareholder's pro rata share of the corporation's items of income, loss, deduction, or credit, the separate treatment of which could affect the liability for tax of any shareholder. IRC § 1366(a)(1)(A). These items include charitable contributions. IRC § 702(a)(4). Thus, charitable contributions by S corporations are passed through to the shareholders and are subject to the limitations on deductibility that apply to individuals, not to corporations.

[6] IRC § 27.

United States, may increase net U.S. tax for some corporations by reducing the foreign tax credit limitation and thus the amount of the foreign tax credit that may be claimed.

For purposes of the foreign tax credit limitation, foreign-source taxable income generally is computed by: (1) determining the items of gross income that are from foreign sources, and then (2) subtracting from those items the corporation's deductions that are allocated or apportioned to foreign-source gross income. A shift in the allocation or apportionment of expenses, from U.S.-source to foreign-source gross income, decreases foreign-source taxable income and thus may increase U.S. tax by reducing the foreign tax credit limitation.

In general, the primary statutory rule for allocating and apportioning deductions between foreign and domestic income is that there must be deducted from foreign and domestic source gross income, respectively, the expenses, losses, and other deductions properly apportioned or allocated to them and a ratable part of any expenses, losses, or other deductions that cannot definitively be allocated to some item or class of gross income.[7] In addition, for a corporation that is a member of an affiliated group of corporations, expenses that are not directly allocated or apportioned to any specific income-producing activity generally must be allocated and apportioned under the *one-taxpayer* rule, that is, as if all of the members of the affiliated group were a single corporation.[8]

Charitable contribution deductions generally are treated as not definitely related to any gross income or income-producing activity, and therefore are apportioned ratably and subject to the one-taxpayer rule.[9]

§ 20.3 GIFT OF GOODS OR SERVICES TO BENEFIT FOREIGN CHARITY

A company may choose to support charitable endeavors by making expenditures from its marketing or advertising budgets. In this situation, funds benefiting charitable organizations overseas may be able to flow through the business expense budget category and be deductible as a business expense under U.S. tax law.[10] This law, however, disallows a business expense deduction of any amount that meets the definition of a charitable contribution but cannot be deducted under that section because of the percentage limitations, dollar limitations, or time-of-payment requirements.[11] These expenditures are sponsorship of broadcasts or concerts of performing arts groups, museum exhibits, public service advertising in support of a charitable cause, purchase of tickets to fundraising events, and other activities that directly or indirectly promote sales of a company's products or services through association with cultural or other charitable activities. To qualify for deduction as business expenses, the corporation must be prepared to justify how the expenditures in fact promote the corporation's business interests.

In-kind gifts of company products are also deductible. Examples include pharmaceutical products that are sent to an overseas hospital or computer

---

[7] IRC §§ 861(b), 862(b), 863(b).
[8] IRC § 864(e)(6).
[9] Reg. § 1.861-8(e)(9)(iv); Notice 89-91, 1989-2 C.B. 408.
[10] IRC § 162(a).
[11] Reg. § 1.162-15(b). See § 3(a)(i).

equipment that is given to a school. The amount of the deduction for such gifts is governed by the general rules applicable to gifts for use outside the United States (discussed in this chapter). There are special rules relating to gifts of inventory, by virtue of which the deduction may be as great as twice the cost basis inherent in the donated property.[12] In general, the rules concerning gifts of tangible personal property allow a donor to deduct only the acquisition cost of the property, rather than the current fair market value, if the property is of a type the donor normally sells in its business.[13]

Another method of supporting a charity is to make in-kind gifts of the use of a corporation's facilities or personnel. This type of charitable giving includes occupancy of surplus office space, use of corporate printing or computer facilities, and loan of corporate staff services. As expenses of these facilities and personnel would have been incurred regardless of the donation, the expenses associated with this type of giving are deductible under U.S. law as business expenses. (There is no U.S. charitable deduction for gifts of the use of property[14] or for gifts of services.[15])

§ 20.4 GRANTS OF FUNDS FROM U.S. CORPORATION-RELATED FOUNDATION TO FOREIGN CHARITY

Large American corporations often consider establishing overseas foundations. The present practice, however, is that an American company with an established philanthropic program makes its outbound grants through its U.S. corporate foundation. A corporate foundation is almost always a private foundation under U.S. law.[16] Nothing in the U.S. tax statutes or regulations prohibits overseas grant-making by private foundations.

(a) Taxable Expenditures

Of considerable concern to a private foundation is avoidance of making a taxable expenditure while engaging in grant-making. U.S. law categorizes certain types of expenditures as taxable ones if made by private foundations, and it levies significant penalties for engaging in these practices.[17]

The term *taxable expenditure* means any amount paid or incurred by a private foundation

- as a grant to an organization unless
  - the organization is a public charity or an exempt operating foundation,[18] or

[12] IRC § 170(c)(3). See § 9.3.
[13] See § 4.4.
[14] See § 9.18.
[15] See § 9.14.
[16] See § 3.4.
[17] IRC § 4945. The rules concerning taxable expenditures are the subject of *Private Foundations* ch. 9.
[18] See § 3.4.

- ◦ the private foundation exercises *expenditure responsibility* with respect to the grant,[19] or
- for any purpose other than a charitable purpose.[20]

The penalty for making a taxable expenditure begins at 10 percent of the expenditure against the foundation and 2.5 percent (maximum $5,000) against any foundation manager (such as a trustee or officer) who agreed to the expenditure.[21] If the expenditure is not timely *corrected*,[22] the penalty increases to 100 percent against the foundation and 50 percent (maximum $10,000) against the foundation manager.[23]

To avoid exposure to taxable expenditure liability, a private foundation must make two preliminary determinations with regard to an overseas grant:

1. Whether the grant is for a charitable purpose
2. Whether the private foundation must exercise expenditure responsibility with respect to the grantee organization because it is not a public charity

(b) Charitable Purpose

The United States regulatory scheme surrounding transborder grant-making parallels the rules concerning domestic grant-making. The most basic concept in this regard is that of *charitable purpose*. A grant to a charitable organization will not, in itself, satisfy the requirement. However, a grant that is specifically designated for a charitable purpose, but made to an organization that is not charitable, can qualify.

To qualify as an eligible grantee, an organization must be organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes; to foster amateur sports competition; or for the prevention of cruelty to children or animals.[24] The emphasis is not on the structure of the organization; it is on the charitable purposes served.

Terms such as *charitable*, *educational*, and *scientific purposes* are specifically defined in U.S. tax law.[25]

(c) Expenditure Responsibility

The U.S. tax law requires *expenditure responsibility* of private foundations to ensure that their grants are spent solely for the purpose for which they were made, and that full and complete reports on how the funds were spent are submitted to the grantor by the grantee. This body of law requires private foundations to exercise expenditure responsibility with respect to grants to certain organizations.[26]

---

[19] IRC § 4945(h).
[20] IRC § 4945(d).
[21] IRC § 4945(a).
[22] IRC § 4945(i)(1).
[23] IRC § 4945(b).
[24] IRC § 170(c)(2)(B).
[25] See § 3.3.
[26] IRC § 4945(h); Reg. § 53.4945-5(h).

As noted, foundation grants to public charities need not be the subject of expenditure responsibility. If the prospective grantee is a charitable organization other than a public charity or qualified operating foundation, though, expenditure responsibility must always be exercised.

In making the determination that the prospective grantee organization is publicly supported, a private foundation must obtain documentation of the sources of the prospective grantee's financing. The prospective grantee must also inquire whether the proposed grant would reduce the general public and/or government support below the required level of public support to qualify as a publicly supported charity, thus changing (or *tipping*) the grantee from status as a public charity to a private charity.

If the grantee is a public charity and will remain so even with the proposed grant, the answer to the question as to whether the private foundation will have to exercise expenditure responsibility depends on the nature of the organization under several categories established in U.S. tax law.

Determination of whether expenditure responsibility is required for grants to overseas donees takes the following five forms:

1. When the grant is made to a governmental unit, expenditure responsibility is generally not required.[27]
2. When the IRS has determined that an organization is publicly supported, expenditure responsibility is generally not required.[28]
3. Whether or not the organization has been classified by the IRS as publicly supported or substantiated by its legal counsel as the equivalent of a publicly supported organization, expenditure responsibility is generally not required if two conditions are met:
    a. The organization, according to the reasonable judgment of the foundation manager, establishes that it is the equivalent of a publicly supported organization, and
    b. Supporting data is in the form of an affidavit or legal opinion provided by the donee organization's legal counsel.[29]
4. If the organization is a tax-exempt charitable organization by virtue of an IRS determination, but is not publicly supported, or if legal counsel has submitted an opinion that the organization is an equivalent of a tax-exempt charitable organization but does not qualify as the equivalent of a publicly supported organization, expenditure responsibility must be exercised.
5. Otherwise, expenditure responsibility is mandatory. A further safeguard is required: Grant funds must be segregated into a separate accountable fund.

If the determination is made that expenditure responsibility must be exercised, the foundation must conduct a pregrant inquiry of the potential grantee.

[27] Reg. § 53.4945-5(a)(4)(iii).
[28] IRC § 4945(d)(4)(A).
[29] Reg. § 53.4945-5(a)(5).

This requirement entails a ''limited inquiry . . . complete enough to give a reasonable man assurance that the grantee will use the grant for the proper purposes.''[30] The following data is usually sufficient to satisfy the pregrant inquiry:

- Basic institutional character (such as educational institution and research institution)
- Names and titles of officers and managers
- Tax status of the proposed grantee in its country of origin
- Any previous grant history with the private foundation
- Summary of information reflecting the proposed grantee's accountability
- Private foundation's analysis of the suitability of the proposed grantee for the requested funds

When a foundation is satisfied that the grantee will use the grant for its stated purposes, the actual grant must be accompanied by an agreement to be signed by an officer of the grantee organization, specifically covering limitations on the grant and providing the grantee's assurance of its intended compliance with all conditions.

(d) Overseas Grantee Categories

For both the *charitable purpose* determination and the analysis as to whether expenditure responsibility is necessary, the character of the grantee organization is important. Fundamentally, four categories of grantee organizations may be recipients of grants from U.S. private foundations:

1. Foreign governmental units that do not have the status of tax-exempt charitable entities under U.S. law
2. Foreign organizations that have obtained recognition as tax-exempt charitable organizations under U.S. law
3. Foreign organizations that are recognized as ''equivalent to'' American tax-exempt charitable organizations
4. Foreign organizations that are within none of the above categories.

Governmental units are entities such as agencies and instrumentalities of foreign governments and other international agencies.[31] The terms *foreign government* and *agency of a foreign government* are used throughout U.S. tax law in their generally accepted sense, including a state or local ministry or department, or a bureau or office of a ministry or department. An *instrumentality* of a government unit is slightly more complex. Taken in its generally accepted meaning, an *instrumentality* would be an entity furthering the purposes financed by a government unit, such as a school or university.

To document the classification of an organization as an instrumentality of a government, a foundation manager is advised to obtain the following information:

[30] Reg. § 53.4945-5(b)(2).
[31] Reg. § 53.4945-5(a)(4)(iii).

- A copy of the document by which the organization was created (termed *articles of organization*), describing its purposes.
- A copy of documentation stating that the organization is exempt from taxation. In some cases, this documentation will consist of a certificate from an appropriate ministry. When the organization is exempt from taxation because it belongs to a general class of organizations, a written statement from the taxation authorities acknowledging tax exemption is recommended. In systems where this is unobtainable, a legal opinion describing the nexus between this particular grantee organization and the classification of tax-exempt organizations will be satisfactory.
- Further documentation provided by the organization's legal counsel in affidavit form that details the source(s) of the organization's operating funds[32]

The term *public international organizations*[33] is used to describe international organizations that are composed of governments as members and are designated as international organizations by executive order.[34] Examples of these organizations are the United Nations, the International Chamber of Commerce, the World Bank, and the World Health Organization. Should a private foundation seek to make a grant to an organization composed of governments but not so designated, it is advised to follow the procedure for establishing that the organization is an instrumentality of a government, as summarized above.

An American private foundation should not automatically assume that a governmental unit's use of a proposed grant will be for a charitable purpose. This must be established by documents supporting the grant application.

Grants to governmental units are generally made for the purpose of carrying out educational, charitable, or social programs. The fact that the grant is made to a governmental unit supervising the pursuit of these activities is not necessarily conclusive, and care should be taken to ascertain that the particular grant supports the stated charitable purpose.

U.S. law provides that expenditure responsibility is not required if the grant is made to "a foreign government, or any agency or instrumentality thereof, or an international organization designated as such by [e]xecutive [o]rder . . . , even if it is not" a tax-exempt charitable organization.[35] Nonetheless, this body of law also states that "any grant to an organization referred to in this subparagraph must be made exclusively for charitable purposes."[36]

(e) Grants to Charitable Organizations and Equivalents

The determination letter issued by the IRS, recognizing an organization to be a tax-exempt charitable entity, establishes that the IRS has found the organization to be in pursuit of charitable purposes. This letter reflects the IRS's findings that:

---

[32] Reg. § 53.4945-5(a)(5).
[33] Reg. § 53.4945-5(a)(4)(iii).
[34] 22 U.S.C. § 288.
[35] Reg. § 53.4945-5(a)(4)(iii).
[36] *Id.*

- The organization is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes; to foster national or international amateur sports competition; or for the prevention of cruelty to children or animals
- No part of the net earnings of the organization inures to the benefit of any private shareholder or individual
- No substantial part of the organization's activities is the carrying on of propaganda programs or otherwise attempting to influence legislation
- No part of the organization's activities is participating in or intervening in any political campaign on behalf of or in opposition to any candidate for public office

U.S. law permits foreign organizations to qualify for recognition of tax exemption. The tax exemption provision[37] merely refers to ''an organization described in'' appropriate categories as being tax-exempt, and another provision of law[38] refers specifically to restrictions on foreign organizations that can obtain tax exemption as charitable organizations. U.S. law defines *private foundation* as ''a domestic or *foreign* organization'' that is a charitable entity.[39]

According to the IRS, in excess of 500 foreign organizations, predominantly in the fields of education, agriculture, and health, have sought determination of exempt organization status.

As with domestic charitable organizations, a private foundation may in large part rely on the tax exemption determination of the overseas exempt organization to support the determination that a grant to that organization is for a charitable purpose. This strong presumption is permissible because the recipient organization is itself answerable to the IRS (as is any charitable organization) on the question of whether the funds are used for a charitable purpose.

Typically, however, a foreign organization will not have obtained recognition of tax exemption as a charitable entity from the IRS. Thus, an American private foundation that is a prospective grantor must establish that the potential donee organization is organized and operated in a manner consistent with a tax-exempt charitable organization, thus constituting the equivalent of a tax-exempt charitable organization.

Charitable organization *equivalents* are foreign organizations that have not obtained determination letters from the IRS but that are organized and operated in such a manner that they can quite easily be determined to be equivalent to public charities under U.S. law. A private foundation is well advised, in these circumstances, to develop its own form modeled after the IRS's application for recognition of tax-exempt status (Form 1023), because the foundation itself is assuming the burden of determining with convincing documentary evidence that the prospective grantee meets the essential requirements for public charity status. This includes evidence of the prospective grantee's nonprofit status and charitable purposes, copies of organizational documents, relevant statutory decrees, evidence (if any) of local tax standing, description of the intended uses of the grant,

---

[37] IRC § 501(a).
[38] IRC § 4948.
[39] IRC § 509(a) (emphasis added).

identification of the organization's directors and officers, and certification by an officer as to the correctness of the information (and compliance with the standards listed above). This documentation must be retained by the grant-maker to defend the grant in the case of an audit by the IRS.

According to U.S. law, if a grant is made to an organization that does not have a ruling or determination letter that it is a public charity, the grant will be considered as made to a public charitable organization if the grantor foundation has made a "good faith determination" that the grantee organization is a public charity.[40] The determination is based on an affidavit of the grantee organization or an opinion of either the grantee's counsel or the grantor's counsel that the grantee is a public charitable organization, setting forth sufficient facts concerning the operations and support of the grantee for the IRS to determine that the grantee would be likely to qualify as a public organization.

If an organization has been determined to be organized for charitable purposes and to be a public charity under U.S. law, there will be a strong presumption that grants to it are made for charitable purposes. Thus, a private foundation is allowed to rely on the IRS letter of determination in satisfying this portion of its inquiry. The presumption also follows when the foundation has made a good faith determination that the organization is organized and operated for purposes that render it equivalent to a public charitable organization.

U.S. law requires expenditure responsibility concerning grants made to charitable organizations and their equivalents unless these organizations can be classified as public charities.[41] Several categories of public charitable organizations are embraced by this section, including various educational organizations, hospitals and medical research organizations, churches and associations of churches, organizations that receive sufficiently wide financial support from a governmental unit or from the "public," and organizations that support one of the above types of organizations and meet certain other criteria.[42]

(f) IRS Simplified Procedure

The IRS developed a simplified procedure enabling private foundations in the United States to make grants to foreign charitable organizations, relying solely on an appropriate affidavit.[43] Essentially, this simplification is accomplished by eliminating the need for a lawyer's opinion as to the tax status of the foreign grantee.[44] This procedure is not available when the grant is a transfer of assets pursuant to a liquidation, merger, redemption, recapitalization, or other similar adjustment, organization, or reorganization.

The procedure is engrafted onto the above-described regulations, which set forth ways in which a U.S. private foundation can make a grant to a foreign charitable organization without contravening the qualifying distribution rules

[40] Reg. § 53.4945-5(a)(5).
[41] IRC § 4945(d)(4).
[42] See § 3.4.
[43] Rev. Proc. 92-94, 1992-2 C.B. 507.
[44] See § 20.4(d), text accompanied by *supra* note 31.

or the taxable expenditure limitations.[45] These circumstances relate to foreign charitable organizations that do not have an IRS determination letter recognizing them as charitable organizations but are equivalent to U.S. public charitable organizations or private operating foundations (which is usually the case). Absent these rulings, the management of a private foundation must make a ''reasonable judgment'' that the prospective grantee is a charitable organization and a ''good faith determination'' that the potential recipient is a public charity or operating foundation.[46]

Under this procedure, both this reasonable judgment and good faith determination may be made on the basis of a ''currently qualified'' affidavit prepared by the grantee for the prospective grantor or for another grantor or prospective grantor. This procedure requires that the affidavit be written in English and state the required substantive information. An affidavit is considered current when it reflects the grantee's latest complete accounting year or (in the case of public charitable organizations whose public charity status is not dependent on public support) if the affidavit is updated at the request of the prospective grantor to reflect the grantee's current data.

(g) Grants to Other Organizations

When a private foundation decides to make a grant to an organization that is neither a governmental unit, nor a tax-exempt charitable organization, nor a charitable organization equivalent, the grant must be highly nondiscretionary and clearly identified with a specific charitable purpose. In this situation, the grant supports a purpose, determined to qualify as a charitable purpose. The structure of the organization carrying out this purpose is therefore overlooked.

When public charity status equivalency cannot be established, the private foundation may nonetheless make the grant, but the grant must be clearly identified for a precise charitable purpose. The U.S. tax laws do not provide a procedure for making this type of determination as to a specific charitable purpose. Foundations that have experience in this area have followed a practice of securing from the prospective grantee a project description demonstrating how the grant is to be used for a charitable purpose and/or securing a written commitment that the grantee will use the grant only for its stated purposes.

Whenever a grant is made to a tax-exempt charitable organization or to an organization that is a charitable organization equivalent and is a public charity, the presumption that the grant will be used for charitable purposes is so strong that a foundation is well advised to seek public charity status equivalency for grants to foreign nongovernmental organizations, whenever possible. An additional advantage of establishing this equivalency is that operating or general support grants may be made to these organizations.

Expenditure responsibility must be exercised when a grant is made to this category of donee organization. Further, the grantee organization must agree to segregate the grant funds in a separate account designated for financing a charitable purpose.

[45] See § 20.4(a), (b), text accompanied by *supra* notes 23–25.
[46] See § 20.4(c), (d), text accompanied by *supra* notes 30 and 31.

PART SIX

Administration of Charitable Giving Programs

CHAPTER TWENTY-ONE

Substantiation and Appraisal Requirements

§ 21.1 **Introduction** 633

§ 21.2 **Substantiation Requirements for Gifts of Money** 634

§ 21.3 **Substantiation Requirements for Gifts of $250 or More** 635
- (a) General Rules 635
- (b) Courts' Interpretation of Rules 641

§ 21.4 **Substantiation Requirements for Noncash Gifts** 643

§ 21.5 **Appraisal Requirements** 645
- (a) Qualified Appraisal 646
- (b) Qualified Appraiser 649

§ 21.6 **Appraisals and Penalties** 651
- (a) Taxpayer Penalties 651
- (b) Aiding and Abetting Penalty 652

§ 21.7 **Appraisals of Clothing and Household Items** 653

§ 21.8 **Burden of Proof Rules** 653

A donor to a charitable organization, and the charitable organization that is the donee, must adhere to a battery of rules as a condition of allowance of the otherwise allowable federal income tax charitable contribution deduction. That is, when there is noncompliance with these rules, the donor will not be entitled to the charitable deduction, notwithstanding the fact that all other applicable rules have been followed. In other instances, these rules impose civil penalties as a sanction. These rules—some of which mandate forms of *substantiation*—embrace receipt, recordkeeping, and reporting requirements.

§ 21.1 INTRODUCTION

The federal tax law concerning the income tax charitable contribution deduction recordkeeping and substantiation requirements has been altered frequently over recent years. For some time, the recordkeeping requirements were minimal. This changed dramatically as to contributions made in tax years beginning after December 31, 1993.[1] Thereafter, other significant law changes occurred in 2004

[1] The pre-1994 law concerning the federal income tax charitable contribution deduction recordkeeping requirements is summarized in § 21.1(a) of the third edition of this book.

and 2006, the latter pertaining to contributions made in tax years beginning after August 17, 2006.[2]

For years, most of these requirements were the subject of tax regulations and court decisions. Today, much of this law is codified, in the form of four provisions of the Internal Revenue Code.[3] These rules consist of recordkeeping requirements for all contributions of money,[4] substantiation requirements for gifts of $250 or more,[5] reporting and substantiation requirements pertaining to charitable deductions for noncash charitable contributions,[6] statutory rules requiring qualified appraisals and defining the term qualified appraiser,[7] and rules pertaining to appraisals of contributions of clothing and household items.[8]

§ 21.2 SUBSTANTATION REQUIREMENTS FOR GIFTS OF MONEY

A federal income tax deduction for a charitable contribution in the form of a cash, check, or other monetary gift is not allowed unless the donor substantiates the deduction with a bank record or a written communication from the donee showing the name of the donee, the date of the contribution, and the amount of the contribution.[9]

For this purpose, the term *monetary gift* includes, in addition to gifts of cash or by check, a transfer of a gift card redeemable for cash and a payment made by credit card, electronic fund transfer,[10] an online payment service, or payroll deduction.[11] The term *bank record* includes a statement from a financial institution, an electronic fund transfer receipt, a canceled check, a scanned image of both sides of a canceled check obtained from a bank Web site, or a credit card statement.[12] The term *written communication* includes e-mail correspondence.[13]

The donor must receive this substantiation on or before the earlier of (1) the date the donor files the original income tax return for the tax year in which the contribution was made or (2) the due date, including extensions, for filing the donor's original return for that year.[14]

---

[2] These law changes were occasioned by enactment of the American Jobs Creation Act of 2004, Pub. L. 108-357 (118 Stat. 1418), and the Pension Protection Act of 2006, Pub. L. 109-280 (120 Stat. 780).

[3] IRC §§ 170(f)(8), (11), (16), and (17).

[4] See § 21.2.

[5] See § 21.3.

[6] See § 21.4.

[7] See § 21.5.

[8] See § 21.7.

[9] IRC § 170(f)(17); Prop. Reg. § 1.170A-15(a)(1). This substantiation requirement and the substantiation requirement summarized in § 21.3 may be satisfied by a single document that contains the information required in both instances, as long as the donor obtains the document on a timely basis (see text accompanied by *infra* notes 14 and 35). Prop. Reg. § 1.170A-15(a)(3).

A court held that donors were not entitled to income tax charitable contribution deductions, in part because these substantiation requirements were not followed (*Smith v. Commissioner*, 94 T.C.M. (CCH) 574 (2007)).

[10] See IRC § 5061(e)(2).

[11] Prop. Reg. § 1.170A-15(b)(1).

[12] Prop. Reg. § 1.170A-15(b)(2).

[13] Prop. Reg. § 1.170A-15(b)(3).

[14] Prop. Reg. § 1.170A-1(c).

For this purpose, charitable organizations[15] and Principal Combined Fund Organizations in connection with the Combined Federal Campaign[16] and acting in that capacity are treated as donees, even if the organization (pursuant to the donor's instructions or otherwise) distributes the amount received to one or more charitable organizations.[17]

In the case of a charitable contribution made by payroll deduction, a donor is treated as meeting these substantiation requirements if, no later than the deadline for receipt of the substantiation,[18] the donor obtains (1) a pay stub, Form W-2, or other employer-furnished document that sets forth the amount withheld during the tax year for payment to a donee; and (2) a pledge card or other document prepared by or at the direction of the donee that reflects the name of the donee.[19]

This substantiation requirement is inapplicable to a donor who incurs unreimbursed expenses of less than $250 incident to the rendition of services to a charitable organization.[20]

If a partnership or an S corporation makes a charitable contribution, the partnership or S corporation is treated as the donor for this purpose.[21]

These substantiation requirements do not apply to a transfer of money, check, or other monetary gift to a charitable remainder trust[22] or to a charitable lead trust[23] that is a grantor trust.[24] The requirements are applicable to such a transfer to a pooled income fund.[25]

§ 21.3 SUBSTANTIATION REQUIREMENTS FOR GIFTS OF $250 OR MORE

As to contributions of at least $250, a set of substantiation rules applies. Under these rules, donors who make a separate charitable contribution of $250 or more in a year, for which they claim a charitable contribution deduction, must obtain written substantiation from the donee charitable organization.

(a) General Rules

Specifically, the income tax charitable deduction is not allowed for a *separate contribution* of $250 or more unless the donor has written substantiation from the

[15] That is, organizations described in IRC § 170(c). See § 3.3(a).
[16] See 5 C.F.R. 950.105.
[17] Prop. Reg. § 1.170A-15(d)(1). These regulations will replace interim guidance issued by the IRS in 2008 (Notice 2008-16, 2008-1 C.B. 315).
[18] See text accompanied by *supra* note 14.
[19] Prop. Reg. § 1.170A-15(d)(2). These regulations will replace interim guidance issued by the IRS in 2006 (Notice 2006-110, 2006-2 C.B. 1127). Also IR-2006-186 (Dec. 1, 2006), IR-2006-192 (Dec. 14, 2006).
[20] Prop. Reg. § 1.170A-15(e). These rules are the subject of present-law Reg. §§ 1.170A-1(g), 1.170A-13(f)(10). See §§ 9.15. For substantiation of unreimbursed out-of-pocket expenses of $250 or more, see Reg. § 1.170A-13(f)(10). See text accompanied by *infra* note 47.
[21] Prop. Reg. § 1.170A-15(f).
[22] See ch. 12.
[23] See ch. 16.
[24] See § 3.4.
[25] See ch. 13. Prop. Reg. § 1.170A-15(g).

charitable donee of the contribution in the form of a *contemporaneous written acknowledgment*.[26]

An acknowledgment meets this requirement if it includes the following information: (1) the amount of money and a description (but not value) of any property other than money that was contributed; (2) whether the donee organization provided any goods or services in consideration, in whole or in part, for any money or property contributed; and (3) a description and good faith estimate of the value of any goods or services involved or, if the goods or services consist solely of intangible religious benefits, a statement to that effect. [27]

The phrase *intangible religious benefit* means ''any intangible religious benefit which is provided by an organization organized exclusively for religious purposes and which generally is not sold in a commercial transaction outside the donative context.''[28] An acknowledgment is considered to be *contemporaneous* if the contributor obtains the acknowledgment on or before the earlier of (1) the date on which the donor filed a tax return for the taxable year in which the contribution was made or (2) the due date (including extensions) for filing the return.[29] Even when no good or service is provided to a donor, a statement to that effect must appear in the acknowledgment.

As noted, this substantiation rule applies with respect to *separate payments*. Separate payments generally are treated as separate contributions and are not aggregated for the purpose of applying the $250 threshold. When contributions are paid by withholding from wages, the deduction from each paycheck is treated as a separate payment.[30]

The written acknowledgment of a separate gift is not required to take any particular form. Thus, acknowledgments may be made by letter, postcard, electronic mail,[31] or computer-generated form. A donee charitable organization may prepare a separate acknowledgment for each contribution, or may provide

---

[26] IRC § 170(f)(8)(A); also Reg. § 1.170A-13(f)(1), Prop. Reg. § 170A-15(a)z. The following is an excellent example of the type of practice Congress hoped to eradicate by means of these substantiation rules: A taxpayer had ''canceled checks showing $500 to $1,000 weekly payments to his church. During an audit, an IRS agent checked with the minister to verify that the money had actually been given to the church. Indeed it had, but the minister added a critical piece of information: The taxpayer was a coin collector who bought the change that worshippers dropped in the collection plate each week.'' 48 *Kiplinger's Personal Fin. Mag.* (no. 5) 140 (May 1994).

[27] IRC § 170(f)(8)(B); Reg. § 1.170A-13(f)(2).

[28] IRC § 170(f)(8)(B), last sentence.

[29] IRC § 170(f)(8)(C); Reg. § 1.170A-13(f)(3).

[30] H. Rep. No. 103-213, 103d Cong., 1st Sess. 565, n. 29 (1993). As for credit card rebate plans (the details of which are the subject of § 3.1(h)), in an instance of a lump-sum payment of $250 or more by the sponsoring company to a charitable organization, the cardholder must obtain the requisite substantiation of the gift from the charity for the gift to be deductible. Priv. Ltr. Rul. 9623035. The company thus must supply donee organizations with the amounts of cardholders' contributions, as well as the names and addresses of the cardholders, to enable the charities to provide the required contemporaneous written acknowledgment.

[31] The IRS first announced that charitable organizations can substantiate gifts electronically when it posted the advance text of *Charitable Contributions—Substantiation and Disclosure Requirements* (Publication 1771) on its Web site in March 2002. There, the agency wrote that an organization ''can provide either a paper copy of the acknowledgment to the donor, or an organization can provide the acknowledgment electronically, such as via e-mail addressed to the donor.'' Substantiation of charitable gifts by e-mail message was thereafter referenced in Notice 2002-25, 2002-1 C.B. 743). Given the way the law is evolving, the IRS had no choice but to allow e-mail substantiation. E.g., *Rio Properties, Inc. v. Rio Int'l Interlink*, 284 F.3d 1007 (9th Cir. 2002), holding that a court, in certain circumstances, may order service of process on foreign business entities by e-mail.

donors with periodic (such as annual) acknowledgments that set forth the required information for each contribution of $250 or more made by the donor during the period.[32]

It is the donor's responsibility to obtain the substantiation documentation and maintain it in his or her records. (Again, the charitable contribution deduction depends on compliance with these rules.)

The substantiation rules do not impose on charitable organizations any requirement as to the reporting of gift information to the IRS. Charitable organizations potentially have the option to avoid these rules by filing an information return with the IRS, reporting information sufficient to substantiate the amount of the deductible contribution.[33]

The regulations define a *good faith estimate* as meaning the donee charitable organization's estimate of the fair market value of any goods or services, ''without regard to the manner in which the organization in fact made that estimate.''[34]

These regulations also define the phrase *in consideration for*. A charitable organization is considered as providing goods or services in consideration for a person's payment if, at the time the person makes the payment, the person receives or expects to receive goods or services in exchange for the payment.[35] Goods or services a donee charity provides in consideration for a payment by a person would include goods or services provided in a year other than the year in which the payment is made.[36]

Certain goods or services may be disregarded when applying these substantiation rules:

The IRS first signaled that it would allow substantiation of charitable gifts by e-mail in 2000 (INFO 2000-0070). Subsequently, in a solicitation of public comment concerning application of the federal tax law, governing tax-exempt organizations, to activities they conduct on the Internet (Ann. 2000-84, 2000-42 I.R.B. 385), the agency posed a series of questions, including this: ''Does a donor satisfy the requirement under [IRC §] 170(f)(8) for a written acknowledgment of a contribution of $250 or more with a printed webpage confirmation or copy of a confirmation e-mail from the donee organization?'' As to the latter approach, the answer now is yes.

[32] H. Rep. No. 103-213, 103d Cong., 1st Sess. at 565, n. 32 (1993). A charitable organization that knowingly provides a false written substantiation document to a donor may be subject to the penalty for aiding and abetting an understatement of tax liability. IRC § 6701; see § 10.14.

[33] IRC § 170(f)(8)(D). This approach has not, however, been implemented by regulations and currently is not available. Earlier versions of this requirement would have caused donee charitable organizations to file information returns with the IRS reflecting contributions made to them.

[34] Reg. § 1.170A-13(f)(7). The phrase *goods or services* means money, property, services, benefits, and privileges. Reg. § 1.170A-13(f)(5).

[35] Reg. § 1.170A-13(f)(6).

[36] This rule relates to a subject that torments the fundraising professional: What to do about the situation in which a charitable organization decides, months after contributions have been made, to honor a class of donors by providing them a tangible benefit, such as a thank-you dinner? The event or other benefit may be provided in a subsequent year. Does the fair market value of this benefit have to be subtracted from the amount of the gift for deduction purposes? The answer generally is no. This is affirmed by these regulations, which require that the goods or services be provided ''at the time'' the payment is made, when the donor receives or expects to receive a benefit. In this instance, the donors did not receive or expect to receive a dinner or anything else at the time of their gifts. But suppose a charitable organization develops a regular pattern of providing these after-the-fact benefits. At what point do expectations arise? This is probably not something the regulations can further address; it may have to be left to a facts-and-circumstances analysis. The regulations observe, however, that the benefit can arise in a year other than (usually, subsequent to) the year of the gift.

- Those that have an insubstantial value, in that the fair market value of all the benefits received is not more than 2 percent of the contribution or $50 (indexed for inflation), whichever is less.[37]
- Those that have an insubstantial value, in that the contribution is $25 or more (indexed for inflation) and the only benefits received by the donor in return have an aggregate cost of not more than a low-cost article, which generally is one with a cost not in excess of $5 (indexed for inflation).[38]
- Annual membership benefits offered to an individual for a payment of no more than $75 per year that consist of rights or privileges that the individual can exercise frequently during the membership period.[39] This exception is not available with respect to payments made in exchange for the opportunity for preferred seating at athletic events of educational institutions, for which there are special rules.[40] Examples of these rights and privileges include free or discounted admission to the organization's facilities or events, free or discounted parking, preferred access to goods or services, and discounts on the purchase of goods or services.
- Annual membership benefits offered to an individual for a payment of no more than $75 per year that consist of admission to events during the membership period that are open only to members of the donee organization.[41] For this rule to apply, the organization must reasonably project that the cost per person (excluding any allocable overhead) for each event is within the limits established for low-cost articles.[42] The projected cost to the donee organization is determined at the time the organization first offers its membership package for the year.
- Goods or services provided by a charitable organization to an entity's employees in return for a payment to the organization, to the extent the goods or services provided to each employee are the same as those covered by the previous two exceptions.[43] When one or more of these goods or services are provided to a donor, the contemporaneous written acknowledgment may indicate that no goods or services were provided in exchange for the donor's payment.

These regulations illustrate the rules pertaining to membership benefits, rights, and privileges. An example is offered concerning a charitable organization that operates a performing arts center.[44] In return for a payment of $75, the center offers a package of basic membership benefits, which includes the right to purchase tickets to performances one week before they go on sale to the general public; free parking

[37] Reg. § 1.170A-13(f)(8)(i)(A). See app. E.
[38] Reg. § 1.170A-13(f)(8)(i)(A). See apps. F, G.
[39] Reg. § 1.170A-13(f)(8)(i)(B)(1).
[40] IRC § 170(1); Reg. § 1.170A-13(f)(14).
[41] Reg. § 1.170A-13(f)(8)(i)(B)(2).
[42] IRC § 513(h)(2).
[43] Reg. § 1.170A-13(f)(9)(i). An acknowledgment in a program at a charity-sponsored event identifying a person as a donor to the charity also is an inconsequential benefit with no significant value; ''[s]uch privileges as being associated with or being known as a benefactor of the [charitable] organization are not significant return benefits that have monetary value.'' Rev. Rul. 68-432, 1968-2 C.B. 104.
[44] Reg. § 1.170A-13(f)(8)(ii), Example 1.

in its garage during evening and weekend performances; and a 10 percent discount on merchandise sold in its gift shop. In exchange for a $150 payment, the center offers a package of preferred membership benefits, which includes all of the benefits in the $75 package as well as a poster that is sold in the center's gift shop for $20. The basic membership and the preferred membership are each valid for 12 months and there are approximately 50 performances of various productions at the center during a 12-month period. The gift shop is open for several hours each week and at performance times. An individual is solicited by the center to make a contribution, being offered the preferred membership option. This individual makes a payment of $300. This individual can satisfy the substantiation requirement by obtaining a contemporaneous written acknowledgment from the center that includes a description of the poster and a good faith estimate of its fair market value ($20), and disregards the remaining membership benefits.

Another example[45] concerned a charitable organization that operates a community theater organization that performs four plays every summer; each is performed twice. In return for a membership fee of $60, the organization offers its members free admission to any of its performances. Nonmembers may purchase tickets on a performance-by-performance basis for $15 a ticket. An individual, being solicited by the organization to make a contribution, is advised that the membership benefit will be provided for a payment of $60 or more. This individual chooses to make a payment of $350 to the organization and receives in exchange the membership benefit. This membership benefit does not qualify for the exclusion because it is not a privilege that can be exercised frequently (due to the limited number of performances offered). Therefore, to meet the substantiation requirements, a contemporaneous written acknowledgment of the $350 payment would have to include a description of the free admission benefit and a good faith estimate of its value. (The example does not continue to state that that value is $60 and the charitable deduction thus is $290.)

If a person makes a contribution of $250 or more to a charitable organization and, in return, the charity offers the person's employees goods or services (other than those that may be disregarded), the contemporaneous written acknowledgment of the person's contribution does not have to include a good faith estimate of the value of the goods or services, but must include a description of those goods or services.[46]

An individual who incurred unreimbursed expenditures incident to the rendition of services is treated as having obtained a contemporaneous written acknowledgment of the expenditures if the individual:

- has adequate records to substantiate the amount of the expenditures, and
- timely obtains a statement prepared by the donee charity containing (1) a description of the services provided; (2) a statement as to whether the donee provides any goods or services in consideration, in whole or in part, for the unreimbursed expenditures; and (3) the information summarized in the third and fourth of the items that must be reflected in the written acknowledgment.[47]

[45] *Id.*, Example 3.
[46] Reg. § 1.170A-13(f)(9)(ii).
[47] Reg. § 1.170A-13(f)(10).

The substantiation rules do not apply to a transfer of property to a charitable remainder trust or a charitable lead trust.[48] They do, however, apply with respect to transfers by means of pooled income funds.[49] The reason for this distinction is grounded in the fact that the grantor of a remainder trust or lead trust is not required to designate a specific organization as the charitable beneficiary at the time property is transferred to the trust, so in these instances there is no designated charity available to provide a contemporaneous written acknowledgment to the donor. Also, even when a specific beneficiary is designated, the identification of the charity can be revocable. By contrast, a pooled income fund must be created and maintained by the charitable organization to which the remainder interests are contributed.

If a partnership or S corporation makes a charitable contribution of $250 or more, the partnership or corporation is treated as the taxpayer for gift substantiation purposes.[50] Therefore, the partnership or corporation must substantiate the contribution with a contemporaneous written acknowledgment from the donee charity before reporting the contribution on its information return or income tax return for the appropriate year, and must maintain the contemporaneous written acknowledgment in its records. A partner of a partnership or a shareholder of an S corporation is not required to obtain any additional substantiation for his or her share of the partnership's or S corporation's charitable contribution.

If a person's payment to a charitable organization is matched, in whole or in part, by another payor, and the person received goods or services in consideration for the payment and some or all of the matched payment, the goods or services are treated as provided in consideration for the person's payment and not in consideration for the matching payment.[51]

The required substantiation may be provided by a properly authorized agent of the charitable donee.[52] For example, when the contribution is of a used vehicle, a for-profit fundraising company or other entity licensed to sell vehicles may act as the charitable donee's agent.[53] The IRS approved of an arrangement whereby a charitable organization that engaged in the solicitation, processing, and sale of donated vehicles denominated a for-profit corporation that was in the business of buying, maintaining, dismantling, and selling used vehicles as the charity's agent for the acceptance of contributed vehicles.[54]

---

[48] Reg. § 1.170A-13(f)(13). Charitable remainder trusts are the subject of ch. 12 and charitable lead trusts are the subject of ch. 16.

[49] Prop. Reg. § 1.170A-15(g). Pooled income funds are the subject of ch. 13.

[50] Reg. § 1.170A-13(f)(15), Prop. Reg. § 1.170A-15(f). If a person purchases an annuity from a charitable organization and claims a charitable contribution deduction of $250 or more for the excess of the amount paid over the value of the annuity, the contemporaneous written acknowledgment must state whether any goods or services in addition to the annuity were provided to the person. Reg. § 1.170A-13(f)(16). The contemporaneous written acknowledgment need not include a good faith estimate of the value of the annuity. *Id.*

[51] Reg. § 1.170A-13(f)(17). An idea for simplified compliance by donors and donees with the charitable gift substantiation rules is the subject of discussion in the charitable community. See, e.g., 69 *Tax Notes* 793 (Nov. 6, 1995). The thought advanced is that the contributor has a rubber stamp made, by which the following is printed on the back of the contribution check: "The negotiation of this check constitutes an acknowledgment that the amount thereof was received by the payee as a charitable contribution and that no goods or services were provided in consideration thereof." The Department of the Treasury has yet to address the efficacy of this approach.

[52] See § 10.1(c).

[53] Rev. Rul. 2002-67, 2002-2 C.B. 873.

[54] Priv. Ltr. Rul. 200230005.

The above-referenced rules concerning use of a single document for purposes of substantiation,[55] the deadline for receipt of substantiation,[56] distributing organizations as donees,[57] and contributions made by payroll deduction[58] are also applicable in this context.

To reiterate, these rules apply with respect to the making of *contributions;* the donor's deduction is not available unless there is full compliance with the rules. By making the requisite acknowledgment, the charitable organization involved is acquiescing in or concurring with the donor's position that the payment is in fact a contribution. There may, however, be an issue as to whether the payment is a gift.[59] A charitable organization that certifies in this fashion that a payment is a gift, when the transaction is not in law a gift, may be subject to one or more tax penalties, such as for participating in an understatement of income tax or promotion of a tax shelter.[60]

(b) Courts' Interpretation of Rules

The U.S. Tax Court ruled that payments made to a charitable organization were not deductible as charitable gifts, because the substantiation requirements were not met, in that there was an undisclosed return benefit.[61] The amounts received by the charity were used to acquire a charitable split-dollar life insurance policy. The court held that there was a reasonable expectation that the charity would purchase the policy, which included a death benefit to one of the donors. The deduction was denied because this expectation was not disclosed and made the subject of a good faith estimate in the substantiation documents.

This case concerned a married couple (H and W) who claimed charitable contribution deductions for their payments of money (in 1997 and 1998) to the National Heritage Foundation (NHF), which NHF used to pay premiums on a life insurance policy for the life of W. The policy was a charitable split-dollar life insurance contract.[62] Under this contract, NHF was entitled to receive 56 percent of the death benefit and the couple's family trust was entitled to receive 44 percent of the benefit. Eleven years before the first of these payments, the couple formed a family trust. They are the trustors, first designee trustees, and initial beneficiaries of this trust. Their children and W's parents or siblings become beneficiaries of the trust on the death of the couple.

In October 1997, H and W established a ''foundation'' (a donor-advised fund) within NHF. On the same day, H wrote to NHF stating that the family trust intended to purchase an insurance policy on the life of W and would grant NHF an option to acquire an interest in that policy. The policy was issued. The couple owned the policy through the trust. H, as trustee of the trust, and NHF entered into a death benefit option agreement relating to the policy. H agreed to pay

[55] See *supra* note 9.
[56] See text accompanied by *supra* note 14.
[57] See text accompanied by *supra* notes 15–17.
[58] See text accompanied by *supra* notes 18, 19.
[59] See §§ 3.1, 9.15, 9.16(a).
[60] See § 10.14.
[61] *Addis v. Commissioner*, 118 T.C. 528 (2002), *aff'd*, 374 F.3d 881 (9th Cir. 2004), *cert. den.*, 543 U.S. 1151 (2005).
[62] See § 17.6.

$4,000 of the $40,000 annual premium on the life insurance policy. H and NHF agreed that if NHF paid $36,000 of the annual premium, NHF would be entitled to its share of the death benefit. The agreement provided that the family trust and NHF each own a separate interest in this life insurance policy.

Later in 1997, H and W sent money ($36,000) to NHF for deposit into their foundation. An accompanying letter from H stated that NHF was not required to use the payment to pay the premium on the life insurance policy, but that H ''expected'' NHF to use the payment to pay the premium. The next day, the couple paid their $4,000 of the premium. NHF credited $36,000 to the foundation account. It simultaneously debited the foundation account $36,000 to pay NHF's portion of the life insurance policy premium. Also on the same day, NHF paid its $36,000 portion of the premium to the insurance company. The same series of transactions occurred the next year. As to both years, NHF provided the couple with a document stating that NHF had not provided any goods or services to the donors in return for the contribution.

The couple stopped making payments to NHF after 1998. The statute that was designed to shut down these programs[63] took effect for transfers after February 8, 1999. The IRS disallowed the charitable contribution deductions claimed by the couple for the transfers to NHF in 1997 and 1998.

The couple argued, of course, that NHF was not required, and did not promise, to use the contributions to pay the premiums on the insurance policy on the life of W. The court held, however, that NHF ''provided consideration'' for the payments because, at the time the payments were made to NHF, the couple ''expected'' to receive a share of the death benefit under the policy.[64] Also, they ''expected'' NHF to use the funds they provided to pay NHF's portion of the premiums on the policy in 1997 and 1998.[65] This ''expectation'' on the part of the couple was deemed ''reasonable'' by the court because it was in NHF's financial interest to pay premiums on the couple's life insurance policy in return for a guaranteed death benefit.[66]

NHF did not state in its substantiation documents that it had paid premiums for the insurance policy on the life of W under which the couple would receive a portion of the death benefit. Also, NHF failed to make a good faith estimate of the value of these benefits. This arrangement was characterized by the court as a ''scheme,'' including a ''pot sweetened by charitable contribution deductions.''[67] The court held that the charitable contribution deduction was not available to this couple because the substantiation provided by the charitable donee was deficient.[68]

---

[63] See § 17.6(c).

[64] *Addis v. Commissioner*, 118 T.C. 528, 536 (2002), *aff'd*, 374 F.3d 881 (9th Cir. 2004), *cert. den*., 543 U.S. 1151 (2005). Also *Weiner v. Commissioner*, 83 T.C.M. (CCH) 1874 (2002), aff'd, 2004-1 U.S.T.C ¶ 50,130 (9th Cir. 2004), *cert. den*., 543 U.S. 1151 (2005); *Roark v. Commissioner*, 88 T.C.M. (CCH) 517 (2004).

[65] *Id*. 118 T.C. at 536.

[66] *Id*. 118 T.C. at 535.

[67] *Id*. 118 T.C. at 536.

[68] In this opinion, the Tax Court equated a donor's *expectation* with the statutory requirement of a *good or service*. See § 21.1(b)(ii), text accompanied by note 32. Donors make charitable contributions with expectations all the time, such as in the case of gifts to donor-advised funds. Charities must be ever so cautious in preparing the substantiation documents, because now—if this interpretation of the law by the Tax Court holds—charities not only must value any goods and services they provided in consideration for a gift, they must also peer into the misty reaches of donor motivation and intent to discern what a donor *expects to be provided*, and value that.

§ 21.4 SUBSTANTIATION REQUIREMENTS FOR NONCASH GIFTS

In the case of a noncash charitable gift of less than $250 by an individual, partnership, S corporation, or C corporation that is a personal service corporation or closely held corporation, there is no income tax charitable deduction unless the donor maintains for each contribution a receipt from the charitable donee showing these elements: (1) the name and address of the donee, (2) the date of the contribution, (3) a description of the property in sufficient detail, and, (4) if the gift is of securities, the name of the issuer, the type of security, and whether the securities are publicly traded. [69]

If, however, it is impractical to obtain a receipt from the donee (such as when a donor deposits canned food at a charity's unattended drop site), the donor may satisfy the recordkeeping rules by maintaining reliable written records for the contributed property. The reliability of a written record is to be determined on the basis of all of the facts and circumstances of a particular case, including the contemporaneous nature of the writing evidencing the gift. Nonetheless, a *reliable written record* must include the above five elements, the fair market value of the property on the contribution date, the method used to determine the value, and, in the case of a contribution of clothing or a household item (see below), the condition of the item.[70]

An income tax charitable contribution deduction is not allowed for a noncash charitable contribution of $250 or more, but not more than $500, unless the donor substantiates the gift with a contemporaneous written acknowledgment.[71] This deduction is not allowed for a noncash charitable contribution of more than $500, but less than $5,000, unless the donor substantiates the contribution with a contemporaneous written acknowledgment and meets the Form 8283, Section A, completion and filing requirements.[72] This latter rule is applicable to individuals, partnerships, S corporations, and C corporations that are personal service corporations or closely held corporations.[73]

A completed Form 8283, Section A, includes the donor's name and taxpayer identification number, the name and address of the donee, the date of the contribution, and certain information about the contributed property. That information consists of: (1) a description of the property in sufficient detail; (2) a statement as to the condition of the property; (3) in the case of securities, the name of the issuer, the type of security, and whether the securities are publicly traded; (4) the fair market value of the property on the contribution date; and (5) the method used in determining the property's value. This schedule also is to include information about the manner in which the property was acquired by the donor and the approximate date of acquisition (or substantial completion) of the property, the donor's basis in the property, and, in the case of tangible personal property, whether the donee has certified it for a use that is related to the donee's exempt purpose.[74]

---

[69] Prop. Reg. § 1.170A-16(a)(1).
[70] Prop. Reg. § 1.170A-16(a)(2).
[71] Prop. Reg. § 1.170A-16(b).
[72] IRC § 170(f)(ii)(A), (B) Prop. Reg. § 1.170A-16(c)(1).
[73] Prop. Reg. § 1.170A-16(c)(2).
[74] Prop. Reg. § 1.170A-16(c)(3). See § 4.6.

In the case of a contribution of a vehicle, the donor must attach a copy of the acknowledgment to the Schedule A for the return on which the deduction is claimed.[75]

Generally, there is no federal income tax charitable contribution deduction for a noncash charitable gift of more than $5,000 unless the donor substantiates the contribution with a contemporaneous written acknowledgment,[76] obtains a qualified appraisal[77] prepared by a qualified appraiser,[78] and completes and files Form 8283, Section B.[79] Nonetheless, a qualified appraisal is not required, and a completed Form 8283, Section A, substitutes for a completed Form 8283, Section B, for contributions of publicly traded securities, intellectual property, vehicles, and inventory.[80]

A completed Form 8283, Schedule B, includes the donor's name and taxpayer identification number; the donee's name, address, taxpayer identification number, and signature; the date signed by the donee and the date the donee received the property; the appraiser's name, address, taxpayer identification number, an appraiser declaration, signature, and the date signed by the appraiser; the fair market value of the contributed property, a description of the property and its condition; the manner of acquisition and the approximate date of acquisition (or substantial completion) of the property by the donor; the donor's basis in the property; and a statement explaining whether the charitable contribution was made by means of a bargain sale[81] and, if so, the amount of consideration received by the donor for the transfer.[82]

Generally, a federal income tax charitable contribution deduction is not allowed for a noncash charitable contribution of more than $500,000 unless the donor substantiates the contribution with a contemporaneous written acknowledgment,[83] obtains a qualified appraisal prepared by a qualified appraiser,[84] completes and files Section B of the Form 8283,[85] and attaches a copy of the qualified appraisal of the property to the return on which the deduction is claimed.[86] Again, a qualified appraisal is not required, and a completed Form 8283, Section A, substitutes for a completed Form 8283, Section B, for contributions of publicly traded securities, intellectual property, vehicles, and inventory.[87]

These rules as to substantiation documents that must be submitted with a tax return also apply to a return reflecting a carryover of the deduction.[88]

In general, for each item of contributed property for which a Form 8283 is required,[89] a donor must attach a separate Form 8283 to the return on which the

[75] Prop. Reg. § 1.170A-16(c)(4). See § 9.25.
[76] See § 21.3(a).
[77] See § 21.5(a).
[78] See § 21.5(b).
[79] IRC § 170(f)(ii)(c); Prop. Reg. § 1.170A-16(d)(1).
[80] Prop. Reg. § 1.170A-16(d)(2). See §§ 4.3, 9.26, 9.25, and 9.3, respectively.
[81] See § 9.19.
[82] Prop. Reg. § 1.170A-16(d)(3).
[83] See § 21.3(a).
[84] See § 21.5.
[85] See *supra* note 79.
[86] IRC § 170 (f)(ii) (D); Prop. Reg. § 1.170A-16(e)(1).
[87] Prop. Reg. § 1.170A-16(e)(2).
[88] Prop. Reg. § 1.170A-16(f)(3). See ch. 7.
[89] See Prop. Reg. § 1.170A-16(c), (d), and (e).

deduction for the item is claimed. A donor may, however, attach a single Form 8283 for all similar items of property[90] contributed to the same donee during the donor's tax year if the donor includes on the Form 8283 certain required information[91] for each item of property.[92]

If the donor is a partnership or S corporation, the donor must provide a copy of the completed Form 8283 to every partner or shareholder who receives an allocation of a federal income tax charitable contribution deduction for the gift of the property described in the form.[93] A partner of a partnership or shareholder of an S corporation who receives an allocation of this charitable deduction for a contribution of property for which the form is required[94] must attach a copy of the partnership's or S corporation's completed Form 1023 to the return on which the deduction is claimed.[95]

The proposed regulations set forth rules for determining whether the amount of a donor's charitable deduction exceeds the $500, $5,000, or $500,000 thresholds. A donor must aggregate the amount claimed as a charitable deduction for all similar items of property contributed during a tax year.[96] In determining the amount of a donor's contribution of inventory[97] or scientific property,[98] the donor must take into account only the excess of the amount claimed as a deduction over the amount that would have been treated as the cost of goods sold if the donor had sold the contributed property to the donee.[99]

If a donor fails to meet these substantiation requirements, the donor's charitable deduction will be disallowed unless the donor establishes that the failure was due to reasonable cause and not to willful neglect. The donor may establish that the failure was due to reasonable cause and not willful neglect only if the donor submits with the return a detailed explanation as to why the failure to meet the requirements was due to reasonable cause and not willful neglect, obtained a contemporaneous written acknowledgment of the gift, and (if required) obtained a qualified appraisal by a qualified appraiser.[100]

§ 21.5 APPRAISAL REQUIREMENTS

As referenced in the summary of the federal tax law concerning the substantiation requirements for deductible charitable gifts of property other than money,[101] where the value of the property is in excess of $5,000, the donor is required to

---

[90] See § 21.5(a), text accompanied by *infra* note 125.
[91] See text accompanied by *supra* notes 82 and 87.
[92] Prop. Reg. § 1.170A-16(f)(2).
[93] Prop. Reg. § 1.170A-16(f)(4)(i).
[94] See *supra* note 73.
[95] Prop. Reg. § 1.170A-16(f)(4)(ii).
[96] Prop. Reg. § 1.170A-16(f)(5)(ii).
[97] See § 9.3.
[98] See § 9.4.
[99] Prop. Reg. § 1.170A-16(f)(5)(iii)(A).
[100] Prop. Reg. § 1.170A-16(f)(6).
[101] See § 21.4. In the case of contributions of property for which a deduction of more than $5,000 is claimed, donors are required to obtain a qualified appraisal of the property (IRC § 170(f)(11)(C)). In the case of contributions of property for which a deduction of more than $500,000 is claimed, donors must attach a qualified appraisal of the property to the tax return on which the deduction is claimed (IRC § 170(f)(11)(D)). IRC § 170 (f)(11) was added by passage of the American Jobs Creation Act of 2004 (§ 883), Pub. L. 108-357 (118 Stat. 1418).

obtain an appraisal of the property. Congress introduced this appraisal requirement in 1984, when it directed the IRS to promulgate regulations requiring that, in order to claim an income tax charitable contribution deduction in connection with property of this value, a donor must obtain a qualified appraisal of the gift property, attach an appraisal summary to the tax return involved, and include in the return certain additional information.

In 2004, statutory reporting and substantiation requirements relating to deductions for noncash charitable contributions were enacted.[102] Statutory definitions of the terms *qualified appraisal* and *qualified appraiser*, also added to the federal tax law in 2004,[103] were amended in 2006.[104] For appraisals prepared with respect to returns filed on or before August 17, 2006, preexisting regulations provided definitions of these two terms.[105] For appraisals prepared with respect to returns filed after August 17, 2006, the statutory definitions that were revised in 2006 apply.[106]

(a) Qualified Appraisal

A *qualified appraisal* is a document that constitutes an appraisal of property that is treated as a qualified appraisal pursuant to tax regulations and is conducted (prepared) by a qualified appraiser in accordance with generally accepted appraisal standards and applicable tax regulations.[107] The phrase *generally accepted appraisal standards* means the substance and principles of the Uniform Standards of Professional Appraisal Practice, as developed by the Appraisal Standards Board of the Appraisal Foundation.[108]

A qualified appraisal must consist of certain information about the contributed property. This information must include a description of the property in sufficient detail under the circumstances (taking into account the value of the property) for an individual who is not generally familiar with the type of property to ascertain that the appraised property is the contributed property, the condition of the property (in the case of real or tangible personal property), the valuation effective date, and the fair market value[109] of the contributed property on the valuation effective date.[110] The *valuation effective date* is the date to which the value opinion applies.[111]

The qualified appraisal must also state the terms of any agreement or understanding by or on behalf of the donor and donee that relates to the use, sale, or

[102] *Id.*
[103] IRC § 170(f)(11)(E).
[104] Pension Protection Act of 2006 (§ 1219), Pub. L. 109-280 (120 Stat. 780).
[105] Reg. § 1.170A-13(c). This body of law is summarized in § 21.2 of the third edition of this book. An illustration of denial of a charitable contribution deduction because these appraisal requirements were not followed is in *Smith v. Commissioner*, 94 T.C.M. (CCH) 574 (2007).
[106] These rules are the subject of Prop. Reg. § 1.170A-17. These regulations will replace interim guidance issued by the IRS in 2006 (Notice 2006-96, 2006-2 C.B. 902).
[107] IRC § 170(f)(11)(E)(i); Prop. Reg. § 1.170A-17(a)(1). Again (see *supra* note 77), this term is used in the context of Prop. Reg. § 1.170A-16(d)(1)(ii) (see text accompanied by *supra* note 79) and Prop. Reg. § 1.170A-16(e)(1)(ii) (see text accompanied by *supra* note 86).
[108] Prop. Reg. § 1.170A-17(a)(2).
[109] That is, the value as defined in Reg. § 1.170A-1(c)(2). See § 10.1(a).
[110] Prop. Reg. § 1.170A-17(a)(3)(i).
[111] Prop. Reg. § 1.170A-17(a)(5)(i).

other disposition of the contributed property, such as a temporary or permanent restriction on the donee's right to use or dispose of the contributed property, a reservation as to right to the income from the property (other than in connection with the donee or an organization participating with the donee in cooperative fundraising) or to possession of the property (including the right to vote contributed securities, to acquire the property by purchase or otherwise, or to designate the person having income or possession rights or a right to acquire), or an earmarking of the property for a particular use.[112] The appraisal must indicate the date (or expected date) of the contribution.[113]

The qualified appraisal must further state certain information about the qualified appraiser, namely, (1) the appraiser's name, address, and taxpayer identification number; (2) the appraiser's qualifications to value the type of property being valued, including the appraiser's education and experience; and (3) if the appraiser is acting in his or her capacity as a partner in a partnership, an employee of any person (whether an individual, corporation, or partnership), or an independent contractor engaged by a person other than the donor, the name, address, and taxpayer identification number of the partnership or the person who employs or engages the appraiser.[114]

In addition, the appraisal must reflect the signature of the appraiser and the date the appraiser signed it (the appraisal report date).[115] It must contain the requisite declaration by the appraiser.[116] The appraisal must include a statement that it was prepared for income tax purposes.[117] It must state the method of valuation used to determine the fair market value, such as the income approach, the market-data approach, or the replacement-cost-less-depreciation approach.[118] The appraisal must state the specific basis for the valuation, such as specific comparable sales transactions or statistical sampling, including a justification for using sampling and an explanation of the sampling procedure employed.[119]

A qualified appraisal must be signed and dated by the qualified appraiser no earlier than 60 days before the date of the contribution and no later than (1) the due date (including extensions) of the return on which the deduction for the contribution is first claimed; (2) in the case of a donor that is a partnership or S corporation, the due date (including extensions) of the return on which the deduction for the contribution is first reported; or (3) in the case of a deduction first claimed on an amended return, the date on which the amended return is filed.[120]

---

[112] Prop. Reg. § 1.170A-17(a)(3)(ii).
[113] Prop. Reg. § 1.170A-17(a)(3)(iii).
[114] Prop. Reg. § 1.170A-17(a)(3)(iv).
[115] Prop. Reg. § 1.170A-17(a)(3)(v).
[116] Prop. Reg. § 1.170A-17(a)(3)(vi). This declaration reads as follows: "I understand that my appraisal will be used in connection with a return or claim for refund. I also understand that, if a substantial or gross valuation misstatement of the value of the property claimed on the return or claim for refund results from my appraisal, I may be subject to a penalty under section 6695A of the Internal Revenue Code [see § 21.6(b)], as well as other applicable penalties. I affirm that I have not been barred from presenting evidence or testimony before the Department of the Treasury or the Internal Revenue Service pursuant to 31 U.S.C. section 330(c)."
[117] Prop. Reg. § 1.170A-17(a)(3)(vii).
[118] Prop. Reg. § 1.170A-17(a)(3)(viii).
[119] Prop. Reg. § 1.170A-17(a)(3)(ix).
[120] Prop. Reg. § 1.170A-17(a)(4).

For an appraisal report dated before the date of the contribution,[121] the valuation effective date must be no earlier than 60 days before the date of the contribution and no later than the date of the contribution. For an appraisal report dated on or after the date of the contribution, the valuation effective date must be the date of the contribution.[122]

An appraisal is not a qualified appraisal for a particular contribution, even if all of these requirements are satisfied, if a reasonable person would conclude that the donor failed to disclose or misrepresented facts that would cause the appraiser to overstate the value of the contributed property.[123]

A donor must obtain a separate qualified appraisal for each item of property for which an appraisal is required and that is not included in a group of similar items of property.[124] The phrase *similar items of property* means property of the same generic category or type, including stamp collections, coin collections, lithographs, paintings, photographs, books, non-publicly traded stock, other non-publicly traded securities, land, buildings, clothing, jewelry, furniture, electronic equipment, household appliances, toys, everyday kitchenware, china, crystal, or silver.[125] Only one qualified appraisal is required for a group of similar items of property contributed in the same tax year, as long as the appraisal includes all the required information for each item.[126] The appraiser may select any items the aggregate value of which is appraised at $100 or less, for which a group description (rather than a specific description of each item) is adequate.[127]

The fee for a qualified appraisal cannot be based, to any extent, on the appraised value of the property. For example, a fee for an appraisal is treated as based on the appraised value of the property if any part of the fee is dependent on the amount of the appraised value that is allowed by the IRS after an examination.[128] If the contributed property is a partial interest,[129] the appraisal must be of the partial interest.[130] The donor must retain the qualified appraisal ''for so long as it may be relevant in the administration of any internal revenue law.''[131]

If an appraisal is disregarded,[132] it has no probative effect as to the value of the appraised property and does not satisfy the appraisal requirements, unless the appraisal and the Form 8283 include the appraiser's signature, the date signed by the appraiser, and the requisite appraiser declaration,[133] and the donor did not have knowledge that the signature, date, or declaration was false when the appraisal and the Form 8283 were signed by the appraiser.[134]

---

[121] See text accompanied by *supra* note 115.
[122] Prop. Reg. § 1.170A-17(a)(5)(ii).
[123] Prop. Reg. § 1.170A-17(a)(6).
[124] Prop. Reg. § 1.170A-17(a)(7).
[125] Reg. § 1.170A-13(c)(7)(iii).
[126] Reg. § 1.170A-13(c)(3)(iv)(A).
[127] *Id*.
[128] Prop. Reg. § 1.170A-17(a)(8).
[129] See § 9.23.
[130] Prop. Reg. § 1.170A-17(a)(11).
[131] Prop. Reg. § 1.170A-17(a)(9).
[132] 31 U.S.C. § 330(c).
[133] See text accompanied by *supra* notes 82, 86, and 116.
[134] Prop. Reg. § 1.170A-17(a)(10).

(b) Qualified Appraiser

The term *qualified appraiser* means an individual who has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements, regularly performs appraisals for compensation, and meets other requirements as may be prescribed by the IRS.[135]

For these purposes,[136] a qualified appraiser is an individual with verifiable education and experience in valuing the type of property for which the appraisal is performed.[137] An individual is treated as having the requisite education and experience if, as of the date the individual signs the appraisal document, he or she has (1) successfully completed (such as by receiving a passing grade on a final examination) professional or college-level coursework in valuing the relevant type of property and has two or more years of experience in valuing the relevant type of property or (2) earned a recognized appraisal designation for the relevant type of property.[138]

This coursework must be obtained from a professional or college-level educational institution,[139] a generally recognized professional appraisal organization that regularly offers educational programs in the principles of valuation, or an employer as part of an employee apprenticeship or educational program substantially similar to the preceding two types of educational programs.[140] A *recognized appraisal designation* is a designation awarded by a recognized professional appraiser organization on the basis of demonstrated competency.[141]

EXAMPLE 21.1

An appraiser who has earned a designation similar to the Member of the Appraisal Institute, Senior Residential Appraiser, Senior Real Estate Appraiser, or Senior Real Property Appraiser membership designation has earned a recognized appraisal designation.[a]

[a] Prop. Reg. § 1.170A-17(b)(2)(iii). The IRS stated that it does not consider any particular organization's ''recognized appraisal designations to be superior to, or preferred over, those of any other organization,'' observing that this example merely illustrates the types of designations that would satisfy the education-and-experience requirement and was not intended to ''indicate any preference for designations offered by a particular organization.'' INFO-2009-0016.

The *relevant type of property* means the category of property customary in the appraisal field for an appraiser to value.[142]

[135] IRC § 170(f)(11)(E)(ii).
[136] See text accompanied by *supra* notes 102 and 114.
[137] IRC § 170(f)(11)(E)(iii)(I); Prop. Reg. § 1.170A-17(b)(1). These regulations will replace interim guidance issued by the IRS in 2006 (Notice 2006-96, 2006-2 C.B. 902).
[138] Prop. Reg. § 1.170A-17(b)(2)(i).
[139] See § 3.4(a), text accompanied by notes 360–364.
[140] Prop. Reg. § 1.170A-17(b)(2)(ii).
[141] Prop. Reg. § 1.170A-17(b)(2)(iii).
[142] Prop. Reg. § 1.170A-17(b)(3)(i).

EXAMPLE 21.2

There are few professional-level courses offered in the process of appraising widgets. It is customary in the appraisal field for personal property appraisers to appraise the value of widgets. Appraiser A has successfully completed professional-level coursework in valuing personal property generally but has not completed any coursework in valuing widgets. The coursework completed by A is for the relevant type of property.[a]

[a] Prop. Reg. § 1.170A-17(b)(3)(ii), Example (1).

EXAMPLE 21.3

It is customary for professional antique appraisers to appraise antique widgets. Appraiser B has two years of experience in valuing antiques generally and is asked to appraise an antique widget. B has obtained experience in valuing the relevant type of property.[a]

[a] Prop. Reg. § 1.170A-17(b)(3)(ii), Example (2).

EXAMPLE 21.4

It is not customary for professional antique appraisers to appraise new widgets. Appraiser C has experience in appraising antiques generally but does not have any experience in appraising new widgets. C is asked to appraise a new widget. C does not have experience in valuing the relevant type of property.[a]

[a] Prop. Reg. § 1.170A-17(b)(3)(ii), Example (3).

Education and experience in valuing the relevant type of property are *verifiable* if the appraiser specifies in the appraisal the appraiser's education and experience in valuing the relevant type of property, and the appraiser makes a declaration in the appraisal that, because of the appraiser's education and experience, the appraiser is qualified to make appraisals of the relevant type of property being valued.[143]

The following individuals cannot be qualified appraisers for the appraised property: (1) an individual who receives a prohibited fee;[144] (2) the donor of the property; (3) a party to the transaction in which the donor acquired the property (such as the individual who sold, exchanged, or gave the property to the donor, or an individual who acted as an agent for the transaction or for the donor for the sale, exchange, or gift), unless the property is contributed within two months of the date of acquisition and its appraised value is not in excess of the acquisition price; (4) the donee of the property; (5) an individual who is (a) related[145] to or an employee of any of the foregoing three categories of individuals or married to an individual who is related to any of the foregoing individuals or (b) an independent contractor who is regularly used as an appraiser by any of the foregoing three categories of individuals and who does not perform a majority of his or her appraisals for others during the tax year; and (6) an individual who is prohibited from practicing before the IRS at any time during the three-year period ending on the date the appraisal is signed by the individual. [146]

[143] Prop. Reg. § 1.170A-17(b)(4).
[144] See text accompanied by *supra* note 128.
[145] See IRC § 267(b).
[146] Prop. Reg. § 1.170A-17(b)(5).

The practice of representation of persons before the U.S. Department of the Treasury is regulated.[147] Following notice and hearing, an individual may be suspended or disbarred from practice before the Treasury Department, including the IRS, if the individual is incompetent, disreputable, has violated the rules regulating practice before the Department, or (with intent to defraud) willfully and knowingly misled or threatened the person being represented (or a person who may be represented).

The Secretary of the Department also has been authorized to bar from appearing before the Department, including the IRS, for the purpose of offering opinion evidence on the value of property, any individual against whom a civil penalty for aiding and abetting the understatement of tax has been assessed. As to appraisals prepared with respect to returns or submissions filed after August 17, 2006, however, an appraiser may be disciplined after notice and hearing (that is, there is no requirement that the civil penalty for aiding and abetting an understatement of tax be first assessed). Disciplinary action may include suspending or barring an appraiser from preparing or presenting appraisals on the value of property to the Department, including the IRS; appearing before the Department for the purpose of offering opinion evidence on the value of property; and providing that the appraisals of an appraiser who has been disciplined have no probative effect in any proceeding before the Department, including the IRS.

§ 21.6 APPRAISALS AND PENALTIES

(a) Taxpayer Penalties

Accuracy-related penalties are imposed on taxpayers in cases involving a substantial valuation misstatement or gross valuation misstatement relating to an underpayment of income tax.[148] For this purpose, a *substantial valuation misstatement* generally has meant a value claimed that is at least twice (200 percent or more) the amount determined to be the correct value; a *gross valuation misstatement* generally means a value claimed that is at least four times (400 percent or more) the amount determined to be the correct value. As to returns filed after August 17, 2006,[149] however, a substantial valuation misstatement exists when the claimed value of any property is 150 percent or more of the amount claimed to be the correct value; a gross valuation misstatement occurs when the claimed value of any property is 200 percent or more of the amount determined to be the correct value.[150]

The penalty is 20 percent of the underpayment of tax resulting from a substantial valuation misstatement; it increases to 40 percent for a gross valuation

[147] 31 U.S.C. § 330.

[148] IRC § 6662(b)(3), (h).

[149] In the case of a contribution of a qualified real property interest that is a restriction with respect to the exterior of a building described in IRC § 170(h)(4)(C)(ii) (see § 9.7), however, and an appraisal with respect to the contribution, this law change is effective with respect to returns filed after July 25, 2006 (Pension Protection Act of 2006 § 1219(e)(3)). This exception also applies with respect to the effective date stated in *infra* notes 152 and 153.

[150] IRC § 6662(e)(1)(A), (h)(2)(A)(i), (ii).

misstatement. A penalty is not imposed unless the portion of the underpayment attributable to the valuation misstatement exceeds $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). A penalty is not imposed with respect to any portion of the understatement attributable to any item if (1) the treatment of the item on the return is or was supported by substantial authority or (2) the facts relevant to the tax treatment of the item were adequately disclosed on the return or in a statement attached to the return and there is a reasonable basis for the tax treatment.[151]

An accuracy-related penalty is also imposed on substantial or gross estate or gift tax valuation understatements. In general, the rule has been that there is a substantial estate or gift tax understatement if the value of an item of property claimed on a return is 50 percent or less of the amount determined to be the correct amount, and a gross estate or gift tax understatement if the value is 25 percent or less of the amount determined to be the correct amount. As to returns filed after August 17, 2006, however, the 50 percent threshold is 65 percent[152] and the 25 percent threshold is 40 percent.[153]

The accuracy-related penalties do not apply if a taxpayer shows there was reasonable cause for an underpayment and the taxpayer acted in good faith.[154] As to returns filed after August 17, 2006, however, the reasonable cause exception to the accuracy-related penalty does not apply in a case of a gross valuation misstatement.

(b) Aiding and Abetting Penalty

A penalty is imposed on a person who (1) aids or assists in or advises with respect to a tax return or other document, (2) knows (or has reason to believe) that the document will be used in connection with a material tax matter, and (3) knows that this would result in an understatement of the tax owed by another person. In general, the amount of this penalty is $1,000. If the document relates to the tax return of a corporation, the amount of the penalty is $10,000.[155]

A civil penalty has been established, as to appraisals prepared with respect to returns or submissions filed after August 17, 2006, on any person who prepares an appraisal that is to be used to support a tax position if the appraisal results in a substantial or gross valuation misstatement.[156] This penalty is equal to the greater of $1,000 or 10 percent of the understatement of tax resulting from a substantial or gross valuation misstatement, up to a maximum of 125 percent of the gross income derived from the appraisal.[157] This penalty is inapplicable if the appraiser establishes that it was ''more likely than not'' that the appraisal was correct.[158]

---

[151] See § 10.14.
[152] IRC § 6662(g)(1).
[153] IRC § 6662(h)(2)(C).
[154] IRC § 6662(c)(2).
[155] See § 10.14.
[156] IRC § 6695A(a).
[157] IRC § 6695A(b).
[158] IRC § 6695A(c).

§ 21.7 APPRAISALS OF CLOTHING AND HOUSEHOLD ITEMS

Generally, a federal income tax charitable contribution deduction is not allowed for a contribution of clothing or a household item unless the property is in good used condition or better at the time of the contribution[159] and the noncash substantiation requirements[160] are satisfied.[161]

The rule requiring that this type of property be in good used condition or better is inapplicable to a contribution of a single item of clothing or a household item for which a charitable deduction of more than $500 is claimed, if the donor submits with the tax return on which the deduction is claimed a copy of a qualified appraisal[162] of the property prepared by a qualified appraiser,[163] accompanied by a completed Form 8283, Section B.[164]

§ 21.8 BURDEN OF PROOF RULES

As a general proposition, a taxpayer has the burden of proving the amount or value of a charitable contribution that he, she, or it wants to be able to deduct.[165] Thus, for example, a charitable contribution deduction for a gift of computer equipment and related lease rights to a school was denied because the donors failed to offer any evidence of the transactions or the value of the contributed items.[166] A claimed charitable contribution deduction may be denied when the ostensible donor cannot provide adequate proof of the gifts.[167] In some instances, a court, convinced that a charitable gift occurred, will estimate the amount or value involved.[168]

As part of this responsibility, it is incumbent upon donors to prove that the donee organizations are in fact charitable in nature. Thus, as an illustration, amounts contributed to an entity were held not deductible as charitable contributions because the donors did not prove that the entity qualified as a charitable organization.[169]

---

[159] See § 9.25.
[160] See § 21.4
[161] Prop. Reg. § 1.170A-18(a).
[162] See § 21.5(a).
[163] See § 21.5(b).
[164] Prop. Reg. § 1.170A-18(b).
[165] E.g., *Guest v. Commissioner*, 77 T.C. 9 (1981); *Lamphere v. Commissioner*, 70 T.C. 391 (1978). This principle of law is a subset of the larger point that all tax deductions are a matter of legislative grace and that the claimant bears the burden of proving entitlement to any of them. *Welch v. Helvering*, 290 U.S. 111 (1933). See also *Dorris v. Commissioner*, 76 T.C.M. (CCH) 423 (1998).
[166] *Brown v. Commissioner*, 72 T.C.M. (CCH) 139 (1995); *Daniel v. Commissioner*, 74 T.C.M. (CCH) 151 (1997); *Short v. Commissioner*, 73 T.C.M. (CCH) 2937 (1997); *Roman v. Commissioner*, 73 T.C.M. (CCH) 2375 (1997).
[167] *Aldea v. Commissioner*, 79 T.C.M. (CCH) 1917 (2001); *Jennings v. Commissioner*, 80 T.C.M. (CCH) 783 (2000), *aff'd in unpublished opinion* (6th Cir. 2001).
[168] This is an application of the *Cohan* rule: *Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930). As an example, an individual contributed clothing to a school and claimed a charitable deduction of $1,000; the IRS determined that the deduction should be $353; the court allowed a deduction for $500. *Cavalaris v. Commissioner*, 72 T.C.M. (CCH) 46 (1996).
[169] *Zeidler v. Commissioner*, 71 T.C.M. (CCH) 2603 (1996). Also *Taylor v. Commissioner*, 79 T.C.M. (CCH) 1364 (2000).

CHAPTER TWENTY-TWO

Disclosure Requirements

§ 22.1 **Disclosure by Charitable Organizations in General** 655

§ 22.2 ***Quid Pro Quo* Contribution Rules** 659

§ 22.3 **Disclosure by Noncharitable Organizations** 663

There is a substantial body of federal tax law that imposes on charitable and certain other tax-exempt organizations the obligation to make various disclosures to donors in the context of giving to these organizations. This area of the law differentiates between charitable and noncharitable tax-exempt organizations.

§ 22.1 DISCLOSURE BY CHARITABLE ORGANIZATIONS IN GENERAL

A tax-exempt charitable organization was not, until 1994, required by statute to state explicitly, in its solicitations for support from the public, whether an amount paid to it was deductible as a charitable contribution, or whether all or part of the payment constituted consideration for goods or services furnished by the organization to the payor.[1]

It has long been the view of the IRS, however, that if any payment or portion of a payment to a charitable organization is not deductible as a charitable gift, the recipient charitable organization should so notify the payor.[2] That is, it has generally been the IRS's position that it is the responsibility of charitable organizations to inform their patrons of the distinction between deductible and nondeductible payments. The latter includes true dues, payments for admissions or merchandise, and other material benefits and privileges received in return for the payment. The IRS expected charities, before solicitation, to determine the nondeductible portion of a payment and to clearly state the separate payments on a ticket or other evidence of payment furnished to a contributor.[3] Also, the federal individual income tax return (Form 1040, Schedule A) and the accompanying instructions inform individuals that, if they made a contribution and received a

[1] See § 22.2.

[2] Rev. Rul. 67-246, 1967-2 C.B. 104.

[3] See § 3.1.

benefit in return, the value of that benefit must be subtracted in calculating any charitable contribution deduction.

This matter of adequate disclosure of the extent of deductibility of *quid pro quo* contributions has been a festering and growing problem from the IRS standpoint. Despite an explicit ruling posture on the subject since 1967,[4] many charitable organizations, either willfully or in ignorance of the IRS's position, did not adhere to the agency's requirements in this regard. In this sense, these rules were, on occasion, honored in their breach. The problem became so severe that in 1988 the Commissioner of Internal Revenue, in an unusual development, sent a written message to the nation's charities, saying: ''I . . . ask your help in more accurately informing taxpayers as to the deductibility of payments by patrons of your fund-raising events.''[5] The message announced a Special Emphasis Program, by which the IRS sought to ''ascertain the extent to which taxpayers are furnished accurate and sufficient information concerning the deductibility of their contributions.''[6]

The commissioner's message focused on fundraising events for which part or all of a payment to a charitable organization is attributable to the purchase of admission or some other privilege. In this context, the law (at least as interpreted by the IRS) presumes that the total amount paid is equivalent to the benefits received in return. Of course, this presumption can be rebutted in appropriate instances, when there is a true gift element in the payment.

In general, this matter has three manifestations. One is the fundraising event where something of value is provided to the patron, such as dinner or entertainment. The IRS expects the charitable organization to determine the fair market value of the event and to notify the patron that only the amount of the payment in excess of that value is deductible as a charitable gift. For example, a fundraising event may center around a dinner; the ticket is $75 and the dinner is worth $50. The IRS expects the charity to tell the patron that only $25 of the $75 is deductible as a charitable gift. (The portion that reflects a purchase rather than a gift may be deductible as an ordinary and necessary business expense.[7])

In determining fair value, a charitable organization must look to comparable circumstances. The cost to the charity is not relevant. Thus, a charity may have the dinner provided to it without cost (such as by a donation from a caterer), yet the dinner still has a value to the recipient.

Another manifestation of this problem occurs when a donor donates and receives something of value in return, such as a package of greeting cards.[8] The IRS position in this connection is the same as receipt of a benefit or a privilege: The IRS expects the donor to claim as a charitable deduction only the amount in excess of value received and expects the charity to provide the donor with that value.[9]

---

[4] See text accompanied by *supra* note 2.

[5] IRS Publication 1391 (1988).

[6] *Id*. This Special Emphasis Program is discussed in § 23.1(b).

[7] IRC § 162(a).

[8] E.g., *Veterans of Foreign Wars, Dep't of Mich. v. Commissioner*, 89 T.C. 7 (1987); *Veterans of Foreign Wars, Dep't of Mo., Inc. v. United States*, 85-2 U.S.T.C. ¶ 9605 (W.D. Mo. 1984).

[9] There is a statutory exception to this rule. When an individual makes a payment to or for the benefit of a college or university, which would be deductible as a charitable contribution but for the fact that the individual receives the right to purchase seating at an athletic event in the institution's athletic stadium, 80 percent of the payment may be treated as a charitable contribution. IRC § 170(l).

The third aspect of this is the payment to a charitable organization that is not deductible at all. Obvious examples of this include payments of tuition to schools and payment for health care services to hospitals. Other types of these payments are dues, subscriptions, purchases made at auctions, and purchases of raffle and sweepstakes tickets.

The IRS conceded that there are no sanctions for violation of its disclosure rules.[10] There was, however, discussion of application of the aiding and abetting (and other) penalties,[11] and of potential litigation in this area. There also was discussion of the use of the unrelated income rules in this setting,[12] as well as of theories by which an organization's tax exemption could be revoked for failure to comport with these rules.

In 1988, the IRS also began reviewing tax returns filed by individuals, looking for situations in which a charitable contribution deduction was being claimed when in fact only a portion or perhaps none of the payment was deductible as a gift.

Congress adopted legislation in 1988 requiring disclosure of nondeductibility in the case of contributions to tax-exempt organizations that are not charitable ones.[13] The report of the Committee on the Budget of the House of Representatives accompanying this legislation contained a discussion of the problem from the standpoint of Congress, with the observation that the committee is "concerned that some charitable organizations may not make sufficient disclosure, in soliciting donations, membership dues, payments for admission or merchandise, or other support, of the extent (if any) to which the payors may be entitled to charitable deductions for such payments."[14]

This discussion focused on "memberships" in a charitable entity, such as a museum or library, for which the "members" receive benefits of some monetary value (such as free admission to events for which others are charged, merchandise discounts, and free subscriptions). The committee cautioned that some or all of these membership payments are not deductible as charitable contributions. The committee's discussion also referenced payments to a charity that are not deductible at all as charitable gifts, such as sales of raffle tickets and the auctioning of property or services. Concerning the amount paid as a winning bid at a charity's auction, however, the analysis stated that the portion of the amount in excess of the fair market value of the item or service received may be deductible as a charitable gift. The discussion noted that some charities wrongfully imply that all such payments are fully deductible, while "many other charities carefully and correctly advise their supporters of the longstanding tax rules governing the deductibility of payments made to a charitable organization in return for, or with the expectation of, a financial or economic benefit to the payor."[15]

---

[10] Priv. Ltr. Rul. 8832003.
[11] See § 10.14.
[12] See § 3.5. The use of the unrelated income rules in the context of fundraising regulation is the subject of Hopkins, *The Law of Fundraising*, 4th ed. (Hoboken, NJ: John Wiley & Sons, 2009) (hereinafter *Fundraising*), § 5.7.
[13] See § 22.3.
[14] H.R. Rep. No. 100-391, 100th Cong., 1st Sess. 1607 (1988).
[15] *Id*. at 1607–08.

The committee wrote that it ''anticipates'' that the IRS ''will monitor the extent to which taxpayers are being furnished accurate and sufficient information by charitable organizations as to the nondeductibility of payments to such organizations where benefits or privileges are received in return, so that such taxpayers can correctly compute their Federal income tax liability.''[16] Moreover, the committee expected the charitable community to do its part, noting its anticipation that groups representing the community will ''further educate their members as to the applicable tax rules and provide guidance as to how charities can provide appropriate information to their supporters in this regard.''[17]

The IRS's seriousness and intensity on this subject was revealed when, at the final meeting of the IRS Exempt Organization Advisory Group, on January 10, 1989, then-Commissioner of Internal Revenue Lawrence B. Gibbs opened the session with the charge that charities and their fundraisers are engaged in ''questionable'' and ''egregious'' fundraising practices, notably suggestions that certain payments are deductible charitable gifts when in fact they are not. Then-Assistant Commissioner for Employee Plans and Exempt Organizations Robert I. Brauer made clear that the IRS feels that these abuses are not isolated, but are ''widespread practices that involve quite legitimate charities.'' Mr. Gibbs stated that charities must ''clean up their act in this regard'' or face stiff regulation from the IRS.[18]

In 1990, the IRS issued guidelines to enable charitable organizations to properly advise their patrons as to the deductibility, if any, of payments made to them when the patrons receive something in return for their payments.[19] These guidelines were issued as part of a program at the IRS to require charitable organizations to disclose to donors and other payors the extent to which payments are deductible when a benefit or service is provided by the payor. These guidelines are also being used by IRS agents.

One of the many problems facing charitable organizations because of the disclosure requirement is what to do about small items or other benefits that are of token value in relation to the amount contributed. These guidelines contain rules whereby a benefit can be regarded as inconsequential or insubstantial, so that the full amount of a payment to a charity becomes deductible as a charitable gift.

Under these guidelines, benefits received in connection with a payment to a charitable organization will be considered to have insubstantial fair market value (so that the payment is fully deductible as a gift), for purposes of advising donors, whenever the following two requirements are met:

- The payment occurs in the context of a fundraising campaign in which the charity informs patrons as to how much of their payment is a deductible contribution, and
- Either of the following is the case:

[16] *Id*. at 1608.
[17] *Id*.
[18] *The Nonprofit Counsel* 7 (no. 2) (1989).
[19] Rev. Proc. 90-12, 1990-1 C.B. 471.

- The fair market value of all of the benefits received in connection with the payment is not more than the lesser of 2 percent of the payment or $50 (indexed for inflation[20]), or
- The payment is $25 (indexed for inflation[21]) or more and the only benefits received in connection with the payment are token items bearing the organization's name or logo.

For these purposes, *token items* include items such as bookmarks, calendars, keychains, mugs, posters, and T-shirts. Also, the costs of all of the benefits received by a donor must, in the aggregate, be within the statutory limits established for low-cost articles. That term generally describes an article with a cost not in excess of $5 (indexed for inflation)[22] that is distributed incidental to a charitable solicitation.[23]

With respect to the first of these two requirements, when a charitable organization provides only insubstantial benefits in return for a payment, disclosure of the fair market value of the benefits is not required. Fundraising materials should include a statement to this effect:

> Under Internal Revenue Service guidelines, the estimated value of [the benefits received] is not substantial; therefore, the full amount of your payment is a deductible contribution.

If it is impractical to state in every solicitation how much of a payment is deductible, the charitable organization can, under these guidelines, seek a ruling from the IRS concerning an alternative procedure. This circumstance can arise, for example, in connection with the offering of a number of premiums in an on-air fundraising announcement by an educational organization.

Resolving what was a difficult problem for many organizations, these guidelines state that newsletters or program guides (other than commercial-quality publications) are treated as not having measurable value or cost if their primary purpose is to inform members about the activities of an organization and if they are not available to nonmembers by paid subscription or through newsstand sales.

The charitable community was unable to achieve a level of compliance with the general IRS disclosure guidelines that satisfied the IRS and Congress. Two important items of legislation were the consequence.[24]

§ 22.2 *QUID PRO QUO* CONTRIBUTION RULES

The federal tax law imposes certain disclosure requirements on charitable organizations that receive *quid pro quo* contributions. A *quid pro quo contribution* is a payment "made partly as a contribution and partly in consideration for goods or services provided to the payor by the donee organization."[25] The term does not include a payment made to an organization, operated exclusively for religious

[20] See app. E.
[21] See app. F.
[22] See app. G.
[23] IRC § 513(h)(2).
[24] See §§ 21.3 and 22.2.
[25] IRC § 6115(b).

purposes, in return for which the donor receives solely an intangible religious benefit that generally is not sold in a commercial transaction outside the donative context.[26] Specifically, if a charitable organization (other than a state, a possession of the United States, a political subdivision of a state or possession, the United States, and the District of Columbia[27]) receives a *quid pro quo* contribution in excess of $75, the organization must, in connection with the solicitation or receipt of the contribution, provide a written statement that: (1) informs the donor that the amount of the contribution that is deductible for federal income tax purposes is limited to the excess of the amount of any money and the value of any property other than money contributed by the donor over the value of the goods or services provided by the organization; and (2) provides the donor with a good faith estimate of the value of the goods or services.[28]

It is intended that this disclosure be made in a manner that is reasonably likely to come to the donor's attention. Therefore, immersing the disclosure in fine print in a larger document is inadequate.[29]

EXAMPLE 22.1

Y, a charitable organization, received a $100 "contribution" from a donor, in exchange for which the donor received a dinner valued at $40. Y must inform the donor in writing that only $60 is deductible as a charitable contribution. (It is the fair market value of the good or service that triggers this rule: it is not the cost of the item to the charity. Thus, in this example, if a caterer provided the dinner at no charge to the charity, the charitable deduction would still be $60.)

For purposes of the $75 threshold, separate payments made at different times of the year with respect to separate fundraising events generally will not be aggregated.

These rules do not apply when only de minimis, token goods or services (such as keychains and bumper stickers) are provided to the donor. In defining these terms, prior IRS pronouncements are followed.[30] Also, these rules do not apply to transactions that do not have a donative element (such as the charging of tuition by a school, the charging of health care fees by a hospital, or the sale of items by a museum).[31]

---

[26] *Id.* See § 21.3, text accompanied by note 28.

[27] IRC §§ 6115(a), 170(c)(1).

[28] IRC § 6115(a). For contributions that have a value of $75 or less, the body of law described in § 22.1 continues to apply.

The IRS signalled that it may support revision of these rules to allow provision of this statement by electronic mail. INFO 2000-0070. Subsequently, in a solicitation of public comment concerning application of the federal tax law governing tax-exempt organizations to activities they conduct on the Internet (Ann. 2000-84, 2000-2 C.B. 385), the IRS posed a series of questions, including this one: "Does an organization meet the requirements of [IRC] 6115 for 'quid pro quo' contributions with a webpage confirmation that may be printed out by the contributor or by sending a confirmation email to the donor?"

[29] H. Rep. No. 103-213, 103d Cong., 1st Sess. 566, n. 35 (1993).

[30] See § 22.1, text accompanied by *supra* notes 19–23.

[31] H. Rep. No. 103-213, 103d Cong., 1st Sess. 566 (1993). The IRS issued temporary regulations (T.D. 8544) and proposed regulations (IA-74-93) to accompany these rules. A hearing on them was held on November 10, 1995, at which time witnesses from the charitable sector expressed dismay at the prospect of having to value benefits, particularly intangible ones, provided in exchange for charitable contributions. A summary of this hearing is at 2 *Fund-Raising Reg. Rep.* (no. 1) 1 (Jan./Feb. 1995). There is little in the final regulations to assuage their concerns.

A nearly identical disclosure provision was part of the Revenue Act of 1992, which was vetoed. The report of the Senate Finance Committee, which accompanied the proposal, contained the following explanation of the need for these rules:

> Difficult problems of tax administration arise with respect to fundraising techniques in which an organization that is eligible to receive deductible contributions provides goods or services in consideration for payments from donors. Organizations that engage in such fundraising practices often do not inform their donors that all or a portion of the amount paid by the donor may not be deductible as a charitable contribution. Consequently, the [Senate Finance] [C] ommittee believes . . . [it] is appropriate that, in all cases where a charity receives a quid pro quo contribution . . . the charity should inform the donor that the [federal income tax charitable contribution] deduction . . . is limited to the amount by which the payment exceeds the value of goods or services furnished, and provide a good faith estimate of the value of such goods or services.[32]

There is a penalty for violation of these requirements.[33]

A charitable organization is able to use ''any reasonable methodology in making a good faith estimate, provided it applies the methodology in good faith.''[34] A good faith estimate of the value of goods or services that are not generally available in a commercial transaction may, under these regulations, be determined by reference to the fair market value of similar or comparable goods or services. Goods or services may be similar or comparable even though they do not have the ''unique qualities of the goods or services that are being valued.''[35]

An example concerns a charitable organization that operates a museum.[36] In return for a payment of $50,000 or more, the museum allows a donor to hold a private event in one of its rooms; in the room is a display of a unique collection of art. No other private events are permitted to be held in the museum. In the community, there are four hotels with ballrooms having the same capacity as the room in the museum. Two of these hotels have ballrooms that offer amenities and atmosphere that are similar to the amenities and atmosphere of the room in the museum; none of them have any art collections. Because the capacity, amenities, and atmosphere of the ballrooms in these two hotels are comparable to the capacity, amenities, and atmosphere of the room in the museum, a good faith estimate of the benefits received from the museum may be determined by reference to the cost of renting either of the two hotel ballrooms. The cost of renting one of these ballrooms is $2,500. Thus, a good faith estimate of the fair market value of the right to host a private event in the room in the museum is $2,500. Here, the ballrooms in the two hotels are considered similar and comparable facilities in relation to the museum's room for valuation purposes, notwithstanding the fact that the room in the museum displays a unique collection of art.

---

[32] *Technical Explanation of the Finance Committee Amendment* (hereinafter *Technical Explanation*), at 586. The *Technical Explanation* was not formally printed; it is, however, reproduced in the Congressional Record. 138 Cong. Rec. (no. 112) S11246 (Aug. 3, 1992).

[33] IRC § 6714; see § 10.14. This requirement is separate from the substantiality rules. See § 21.3. An organization may be able to meet both sets of requirements with the same written document. An organization in this position should, however, be careful to satisfy the *quid pro quo* contribution rules in a timely manner because of this penalty.

[34] Reg. § 1.6115-1(a)(1).

[35] Reg. § 1.6115-1(a)(2).

[36] Reg. § 1.6115-1(a)(3), Example 1.

In another example, a charitable organization offers to provide a one-hour tennis lesson with a tennis professional in return for the first payment of $500 or more it receives.[37] The professional provides tennis lessons on a commercial basis at the rate of $100 per hour. An individual pays the charity $500 and in return receives the tennis lesson. A good faith estimate of the fair market value of the tennis lesson provided in exchange for the payment is $100.

In this context, the regulations somewhat address the matter of the involvement of celebrities. This is another of the problems plaguing the fundraising community, as was articulated so well at an IRS hearing in November 1994.[38] This subject is not addressed by a separate regulation but rather by an example.[39] A charity holds a promotion in which it states that, in return for the first payment of $1,000 or more it receives, it will provide a dinner for two followed by an evening tour of a museum conducted by an artist whose most recent works are on display there. The artist does not provide tours of the museum on a commercial basis. Typically, tours of the museum are free to the public. An individual pays $1,000 to the charity and in exchange receives a dinner valued at $100 and the museum tour. Because the tours are typically free to the public, a good faith estimate of the value of the tour conducted by the artist is $0. The fact that the tour is conducted by the artist rather than one of the museum's regular tour guides does not render the tours dissimilar or incomparable for valuation purposes.[40]

Five types of goods or services are disregarded for purposes of the *quid pro quo* contribution rules.[41] A comparable rule as to goods or services provided to employees of donors is applicable in this context.[42]

No part of this type of a payment can be considered a deductible charitable gift unless two elements exist: (1) the patron makes a payment in an amount that is in fact in excess of the fair market value of the goods or services received, and (2) the patron intends to make a payment in an amount that exceeds that fair market value.[43] This requirement of the element of *intent* may prove to be relatively harmless, as the patron is likely to know the charity's good faith estimate figure in advance of the payment and thus cannot help but have this intent. Still, proving intent is not always easy. This development is unfortunate, inasmuch as the law has been evolving to a more mechanical test (and thus is less reliant on subjective proof): any payment to a charitable organization in excess of fair market value is regarded as a charitable gift.[44]

---

[37] Reg. § 1.6115-1(a)(3), Example 2.

[38] See *supra* note 31.

[39] Reg. § 1.6115-1(a)(3), Example 3.

[40] This rule as to celebrity presence is more important for what it does not say than for what it actually says. Basically, the regulation states that if the celebrity does something different from what he or she is known for (for example, a painter conducting a tour), the fact that he or she is part of the event can be ignored for valuation purposes. The regulation suggests, however, that if the celebrity does what he or she is celebrated for (for example, a singer or a comedian who performs as such), the value of that performance—being a service available on a commercial basis—should be taken into account in valuing the event.

[41] See § 21.3, text accompanied by notes 37–43.

[42] *Id*., text accompanied by note 43.

[43] Reg. § 1.170A-1(h)(1).

[44] See § 3.2(b). A payment made to a charitable organization in excess of the fair market value of an item is not necessarily the consequence of donative intent. In the case of an auction, for example, the patron (successful bidder) may just intensely want the item, or be motivated by peer pressure or extensive access to an open bar; charity may be the farthest thing from the patron's mind.

These part-sale, part-gift transactions are sometimes also referred to as transactions having a dual character. This rationale may be rejected, however, in favor of the view that the transaction is an integrated transaction. As an example of this, a group of physicians transferred their practices to a charitable medical foundation; they claimed charitable contribution deductions for the value of the intangible assets associated with these medical practices. These transfers took place because, in the managed care era, the physicians wanted to cease practicing as a small group and wanted affiliation with a large health care organization. Following protracted and sometimes acrimonious negotiations, they transferred their practices to the foundation, which operated group medical practices that were integrated with affiliated hospitals in an integrated delivery system. The foundation, which paid for the tangible assets, was unwilling to pay anything for the intangible assets (goodwill). A court concluded that the transfer of the intangible assets was part of an integrated transaction, in which the physicians were provided future employment.[45] The court rejected the dual character rationale for the transaction, writing that the intangible assets "functioned as leverage in the negotiations and that their transfer to [the foundation] resulted in an increase in the total consideration [that the physicians] received in the transaction."[46]

§ 22.3 DISCLOSURE BY NONCHARITABLE ORGANIZATIONS

Certain contribution disclosure rules are part of the federal tax law.[47] These rules are *not* applicable to charitable organizations.

These disclosure rules *are* applicable to all types of tax-exempt organizations (other than charitable ones), and are targeted principally at social welfare organizations.[48] They are designed to prevent these noncharitable organizations from engaging in gift-solicitation activities under circumstances in which donors will assume, or be led to assume, that the contributions are tax deductible, when in fact they are not. These rules do not, however, apply to an organization that has annual gross receipts that are normally no more than $100,000.[49] Also, when all of

---

[45] *Derby v. Commissioner*, 95 T.C.M. (CCH) 1177 (2008).

[46] Id. at 1189. In general, Faber, "Final Regulations Issued on Quid Pro Quo Contributions and Substantiation Requirements," 8 *J. Tax. Exempt Orgs*. (no. 5) 195 (Mar./April 1997).

[47] IRC § 6113. The IRS published rules to accompany this law in 1988. IRS Notice 88-120, 1988-2 C.B. 459.

[48] That is, organizations that are exempt under IRC § 501(a) by reason of being described in IRC § 501(c)(4). See *Tax-Exempt Organizations* ch. 13.

[49] IRC § 6113(b)(2)(A). In determining this threshold, the same principles that obtain in ascertaining the annual information return (Form 990) $25,000 filing threshold apply. Rev. Proc. 82-23, 1982-1 C.B. 687. This $25,000 filing threshold is discussed in *Tax-Exempt Organizations* § 27.2(b)(ii). In general, these rules utilize a three-year average. The organization must include the required disclosure statement on all solicitations made more than 30 days after reaching $300,000 in gross receipts for the three-year period of the calculation. IRS Notice 88-120, 1988-2 C.B. 459.

A local, regional, or state chapter of an organization with gross receipts under $100,000 must include the disclosure statement in its solicitations if at least 25 percent of the money solicited will go to the national, or other, unit of the organization that has annual gross receipts over $100,000, because the solicitation is considered as being in part on behalf of that unit. Also, if a trade association or labor union with more than $100,000 in annual gross receipts, the solicits funds that will pass through to a political action committee with less than $100,000 in annual gross receipts, the solicitation must include the required disclosure statement. (These three types of tax-exempt organizations are the subject of Tax-Exempt Organizations chs. 14, 16, and 17, respectively.)

the parties being solicited are tax-exempt organizations, the solicitation does not have to include the disclosure statement (inasmuch as these grantors have no need of a charitable deduction).[50]

This law applies in general to any organization to which contributions are not deductible as charitable gifts and which

- is tax-exempt,[51]
- is a political organization,[52]
- was either type of organization at any time during the five-year period ending on the date of the solicitation, or
- is a successor to one of these organizations at any time during this five-year period.[53]

The IRS is accorded the authority to treat any group of two or more organizations as one organization for these purposes when ''necessary or appropriate'' to prevent the avoidance of these rules through the use of multiple organizations.[54]

Under these rules, each fundraising solicitation by or on behalf of a tax-exempt noncharitable organization must contain an express statement, in a ''conspicuous and easily recognizable format,'' that gifts to it are not deductible as charitable contributions for federal income tax purposes.[55] (The IRS has promulgated rules as to this statement; these rules are summarized below.) A *fundraising solicitation* is any solicitation of gifts made in written or printed form, by television, radio, or telephone (although there is an exclusion for letters or calls not part of a coordinated fundraising campaign soliciting more than 10 persons during a calendar year).[56] Despite the clear reference in the statute to ''contributions and gifts,'' the IRS interprets this rule to mandate the disclosure when any tax-exempt organization (other than a charitable one) seeks funds, such as dues from members.

Failure to satisfy this disclosure requirement can result in imposition of penalties.[57] The penalty is $1,000 per day (maximum of $10,000 per year), albeit with a reasonable-cause exception. In an instance of ''intentional disregard'' of these rules, however, the penalty for the day on which the offense occurred is the greater of $1,000 or 50 percent of the aggregate cost of the solicitations that took place on that day, and the $10,000 limitation is inapplicable. For these purposes, the days involved are those on which the solicitation was telecast, broadcast, mailed, otherwise distributed, or telephoned.

[50] IRS Notice 88-120, 1988-2 C.B. 459.

[51] That is, is described in IRC § 501(a) and IRC § 501(c) (other than, as noted, charitable organizations described in IRC § 501(c)(3)).

[52] That is, is described in IRC § 527.

[53] IRC § 6113(b)(1). For this purpose, a fraternal organization (one described in IRC § 170(c)(4) and discussed in § 3.2) is treated as a charitable organization only with respect to solicitations for contributions that are to be used exclusively for purposes referred to in IRC § 170(c)(4). IRC § 6113(b)(3).

[54] IRC § 6113(b)(2)(B).

[55] IRC § 6113(a).

[56] IRC § 6113(c). As part of a series of questions posed by the IRS as to Internet use by tax-exempt organizations (see § 22.2, *supra* note 28), the IRS asked: ''Are solicitations for contributions made on the Internet (either on an organization's website or by email) in 'written or printed form' for purposes of [IRC §] 6113? If so, what facts and circumstances are relevant in determining whether a disclosure is in a 'conspicuous and easily recognizable format'?''

[57] IRC § 6710.

The IRS promulgated rules in amplification of this law, particularly the requirement of a disclosure statement.[58] These rules, which include guidance in the form of ''safe-harbor'' provisions, address the format of the disclosure statement in instances of use of print media, telephone, television, and radio. They provide examples of acceptable disclosure language and methods (which, when followed, amount to the safe-harbor guidelines), and of included and excluded solicitations. They also contain guidelines for establishing the $100,000 threshold.[59]

The safe-harbor guideline for print media (including solicitations by mail and in newspapers) is fourfold:

1. The solicitation should include language such as the following: ''Contributions or gifts to [name of organization] are not deductible as charitable contributions for federal income tax purposes.''
2. The statement should be in at least the same type size as the primary message stated in the body of the letter, leaflet, or advertisement.
3. The statement should be included on the message side of any card or tear-off section that the contributor returns with the contribution.
4. The statement should be either the first sentence in a paragraph or itself constitute a paragraph.

The safe-harbor guidelines for telephone solicitations are the following:

- The solicitation includes language such as the following: ''Contributions or gifts to [name of organization] are not deductible as charitable contributions for federal income tax purposes.''
- The statement must be made in close proximity to the request for contributions, during the same telephone call, by the same solicitor.
- Any written confirmation or billing sent to a person pledging to contribute during the telephone solicitation must be in compliance with the requirements for print media solicitations.

To conform to the guideline, solicitation by television must include a solicitation statement that complies with the first of the print medium requirements. Also, if the statement is spoken, it must be in close proximity to the request for contributions. If the statement appears on the television screen, it must be in large, easily readable type appearing on the screen for at least five seconds.

In the case of a solicitation by radio, the statement must, to meet the safe-harbor test, comply with the first of the print medium requirements. Also, the statement must be made in close proximity to the request for contributions during the same radio solicitation announcement.

When the soliciting organization is a membership entity, classified as a trade or business association or other form of business league,[60] or a labor or agricultural

---

[58] IRS Notice 88-120, 1988-2 C.B. 459.
[59] See text accompanied by *supra* note 49.
[60] That is, an organization described in IRC § 501(c)(6) and tax-exempt under IRC § 501(a). See *Tax-Exempt Organizations* ch. 14.

organization,[61] the following statement is in conformance with the safe-harbor guideline: ''Contributions or gifts to [name of organization] are not tax deductible as charitable contributions. They may, however, be deductible as ordinary and necessary business expenses.''

If an organization makes a solicitation to which these rules apply and the solicitation does not comply with the applicable safe-harbor guidelines, the IRS will evaluate all of the facts and circumstances to determine whether the solicitation meets the disclosure rule. A good faith effort to comply with these requirements is an important factor in the evaluation of the facts and circumstances. Nonetheless, disclosure statements made in ''fine print'' do not comply with the statutory requirement.

This disclosure requirement applies to solicitations for voluntary contributions as well as to solicitations for attendance at testimonials and similar fundraising events. The disclosure must be made in the case of solicitations for contributions to political action committees.

Exempt from this disclosure rule are: the billing of those who advertise in an organization's publications; billing by social clubs for food and beverages; billing of attendees of a conference; billing for insurance premiums of an insurance program operated or sponsored by an organization; billing of members of a community association for mandatory payments for police and fire (and similar) protection; and billing for payments to a voluntary employees' beneficiary association,[62] as well as similar payments to a trust for pension and/or health benefits.

General material discussing the benefits of membership in a tax-exempt organization, such as a trade association or labor union, does not have to include the required disclosure statement. The statement is required, however, when the material both requests payment and specifies the amount requested as membership dues. If a person responds to the general material discussing the benefits of membership, the follow-up material requesting the payment of a specific amount in membership dues (such as a union check-off card or a trade association billing statement for a new member) must include the disclosure statement. General material discussing a political candidacy and requesting persons to vote for the candidate or ''support'' the candidate need not include the disclosure statement, unless the material specifically requests either a financial contribution or a contribution of volunteer services in support of the candidate.

[61] That is, an organization described in IRC § 501(c)(5) and tax-exempt under IRC § 501(a). See *Tax-Exempt Organizations* § 16.1.

[62] That is, an organization that is tax-exempt under IRC § 501(a) by reason of description in IRC § 501(c)(9). See *Tax-Exempt Organizations* § 18.3.

CHAPTER TWENTY-THREE

Special Events, Corporate Sponsorships, and Donor-Advised Funds

§ 23.1 IRS Audit Guidelines 668
- (a) Regulatory History 668
- (b) Special Emphasis Program 669
- (c) Checksheet 670
- (d) Audit Guidance 671

§ 23.2 Special Events 671

§ 23.3 Corporate Sponsorship Rules 673
- (a) Background 673
- (b) Qualified Sponsorship Payments 674

§ 23.4 Donor-Advised Funds 676

As is discussed throughout the book, a payment to a charitable organization is not always deductible as a charitable gift for federal income tax purposes.[1] Payments that can fall into these categories of questionable transfers are:

- A payment when the donor is provided some tangible item of property in exchange for the contribution, so that only a portion of the transaction is a charitable gift
- A payment when the donor is provided some benefit, service, or privilege in exchange for the contribution, so that only a portion of the transaction is a charitable gift
- A payment when the donor is provided with an item of property, or a benefit, service, or privilege to the extent that none of the payment constitutes a charitable gift

Years ago, the IRS launched a Special Emphasis Program to disseminate information about the law on these points and to provide audit guidance to its agents in the field. Two types of fundraising practices have dominated the development of the law in this area: special events and donor recognition programs. This body of law addresses the question of whether payments to a charitable

[1] See, e.g., § 3.2.

organization are, in whole or in part, tax deductible as gifts, as well as the question of whether the charitable organization that is the recipient of these payments must pay the unrelated business income tax on them.

§ 23.1 IRS AUDIT GUIDELINES

The IRS uses its inherent authority, in conjunction with its task of administering the federal tax laws, to regulate the field of fundraising for charitable purposes. In part, this is the result of mandates from Congress to the IRS to increase its review and regulation of the processes of charitable giving.[2] Thus, the IRS audits the fundraising programs of charitable organizations, either alone or in conjunction with a broader examination. One of the tools the agency once employed in this regard was documentation issued in early 1990 to IRS agents in the field, including an extensive ''checksheet.''

(a) Regulatory History

Prior to a discussion of this checksheet, some background is appropriate. Today's regulation of charitable giving by the federal government can best be appreciated in the light of its history.

For years, it has seemed that wide-ranging regulation of charitable giving by the IRS was inevitable. The IRS's new activism in this regard is directly affecting the administration of giving programs by charitable organizations, as well as placing increased responsibilities and requirements on donors.

The broad regulation of charitable giving that is part of contemporary law did not materialize as most observers expected. No great scandal involving fraudulent ''charitable'' giving was uncovered by the media or IRS audit that led the IRS to act. Nor was there development of new regulations on the subject by the Department of the Treasury or enactment of a far-reaching statute by Congress.

Rather, regulation of charitable giving through the tax system arrived because the IRS decided to act with respect to a longstanding problem—some would characterize it as an ''abuse.'' The problem/abuse is the casting of a payment to a charitable organization as a deductible gift when in fact the transaction does not involve a gift at all or is only partially a gift. Legislation enacted in 1993 characterizes these latter types of transactions as *quid pro quo contributions*.[3]

The IRS position is that a payment to a charitable organization is not a gift when the donor receives something of approximately equal value in return. This stance certainly is not new; it was made quite explicit on a number of occasions, including a pronouncement in 1967.[4] At that time and since, it has been the IRS's view that charitable organizations have an obligation to notify their patrons when payments to the organizations are not gifts, or are only partially gifts, particularly in the context of a special fundraising event.[5]

[2] See the discussion in § 22.1, text accompanied by notes 14–17.
[3] See § 22.2.
[4] Rev. Rul. 67-246, 1967-2 C.B. 104.
[5] See § 22.1.

There were, over the years, a few instances of deliberate and blatant wrongdoing in this area by ''donors'' and patrons. For example, there were individuals who wrote a check to a school for something acquired at the school's annual auction and who could not resist the temptation to treat the entire payment as a charitable gift on their federal income tax returns. The same may be said of raffles, sweepstakes, book sales, sports tournaments, dinner and theater events, dues payments, and the like. Most of the abuses of this nature, however, were inadvertent, based on ignorance or misunderstanding of the legal requirements.

Matters changed somewhat when charitable organizations began explicitly or implicitly telling donors and patrons that their payments to the organizations were deductible as gifts, when in fact those payments were only partially deductible or not deductible at all. This practice became so overt and pervasive that the IRS decided that the time had come to enhance government review of these areas of fundraising and giving.[6] The extent of regulation in this area was broadened by reason of the increase in the extent of donor recognition efforts, particularly in the setting of corporate sponsorships.[7]

(b) Special Emphasis Program

The IRS launched its contemporary attack on these forms of fundraising misperformance by inaugurating a Special Emphasis Program. This program evolved in two parts: an educational phase and an audit phase.

Phase I of this Special Emphasis Program took place throughout 1989. During this period, the IRS engaged in educational efforts to explain the rules to charitable organizations, which were expected to apply them when soliciting contributions and other payments. This aspect of the Program consisted of speeches by representatives of the IRS, workshops with charitable organizations, and the encouragement of educational efforts by national ''umbrella'' charitable organizations.

At this time, the IRS began reviewing annual information returns (Form 990) filed by charitable organizations. Special emphasis was placed on the returns of organizations that were engaged in gift solicitation. Charitable organizations that were not in compliance with the disclosure requirements received letters from the IRS requesting immediate compliance with these rules. Some organizations (such as the Public Broadcasting Service[8]), working with the IRS, developed formal guidelines for their members. There was also talk of more audits of charitable organizations and donors by the IRS, review of lists of contributors by the IRS, and the imposition of various tax penalties.

The IRS's regulation of charitable giving and other fundraising programs became much more serious when the second phase of the Special Emphasis Program was inaugurated in early 1990. This aspect of the IRS's involvement and scrutiny was evidenced by the rather extraordinary checksheet sent by the National Office of the IRS to its agents in the field, to enable them to review the fundraising practices of charitable organizations.

---

[6] *Id.*, text accompanied by note 5.
[7] See § 23.3.
[8] See ch. 23, note 35, of the first edition of this book.

(c) Checksheet

The checksheet, bearing the title ''Exempt Organizations Charitable Solicitations Compliance Improvement Program Study Checksheet'' (Form 9215), reflected the beginning of the second phase of the IRS's Special Emphasis Program concerning solicitation practices of charitable organizations.[9] This checksheet required an auditing IRS agent to review, in conjunction with examinations of annual information returns (principally Form 990), the gift solicitation practices of charitable organizations, including the solicitation of gifts when the donor is provided a benefit, the use of special events, the conduct of bingo and other games of chance, travel tours, thrift stores, and the receipt of nonmoney contributions. A special section of the checksheet inquired about the use of professional fundraisers. Overall, the checksheet consisted of 82 questions, plus requested financial information.

One question asked the IRS agent to determine whether the charitable organization is meeting the *commensurate* test. This is a standard, established by the IRS in 1964,[10] that looks to determine whether a charitable organization is carrying on charitable works that are commensurate in scope with its financial resources. The scope of the commensurate test in the context of charitable fundraising was unclear,[11] but presumably the agent was supposed to ascertain whether the charitable organization was engaging in sufficient charitable activity in relation to its available resources, including gifts received through fundraising campaigns, in relation to the time and expense of fundraising.[12]

The checksheet focused on the nature of benefits, goals, or services provided to donors. These items included retail merchandise, new and donated merchandise received at auctions, tickets for games of chance, tuition at educational institutions, travel, tickets to athletic or other events, discounts, free subscriptions, and preferential seating at college or university athletic events.[13] The checksheet asked whether the charitable organization made any reference to the deductibility of a payment in its solicitation or professional literature or in any thank-you letter, receipt ticket, or other written receipt to donors.

As to contributions of property, the IRS wanted a list of all nonmoney gifts, the fair market value of which is in excess of $500, during the year of examination. The checksheet inquired about the individual who had valued the gift property, whether a proper receipt had been provided, whether there was an agreement between the donor and the donee as to disposition of the property, and whether the requisite forms had been properly completed and filed.[14]

---

[9] This checksheet appeared as Appendix C in Hopkins, *The Law of Fund-Raising*, 2d ed. (John Wiley & Sons, 1996).

[10] Rev. Rul. 64-182, 1964-1 C.B. (Part 1) 186.

[11] The IRS initially deployed the commensurate test in a court case, although that argument was abandoned during the course of the litigation and the test was not used by the court. *United Cancer Council, Inc. v. Commissioner*, 109 T.C. 326 (1997), *rev'd & remanded*, 165 F.3d 1173 (7th Cir. 1999).

[12] The commensurate test, as applied in the charitable fundraising context, is the subject of *Fundraising* § 5.15. The commensurate test, as applied in the exempt organizations context generally, is the subject of *Tax-Exempt Organizations* § 4.7.

[13] As to this latter item, see § 22.1, text accompanied by note 9.

[14] Other aspects of this checksheet, which inquire into fundraising practices, are the subject of *Fundraising* § 6.1, n. 9.

(d) Audit Guidance

In directions disseminated to its examining agents in 1990, and revised and redisseminated in 1992,[15] concerning the Phase II examinations, the National Office of the IRS cautioned that the "examinations must be thorough." The examiner was entreated to "pursue the examination to the point where he/she can conclude that all areas and data concerning fund-raising activities have been considered."[16]

This guidance stated that the second phase of the Program focuses on "all aspects of fund-raising and charitable solicitations."[17] Some of the practices the IRS agents were to look for were:

- Misleading statements in solicitations and literature that imply deductibility of contributions, "where none probably exists"
- Contracts with professional, for-profit fundraisers, who use "questionable fundraising methods" to solicit funds from the public
- Situations in which other expenses, such as administrative and fundraising costs, constitute an "unusually high portion" of the solicited funds and property
- Fundraising activities that result in consequences such as taxable income or additional filing requirements

These directions continued: "The scope and depth of the examination should be sufficient to fully disclose the nature of abusive situations involving fundraising activities that mislead donors to claim the incorrect charitable contribution deductions; misrepresent the use of the solicited funds; engage in questionable fund-raising practices, etc."[18] There was such an insistence on thoroughness because the results of these examinations "are to be used in a report that will be submitted to Congress."[19]

Thus, what started out in 1967 as concern with overdeductibility in the context of gifts and other payments to charitable organizations evolved into a nationwide examination by the IRS of all "questionable fund-raising practices and techniques."[20]

§ 23.2 SPECIAL EVENTS

Special events (or *benefit events*) are social occasions that use ticket sales and underwriting to generate revenue. These events are typically the most expensive and least profitable method of charitable fundraising. Nonetheless, they have a great

---

[15] The directions that were sent in 1990 are the subject of *Fundraising* § 6.1. This guidance is contained in Manual Supplement 7(10)G-59.

[16] *Fundraising* § 11.02.

[17] *Id.* § 11.09.

[18] *Id.* § 11.03.

[19] *Id.* § 11.02. Although this report was never formally submitted, Congress acted. See § 23.2.

[20] The attention given by the IRS to the matter of charitable fundraising continues unabated, albeit in differing manifestations. For example, the contemporary focus is on charitable organizations that report considerable amounts of charitable contributions—and little or no fundraising cost. The IRS is in the process of monitoring a large group of these organizations; the agency sends them reminders of their fundraising cost reporting obligations in the form of "educational letters."

value in public relations visibility, both for the charitable organization involved and for its volunteers.[21]

Examples of these special events include:

- Annual balls
- Auctions
- Bake sales
- Car washes
- Dinners
- Fairs and festivals
- Games of chance (such as bingo, raffles, and sweepstakes)
- Luncheons
- Sports tournaments (particularly golf and tennis)
- Theater outings

There is some confusion in the law as to exactly what constitutes a *special event* in the charitable fundraising context. For instance, one court defined a *fundraising event* as ''a single occurrence that may occur on limited occasions during a given year and its purpose is to further the exempt activities of the organization.''[22] These events were contrasted with activities that ''are continuous or continual activities which are certainly more pervasive a part of the organization than a sporadic event and [that are] . . . an end in themselves.''[23] There is a wide variety of fundraising methods, however, other than special events, that are ''continuous'' and ''pervasive.'' Rarely, moreover, is the purpose of a special event to ''further the exempt activities of the organization''; they are events that usually have no relationship to a charitable organization's exempt purposes and activities, and are engaged in largely to generate some funds and favorable publicity, which in turn helps the organization advance its tax-exempt activities. Finally, a fundraising activity is rarely an end in itself, yet many charitable organizations and institutions have major, ongoing fundraising and development programs that are permanent fixtures in the totality of the organizations' functions.

Special events figure prominently in a charitable organization's annual reporting to the IRS. In determining whether an annual information return (Form 990) is required, only net receipts (not gross receipts) from special events are used in determining the $25,000 filing threshold. (Organizations, other than private foundations, with gross receipts that are normally not in excess of $25,000 need not file annual information returns.[24]) Part VII-A of the annual information return requires a tax-exempt organization to identify each income-producing activity; a separate line is provided for special fundraising events.[25]

---

[21] See Greenfield, *Fundraising: Evaluating and Managing the Fund Development Process*, 2d ed., 130–39 (Hoboken, NJ: John Wiley & Sons, Inc., 1999).

[22] *U.S. CB Radio Ass'n, No. 1, Inc. v. Commissioner*, 42 T.C.M. (CCH) 1441, 1444 (1981).

[23] *Id.*

[24] IRC § 6033(a)(2)(A)(ii).

[25] For more details on the federal reporting requirements for charitable organizations in the fundraising setting, see *Fundraising* § 5.9.

As discussed, it has been the view of the IRS for years that charitable organizations that conduct special events have the obligation to notify the participants in these events of the amount (if any) expended for their participation in the event that is deductible as a charitable gift.[26] Also, as discussed, legislation that took effect in 1993 requires charitable organizations to make a good faith estimate of the value of benefits, services, and/or privileges provided to a donor as the consequence of a gift and to notify the donor that only an amount in excess of that value is deductible.[27]

The revised annual information return[28] introduced detailed reporting requirements for the conduct of fundraising events.[29] In that connection, the IRS, in the instructions accompanying this return, defined the term *fundraising event* to include ''dinners/dances, door-to-door sales of merchandise, concerts, carnivals, sports events, auctions, and casino nights that are not regularly carried on.'' These events do not include ''sales of gifts or goods or services of only nominal value, sweepstakes, lotteries or raffles where the names of contributors or other respondents are entered in a drawing for prizes, raffle[s] or lotteries where prizes have only nominal value [,] or solicitation campaigns that generate only contributions.''

§ 23.3 CORPORATE SPONSORSHIP RULES

The federal tax law includes rules pursuant to which, under certain circumstances, a payment from a corporate sponsor to a tax-exempt (usually charitable) organization is treated in essence as a contribution, rather than being considered unrelated business income.

(a) Background

The IRS caused substantial controversy in 1991 by determining that a payment received by a college bowl association from a for-profit corporation sponsoring a bowl football game was taxable as unrelated business income, because the payment was for a package of ''valuable'' services rather than a gift. This IRS pronouncement was a technical advice memorandum passing on the federal tax consequences of *corporate sponsorships*, arrangements under which the sponsoring business has the corporate name included in the name of the event.[30] (One of the most visible of these situations was the Mobil Oil Corporation's sponsorship of the Cotton Bowl, once known as the Mobil Cotton Bowl.) The associations involved contended that the payments were gifts, but the IRS held that the companies received a substantial *quid pro quo* for the payments. This determination raised the question, once again, of whether a payment is a ''gift'' when the ''donor'' is provided something of value in return.

Charitable organizations throughout the United States became concerned about this IRS initiative—and properly so, as it had implications far beyond

---

[26] See § 22.1.
[27] See § 23.1.
[28] See ch. 24.
[29] See *New Form 990*, §§ 14.1(c), 14.2(b).
[30] Tech. Adv. Mem. 9147007.

college and university bowl games. The IRS bowl game technical advice memorandum raised the deeper question of when the extent of donor recognition renders a payment not a gift or only partially a gift.

The IRS promptly recognized this problem. Thus, it soon thereafter promulgated proposed guidelines for its auditing agents to use when conducting examinations of tax-exempt organizations.[31] The issuance of these guidelines was followed by hearings conducted by the IRS in mid-1992; in that connection, the IRS sought comment on other issues.[32] As the IRS was endeavoring to finalize its guidelines in this area, Congress attempted to legislate in this area, only to have the measure vetoed (for other reasons).[33] In early 1993, the IRS issued proposed regulations concerning the tax treatment, as gifts or items of unrelated income, of sponsorship payments received by tax-exempt organizations.[34]

(b) Qualified Sponsorship Payments

These developments led to the enactment of legislation that added to the federal tax statutory law the concept of the *qualified sponsorship payment*. These payments received by tax-exempt organizations and state colleges and universities are, pursuant to this safe-harbor provision, exempt from the unrelated business income tax. That is, the activity of soliciting and receiving these payments is not an unrelated business.[35]

From the standpoint of charitable giving, these rules differentiate between a qualified sponsorship payment, which is a deductible charitable contribution and as to which there is merely an acknowledgment, and a payment for services that are, or are in the nature of, advertising.

A *qualified sponsorship payment* is a payment made by a person engaged in a trade or business, with respect to which there is no arrangement or expectation that the person will receive any substantial return benefit other than the use or acknowledgment of the name or logo (or product lines) of the person's trade or business in connection with the organization's activities.[36] It is irrelevant whether the sponsored activity is related or unrelated to the organization's exempt purpose.[37]

This use or acknowledgment does not include advertising of the person's products or services, including messages containing qualitative or comparative language, price information or other indications of savings or value, an endorsement, or an inducement to purchase, sell, or use the products or services.[38] For example, if in return for receiving a sponsorship payment, an exempt organization promises to use the sponsor's name or logo in acknowledging the sponsor's support for an educational or fundraising event conducted by the organization, the payment is not taxable. If an organization provides advertising of a sponsor's

[31] Ann. 92-15, 1992-6 I.R.B. 51. These guidelines are summarized in § 23.3(b) of the first edition of this book.

[32] These hearings and the questions posed by the IRS are summarized in § 23.3(e) of the first edition of this book.

[33] This legislation is summarized in § 23.3(f) of the first edition of this book.

[34] EE-74-92. These proposed regulations are summarized in § 23(g) of the first edition of this book.

[35] IRC § 513(i)(1); Reg. § 1.513-514.

[36] IRC § 513(i)(2)(A).

[37] H. Rep. No. 105-220, 105th Cong., 1st Sess. 69 (1997).

[38] IRC § 513(i)(2)(A).

products, however, the payment made to the organization by the sponsor in order to receive the advertising is subject to unrelated business income tax (assuming that the other requirements for taxation are satisfied).[39]

A qualified sponsorship payment does not include any payment arrangement whereby the amount of the payment is contingent on the level of attendance at one or more events, broadcast ratings, or other factors indicating the degree of public exposure to one or more events.[40] The fact that a sponsorship payment is contingent on an event actually taking place or being broadcast, in and of itself, does not, however, cause the payment to fail to qualify. Also, mere distribution or display of a sponsor's products by the sponsor or the exempt organization to the general public at a sponsored event, whether for free or for remuneration, is considered a ''use or acknowledgment'' of the sponsor's product lines—not advertising.[41]

This law does not apply to a payment that entitles the payor to the use or acknowledgment of the name or logo (or product line) of the payor's trade or business in a tax-exempt organization's periodical. A *periodical* is regularly scheduled and printed material published by or on behalf of the payee organization that is not related to and primarily distributed in connection with a specific event conducted by the payee organization.[42] Thus, the exclusion does not apply to payments that lead to acknowledgments in a monthly journal, but it does apply if a sponsor receives an acknowledgment in a program or brochure distributed at a sponsored event.[43] The term *qualified sponsorship payment* also does not include a payment made in connection with a qualified convention or trade show activity.[44]

To the extent that a portion of a payment would (if made as a separate payment) be a qualified sponsorship payment, that portion of the payment is treated as a separate payment.[45] Therefore, if a sponsorship payment made to a tax-exempt organization entitles the sponsor to product advertising and use or acknowledgment of the sponsor's name or logo by the organization, the unrelated business income tax does not apply to the amount of the payment that exceeds the fair market value of the product advertising provided to the sponsor.[46]

The provision of facilities, services, or other privileges by an exempt organization to a sponsor or the sponsor's designees (such as complimentary tickets, pro-am playing spots in golf tournaments, or receptions for major donors) in connection with a sponsorship payment does not affect the determination of whether the payment is a qualified one. Instead, the provision of the goods or services is evaluated as a separate transaction in determining whether the organization has unrelated business income from the event. In general, if the services or facilities do not constitute a substantial return benefit (or if the provision of the services or

---

[39] H. Rep. No. 105-220, 105th Cong., 1st Sess. 68 (1997).
[40] IRC § 513(i)(2)(B)(i).
[41] H. Rep. No. 105-220, 105th Cong., 1st Sess. 69 (1997).
[42] IRC § 513(i)(2)(B)(ii)(I).
[43] H. Rep. No. 105-220, 105th Cong., 1st Sess. 69 (1997).
[44] IRC § 513(i)(2)(B)(ii)(II).
[45] IRC § 513(i)(3).
[46] H. Rep. No. 105-220, 105th Cong., 1st Sess. 69 (1997).

facilities is a related business activity), the payments attributable to them are not subject to the unrelated business income tax.[47]

Likewise, a sponsor's receipt of a license to use an intangible asset (such as a trademark, logo, or designation) of the tax-exempt organization is treated as separate from the qualified sponsorship transaction in determining whether the organization has unrelated business taxable income.[48]

The corporate sponsorship rules are, as noted, formulated as a safe-harbor body of law. Thus, if the terms and conditions of these rules cannot be satisfied, the opportunity nonetheless remains for application of other rules that may cause a corporate sponsorship payment not to be treated as unrelated business income. These other rules might include use of the exclusion for royalties,[49]or the exception for activities substantially all the work for which is performed by volunteers,[50] or the exception for activities not regularly carried on.[51]

§ 23.4 DONOR-ADVISED FUNDS

Legislation that generally took effect for tax years beginning after August 17, 2006, brought a statutory definition of the term *donor-advised fund.* Essentially, it is a fund or account (1) that is separately identified by reference to contributions of one or more donors, (2) that is owned and controlled by a sponsoring organization, and (3) as to which a donor or a donor advisor[52] has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in the fund or account by reason of the donor's status as a donor.[53] A *sponsoring organization* is a public charity that maintains one or more donor-advised funds.[54] A donor-advised fund does not include funds that make distributions only to a single identified organization or governmental entity, or certain funds where a donor or donor advisor provides advice as to which individuals receive grants for travel, study, or other similar purposes.[55]

A distribution from a donor-advised fund is taxable if it is to (1) a natural person or (2) any other person for a noncharitable purpose unless expenditure responsibility is exercised with respect to the distribution.[56] A tax, of 20 percent of the amount involved, is imposed on the sponsoring organization.[57] Another

---

[47] *Id.*
[48] *Id.*
[49] See § 3.4(g).
[50] See § 3.4(f).
[51] See § 3.4(c). For further reading about corporate sponsorship payments, see Appendix K. In general, Woods, "Tax Treatment of Corporate Sponsorship Payments to Exempt Organizations: Final Regulations," 38 *Exempt Org. Tax Rev.* (no. 2) 205 (2002); Wirtschafter, "Fourth Quarter Choke: How the IRS Blew the Corporate Sponsorship Game," 10 *Exempt Org. Tax Rev.* (no. 3) 501 (Sep. 1994).
[52] That is, a person appointed or designated by a donor.
[53] IRC §4966(d)(2)(A).
[54] IRC §4966(d)(1).
[55] IRC §4966(d)(2)(B). The IRS has the authority to exempt a fund or account from treatment as a donor-advised fund under certain circumstances (IRC §4966(d)(2)(C)). Exercising this authority, the IRS announced that certain employer-sponsored disaster relief assistance funds do not constitute donor-advice funds (Notice 2006-109, 2006-2 C.B. 1121 § 5.01)
[56] IRC §4966(c)(1). This is termed a *taxable distribution*. The expenditure responsibility rules are the subject of *Tax-Exempt Organizations* § 12.4(e).
[57] IRC § 4966(a)(1).

tax, of 5 percent, is imposed on the agreement of a fund manager[58] to the making of a taxable distribution, where the manager knew that the distribution was a taxable one.[59] Thetaxonfund management is subject to a joint and several liability requirement.[60] This tax does not apply to a distribution from a donor-advised fund to most public charities,[61] the fund's sponsoring organization, or another donor-advised fund.[62]

If a donor, donor advisor, or a person related to a donor or donor advisor with respect to a donor-advised fund provides advice as to a distribution that results in any of those persons receiving, directly or indirectly, a benefit that is more than incidental, an excise tax equal to 125 percent of the amount of the benefit is imposed on the person who advised as to the distribution and on the recipient of the benefit.[63] Also, if a manager of the sponsoring organization agreed to the making of the distribution, knowing that the distribution would confer more than an incidental benefit on a donor, donor advisor, or related person, the manager is subject to an excise tax equal to 10 percent of the amount of the benefit.[64] These taxes are subject to a joint and several liability requirement.[65]

The private foundation excess business holdings rules[66] apply to donor-advised funds.[67] For this purpose, the term *disqualified person* means, with respect to a donor-advised fund, a donor, donor advisor, member of the family of either, or a 35-percent controlled entity of any such person.[68]

Contributions to *a* sponsoring organization for maintenance in a donor-advised fund are not eligible for a charitable deduction for federal income tax purposes if the sponsoring organization is a fraternal society, a cemetery company, or a veterans' organization.[69] Contributions to a sponsoring organization for such maintenance are not eligible for a charitable deduction for federal estate or gift tax purposes if the sponsoring organization is a fraternal society or a veterans' organization.[70] Contributions to a sponsoring organization for such maintenance are not eligible for a charitable deduction for income, estate, or gift tax purposes if the sponsoring organization is a Type 111 supporting organization (other than a functionally integrated Type III supporting organization)[71] A donor must obtain, with respect to each charitable contribution to a sponsoring organization to be maintained in a donor-advised fund, a contemporaneous written

---

[58] This term embraces trustees, directors, officers, and executive employees of a sponsoring organization (IRC §4966(d)(3)).

[59] IRC §4966(a)(2). This tax is confined to $10,000 per transaction (IRC §4966(b)(2)).

[60] IRC §4966(b)(1).

[61] That is, organizations described in IRC § 170(b)(1)(A), other than a *disqualified supporting organization*, which is a Type III supporting organization (other than a functionally integrated one) and certain type I and II supporting organizations (IRC §4966(d)(4)). See §3.4 and *Tax-Exempt Organizations* § 12.3(c).

[62] IRC §4966(c)(2).

[63] IRC §4967(a)(1).

[64] IRC § 4967(a)(2). The maximum amount of this tax per distribution is $10,000 (IRC §4967(c)(2)). This tax and the tax referenced in *supra* note 63 may not be imposed if a tax with respect to the distribution has been imposed pursuant to the intermediate sanctions rules (IRC § 4967(b)); see *Tax-Exempt Organizations* ch. 21.

[65] IRC §4967(c)(1).

[66] See *Tax-Exempt Organizations* § 12.4(c).

[67] IRC §4943(e)(1).

[68] IRC §4943(e)(2).

[69] IRC § 170(f)(18)(A)(i).

[70] IRC §§2055(e)(5)(A)(i), 2522)(c)(5)(A)(i).

[71] IRC §§ 170 (f)(18)(A)(ii), 2055(e)(5)(A)(ii), 2522(c)(5)(A)(ii).

acknowledgment from the sponsoring organization that the organization has exclusive legal control over the funds or assets contributed.[72]

The Department of the Treasury has been directed by Congress to undertake a study on the organization and operation of donor-advised funds, to consider whether (1) the deductions allowed for income, estate, or gift taxes for charitable contributions to sponsoring organizations of donor-advised funds are appropriate in consideration of the use of contributed assets or the use of the assets of such organizations for the benefit of the person making the charitable contribution, (2) donor-advised funds should be required to distribute for charitable purposes a specified amount in order to ensure that the sponsoring organization with respect to the donor-advised fund is operating in a manner consistent with its tax exemption or public charity status, (3) the retention by donors to donor-advised funds of ''rights or privileges'' with respect to amounts transferred to such organizations (including advisory rights or privileges with respect to the making of grants or the investment of assets) is consistent with the treatment of these transfers as completed gifts, and (4) these issues are also issues with respect to other forms of charitable organizations or charitable contributions.[73]

---

[72] IRC §§ 170(f)(18)(B),2055(e)(5)(B), 2522(c)(5)(B). This requirement is in addition to other charitable giving substantiation requirements (see § 21.3).

[73] Pension Protection Act of 2006, Pub. L. No. 109-280 § 1226.

CHAPTER TWENTY-FOUR

Reporting Requirements

§ 24.1 **Gift Reporting by Individuals** **679**

§ 24.2 **Gift Reporting by C Corporations** **680**

§ 24.3 **Gift Reporting by S Corporations** **680**

§ 24.4 **Gift Reporting by Partnerships** **680**

§ 24.5 **Gift Reporting by Donees in General** **680**
- (a) General Requirements 681
- (b) Form 990, Schedule A 683
- (c) Form 990, Schedule B 684

§ 24.6 **Gift Reporting in Unrelated Business Context** **686**

§ 24.7 **Reporting of Noncash Gifts in General** **688**
- (a) Form 8283 688
- (b) Form 990, Schedule M 696

§ 24.8 **Reporting of Gifts of Vehicles** **703**

§ 24.9 **Reporting of Gifts of Intellectual Property** **704**

§ 24.10 **Reporting on Dispositions of Contributed Property** **705**

§ 24.11 **Applicable Insurance Contract Reporting Requirements** **708**

§ 24.12 **Personal Benefit Contract Reporting Requirements** **709**

§ 24.13 **Split-Interest Trust Filing Requirements** **710**

The federal tax law imposes a variety of reporting requirements on those who make charitable gifts and on the charitable organizations that receive them. Some of these reporting obligations are general; the making of certain types of charitable contributions triggers other reporting requirements.

§ 24.1 GIFT REPORTING BY INDIVIDUALS

Individuals are generally required to annually file income tax returns with the IRS.[1] This return is on Form 1040. In computing taxable income,[2] individuals who itemize their deductions[3] subtract those deductions from their adjusted gross income.[4] On the Form 1040 for 2008, the amount of these itemized deductions is reported on line 40.

[1] IRC § 6012(a)(1).
[2] See § 2.7.
[3] See § 2.5.
[4] See § 2.4.

Itemized deductions are reported on Form 1040, Schedule A. Charitable contributions made in cash or by check are reported on the Schedule A for 2008, line 16. Other charitable contributions are reported on Schedule A, line 17.

§ 24.2 GIFT REPORTING BY C CORPORATIONS

C corporations[5] are required to annually file income tax returns with the IRS.[6] This return is on Form 1120. In computing taxable income, these corporations subtract certain deductions from total income. On the Form 1120 for 2008, these deductions are reported on lines 12–26.

Charitable contributions made by these corporations are reported on Form 1120, line 19. Charitable contributions recorded on a corporation's books for the reporting year but not deducted on the return are itemized on Schedule M-1 (or M-3), line 5b. Charitable contributions reflected on this tax return that are not charged against book income for the reporting year are itemized on Schedule M-1 (or M-3), line 8b.

§ 24.3 GIFT REPORTING BY S CORPORATIONS

S corporations[7] are required to annually file income tax returns with the IRS.[8] This return is on Form 1120S. Various deductions are reported on lines 7–19 on the Form 1120S for 2008. Any charitable deduction is not reported there, however; the pro rata shares of this deduction are reported to each shareholder[9] on Schedule K-1, Part III, line 12.

§ 24.4 GIFT REPORTING BY PARTNERSHIPS

Partnerships (including some joint ventures and limited liability companies) are required to annually file information returns with the IRS.[10] These returns are on Forms 1065 or 1065-B. The pro rata shares of one or more charitable deductions, generated by charitable giving by the partnership, are reported to each partner[11] on Schedule K-1.[12]

§ 24.5 GIFT REPORTING BY DONEES IN GENERAL

Most charitable and other tax-exempt organizations are required to annually file information returns with the IRS.[13] These returns are in the Form 990 series. Larger exempt organizations file Form 990.[14] Smaller organizations file

[5] See, e.g., § 2.8, note 33.
[6] IRC § 6012(a)(2).
[7] See, e.g., § 2.8, note 34.
[8] IRC § 6037.
[9] See § 6.15.
[10] IRC § 6031.
[11] See § 6.16.
[12] See § 22.3.
[13] IRC § 6033(a).
[14] See *Tax-Exempt Organizations* §§ 27.2(a)(i), 27.2A.

Form 990-EZ.[15] Very small organizations file Form 990-N.[16] Private foundations[17] file Form 990-PF.[18]

(a) General Requirements

The Form 990[19] requires the filing organization to report the amount of contributions it received during the year.[20] These contributions include those derived from federated campaigns and fundraising events; noncash contributions need to be separately identified.[21]

If the organization maintains one or more donor-advised funds[22] or any "accounts where donors have the right to provide advice on the distribution or investment of amounts in such funds or accounts," it must file the Schedule D, Part I, accompanying the Form 990.[23] A sponsoring organization maintaining a donor-advised fund is asked to report on the Form 990 if it made any taxable distributions[24] or if it made a distribution to a donor, a donor advisor, or a related person.[25]

If the organization received or holds a conservation easement, including easements to preserve open space, the environment, historic land areas, or historic structures,[26] it must file the Schedule D, Part II, accompanying the Form 990.[27]

If the organization received more than $25,000 in the form of noncash contributions,[28] it must file the Schedule M accompanying the Form 990.[29] If the organization received contributions of art, historical treasures, or other similar assets, or qualified conservation contributions, it must file the Schedule M.[30]

The organization must report on the Form 990 whether it had unrelated business gross income[31] of at least $1,000 during the reporting year.[32] If the answer to this question is yes, the organization must indicate whether it filed a Form 990-T[33] for the year.[34] If the answer to the question is no, an explanation on the Schedule O accompanying Form 990 is required.[35]

---

[15] *Id.* § 27.2(a)(iv).
[16] *Id.* § 27.3.
[17] See § 3.4.
[18] IRC § 6033(c). See *Tax-Exempt Organizations* § 27.2(a)(v); *Private Foundations*, ch. 12.
[19] This analysis is based on the Form 990 filed for the 2008 calendar year or a tax year beginning in 2008. See, in general, *New Form 990*.
[20] Form 990, Part I, line 8.
[21] Form 990, Part VIII, line 1h. Gross income from fundraising events that is not in the form of contributions (see Form 990, Part VIII, line 1c) is reported on Form 990, Part VIII, line 8a. See *New Form 990* § 14.2(b).
[22] See § 23.4; *Private Foundations*, ch. 16.
[23] Form 990, Part IV, line 6.
[24] Form 990, Part V. line 9a.
[25] Form 990, Part V, line 9b.
[26] See § 9.7.
[27] Form 990, Part IV, line 7.
[28] See § 24.7.
[29] Form 990, Part IV, line 29. See *New Form 990*, ch. 19.
[30] Form 990, Part IV, line 30.
[31] See § 3.5.
[32] Form 990, Part V, line 3a.
[33] See § 24.6.
[34] Form 990, Part V, line 3b.
[35] *Id.*

The organization must report on the Form 990 whether it was a party to a prohibited tax shelter transaction[36] at any time during the reporting year.[37] The organization is asked whether a taxable party notified it that it was or is a party to a prohibited tax shelter transaction.[38] If the answer to either question is yes, the organization is asked whether it filed the requisite disclosure form (Form 8886-T) with the IRS.[39]

The organization must report on the Form 990 whether it solicited any contributions that were not tax-deductible.[40] If the answer to this question is yes, the organization is asked whether it included with every solicitation an express statement that the contributions were not tax deductible.[41]

An organization that is a charitable entity is asked to report on the Form 990 whether it provided goods or services in exchange for a contribution of $75 or more.[42] If the answer to this question is yes, the organization must indicate whether it notified the donor of the value of the goods or services provided.[43]

An organization that is a charitable entity is asked to report on the Form 990 if it sold, exchanged, or otherwise disposed of tangible personal property for which it was required to file the Form 8282.[44] If the answer to this question is yes, the organization is asked to indicate the number of Forms 8282 filed during the year.[45]

An organization that is a charitable entity is asked to report on the Form 990 if it, during the year, received any funds, directly or indirectly, to pay premiums on a personal benefit contract.[46] The organization is also asked to report whether it, during the year, paid premiums, directly or indirectly, on a personal benefit contract.[47]

An organization that is a charitable entity is asked to report on the Form 990 whether it, in connection with a contribution of qualified intellectual property,[48] filed the Form 8899 (as required).[49] Likewise, an organization that is a charitable entity is asked to report on the Form 990 whether it, in connection with a contribution of a qualified vehicle,[50] filed the Form 1098-C (as required).[51]

A nonexempt charitable trust[52] is asked to report on the Form 990 if it is filing the return in lieu of the Form 1041.[53] If the answer to this question is yes, the organization is asked to enter the amount of tax-exempt interest received or accrued during the year.[54]

---

[36] See § 10.15.
[37] Form 990, Part V, line 5a.
[38] Form 990, Part V, line 5b.
[39] Form 990, Part V, line 5c.
[40] Form 990, Part V, line 6a. See § 22.3.
[41] Form 990, Part V, line 6b.
[42] Form 990, Part V, line 7a. See § 22.2.
[43] Form 990, Part V, line 7b.
[44] Form 990, Part V, line 7c. See § 24.10.
[45] Form 990, Part V, line 7d.
[46] Form 990, Part V, line 7e. See *Tax-Exempt Organizations* § 27.12(d).
[47] Form 990, Part V, line 7f.
[48] See § 9.28.
[49] Form 990, Part V, line 7g.
[50] See §§ 9.27, 24.8.
[51] Form 990, Part V, line 7h.
[52] That is, an entity described in IRC § 4947(a)(1). See *Private Foundations* § 3.6.
[53] Form 990, Part V, line 12a.
[54] Form 990, Part V, line 12b.

(b) Form 990, Schedule A

If the filing organization is a public charity[55] or a nonexempt charitable trust,[56] it is required to file the Schedule A accompanying the Form 990 (or Form 990-EZ).[57] The organization, if it is filing as a public charity, is asked to indicate its public charity type.[58] If the organization is claiming to be a donative publicly supported charity,[59] it is required to report, among other elements, the amounts of contributions it received during the preceding five-year period.[60] Likewise, if the organization is claiming to be a service provider publicly supported charity,[61] it is required to report, among other elements, the amounts of contributions it received during the preceding five-year period.[62]

In preparing the Schedule A, the filing organization must use the same accounting method it is using in preparing the Form 990 (see Form 990, Part XI, line 1, or Form 990-EZ, line G). The organization must use this accounting method in reporting all amounts on the Schedule A, irrespective of the accounting method it used in completing the schedule for the prior year. Thus, if the accounting method the organization used in completing the 2007 Schedule A was different from the accounting method indicated on its Form 990 (or Form 990-EZ) for 2008, the organization should not report, in either Part II or Part III of this schedule, the amounts reported in the applicable columns of the 2007 Schedule A; instead, the organization must report all amounts in Parts II or III in conformity with the accounting method indicated on the 2008 Form 990 (or Form 990-EZ).[63]

EXAMPLE 24.1

An organization checks "cash" on its 2008 Form 990, Part XI, line 1. It must report the amounts in its 2008 Schedule A, Part II or III, using the cash method. If the organization filed a 2007 Schedule A using the cash method, it reports in the 2004–2006 columns on the 2008 Schedule A the same amounts that it reported in the 2004–2006 columns on the 2007 Schedule A.

EXAMPLE 24.2

An organization checks "accrual" on its 2008 Form 990, Part XI, line 1. It must report the amounts in Part II or III of its 2008 Schedule A using the accrual method. The organization filed its 2007 Schedule A using the cash method. This organization may not report in the 2004–2006 columns on its 2008 Schedule A the same amounts that it reported in the 2004–2006 columns on its 2007 Schedule A. Instead, it must go back into its books and records and recompute those amounts using the accrual method.

---

[55] See § 3.4.
[56] See *supra* note 52.
[57] Form 990, Part IV, line 1.
[58] Form 990, Schedule A, Part I.
[59] See § 3.4, text accompanied by notes 383–402.
[60] Form 990, Schedule A, Part II, Section A, line 1.
[61] See § 3.4, text accompanied by notes 404–420.
[62] Form 990, Schedule A, Part III, Section A, line 1. In general, see *New Form 990*, ch. 8.
[63] 2008 Schedule A instructions. This new rule may thus require a recalculation of the amounts reported for 2004–2007 (columns (a)–(d)).

(c) Form 990, Schedule B

If the organization is required to do so, it files a schedule of contributors, which is the Schedule B accompanying the Form 990 (or Form 990-EZ or Form 990-PF).[64] The general rule is that an organization that is filing an annual information return and that received, directly or indirectly, during the year, $5,000 or more (in money or property) from any one contributor is required to file Schedule B, Parts I and II. In determining this aggregate amount, separate and independent gifts of less than $1,000 may be disregarded. A charitable organization that is filing the annual information return, met the one-third support test as a donative publicly supported charity,[65] and received from any one contributor, during the year, a contribution that is greater than (1) $5,000 or (2) 2 percent of the organization's contributions and the like[66] (or 2 percent of the amount on Form 990-EZ, line 1) is required to file Schedule B, Parts I and II.

EXAMPLE 24.3

A donative publicly supported charity reported, for 2008, total contributions of $700,000. This organization is required to list in Parts I and II of its Schedule B (see below) only each person who contributed more than $14,000 (2 percent of $700,000). Thus, a person who contributed, for example, $11,000 to this organization would not be reported in its Schedule B, Parts I and II. Although the $11,000 gift was greater than $5,000, it did not exceed $14,000.

Two other special rules apply in conjunction with the requirement to file the Schedule B. If the filing organization is a tax-exempt social club[67] or an exempt fraternal organization,[68] and received from any one contributor during the year aggregate contributions or bequests of more than $1,000 for use exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, it is required to file Schedule B, Parts I–III. An exempt social club or fraternal organization filing Form 990 (or Form 990-EZ) that received from any one contributor, during the year, contributions for use exclusively for religious, charitable, or like purposes, where these contributions did not total more than $1,000, is required to report the amount of those contributions on Schedule B. An organization in this latter circumstance is not required to complete any of the parts of Schedule B unless the general rule applies to the organization because it received nonexclusively religious, charitable, or like contributions of $5,000 or more during the year.

Schedule B, Part I, consists of boxes by which contributors (persons) are identified. For this purpose, a *contributor* includes an individual, a fiduciary, a corporation, an association, a partnership, a trust, a tax-exempt organization, and, where a publicly supported charity is the grantee, a governmental unit.[69] A *contribution* includes a grant, a bequest, and a devise, whether or not for charitable

[64] Form 990, Part IV, line 2.
[65] See *supra* note 59.
[66] That is, the amount reported on Form 990, Part VIII, line 1h.
[67] See *Tax-Exempt Organizations*, ch. 15.
[68] *Id*. § 19.4.
[69] 2008 Instructions for Schedule B.

purposes (e.g., for political campaign purposes).[70] A *cash contribution* includes gifts made by means of credit cards, checks, money orders, electronic fund or wire transfers, and other charges against funds on deposit at a financial institution.[71] Contributors' names and addresses must be reported, along with the amount of the contributor's aggregate contributions and an indication of the type of contribution (person, payroll, or noncash).

In the case of a political organization[72] that files a notice of tax-exempt status with the IRS (Form 8871), the names and addresses of contributors that are not reported on the organization's report of contributions and expenditures (Form 8872) do not need to be reported in Schedule B, Part I, if the organization paid the penalty for failure to disclose contributions or expenditures[73] on that report.[74]

Part II of Schedule B also consists of boxes, where the gift as reported in Part I is identified, the noncash property is described, the fair market value of the property or an estimate is reported, and the date the property was received by the donee is reported. If the organization immediately sells property contributed to it, the contribution must nonetheless be reported as a gift of property, rather than cash. Part III of Schedule B, consisting of boxes, is used by exempt social clubs and fraternal organizations reporting contributions set aside exclusively for charitable and like purposes; to be reported are the purpose of the gift, the use of the gift, a description of how the gift is held (for example, whether it is commingled with amounts held for other purposes), the transferee's (if any) name and address, and the relationship of the transferor to the transferee.

When preparing the Schedule B, the filing organization must use the same accounting method it checked on Form 990, Part XI, line 1 (or on the Form 990-EZ, line G, or Form 990-PF, line J).[75]

The Schedule B is open to public inspection for an organization that files the Form 990-PF and for a political organization that files the Form 990 (or the Form 990-EZ).[76] For the other organizations that file the Form 990 (or the Form 990-EZ), the names and addresses of contributors are not open to public inspection. All other information provided, including the amount of contributions and the description of noncash contributions, is open to public inspection unless it clearly identifies the contributor. If an organization files a copy of the Form 990 (or the Form 990-EZ) with a state, it should not include its Schedule B with the filing unless a schedule of contributors is required by the state; states that do not require this information might inadvertently make the schedule available for public inspection.[77]

Organizations that are not covered by the Schedule B general rule and/or the special rules thus do not file the Schedule B; they must, however, answer no on Form 990, Part IV, line 2 (or check the box in the heading of the Form 990-EZ or

---

[70] *Id.*
[71] *Id.*
[72] See *Tax-Exempt Organizations*, ch. 17.
[73] IRC § 527(j)(1). See *Tax-Exempt Organizations* § 27.5(a), text accompanied by note 187.
[74] 2008 Instructions for Schedule B. In this instance, the organization enters "Pd. 527(j)(1)" in column (b) and enters the amount of the contributions in column (c).
[75] 2008 Instructions for Schedule B.
[76] See *Tax-Exempt Organizations* § 27.9.
[77] 2008 Instructions for Schedule B.

on line 2 of the Form 990-PF), to certify that they do not meet the Schedule B filing requirements.[78]

§ 24.6 GIFT REPORTING IN UNRELATED BUSINESS CONTEXT

Most tax-exempt organizations that have unrelated business income are required to annually file an unrelated business income tax return with the IRS.[79] This return is on Form 990-T.[80] In computing unrelated business taxable income, the reporting organization subtracts various deductions, including the charitable contribution deduction, from gross unrelated trade or business income. The charitable contribution deduction is reported on the 2008 Form 990-T, line 20. This entry includes any unused contributions carried over from prior years. This deduction is allowed irrespective of whether the charitable gift was directly connected with the carrying on of a trade or business.

The total amount claimed, as a charitable deduction, by a tax-exempt corporation may not be more than 10 percent of its unrelated business taxable income determined without regard to this charitable deduction.[81] Contributions in excess of this limitation are not deductible but may be carried over for deductibility purposes for up to five subsequent tax years.[82] In computing the charitable contribution deduction, if the tax-exempt corporation has a net operating loss carryover to the tax year, the 10 percent limit is applied using the taxable income, after taking into account any deduction for the net operating loss. In determining any remaining net operating loss carryover to later years, taxable income must be modified.[83] To the extent charitable contributions are used to reduce taxable income, or to increase a net operating loss carryover, a contributions carryover is not allowed.[84]

If the reporting entity is a tax-exempt trust, in the case of contributions to public charities and certain other charitable entities,[85] the amount claimed may not be more than 50 percent of the unrelated business taxable income computed without this deduction.[86] As to contributions to other charitable organizations, the amount claimed may not be more than the lesser of (1) 30 percent of unrelated business taxable income computed without the charitable deduction or (2) the amount by which 50 percent of the unrelated business taxable income exceeds the contribution allowed in conjunction with gifts to public charities.[87]

If the contribution is of property other than money and the claimed charitable deduction is in excess of $500, the reporting tax-exempt organization must attach, to the Form 990-T, a schedule describing the kind of property contributed and the method used to determine its fair market value. If the total claimed deduction for all property contributed is more than $5,000, the filing organization must attach a

[78] In general, see *New Form 990*, § 14.1(m).
[79] IRC §§ 6011, 6012(a)(2), (4).
[80] See *Tax-Exempt Organizations* § 27.7.
[81] IRC § 170(b)(2). See § 7.18(a).
[82] IRC § 170(d)(2)(A). See § 7.18(b).
[83] IRC § 172(b).
[84] IRC § 170(d)(2)(B).
[85] That is, to organizations described in IRC § 170(b)(1)(A).
[86] In other words, the rules pertaining to charitable contributions by individuals apply. See § 7.5(a).
[87] IRC § 170(b)(1)(B). See § 7.6.

Form 8283[88] to the return, and it may have to satisfy certain appraisal requirements.[89] If the organization made a qualified conservation contribution,[90] it must also include the fair market value of the underlying property before and after the contribution, the type of legal interest contributed, and a description of the conservation purpose furthered by the gift; if a contribution carryover is included, the organization should show the amount and how it was determined. Special rules apply in connection with certain contributions of ordinary income and capital gain property.[91]

If a charitable contribution deduction is taken for property sold to a charitable organization, in a bargain sale transaction, the adjusted basis for determining gain from the sale is an amount that is in the same ratio to the adjusted basis as the amount realized bears to the fair market value of the property.[92]

Tax-exempt corporations on the accrual basis method of accounting[93] may elect to deduct contributions paid by the fifteenth day of the third month following the close of the tax year, if the contributions are authorized by the board of directors during the tax year.[94] The organization should attach a declaration to the return stating that its board of directors adopted the resolution authorizing the contributions during the tax year; this declaration must include the date the resolution was adopted.

Generally, the federal income tax charitable contribution deduction is not allowed to a tax-exempt organization (as is the case with any other donor) for a gift of $250 or more unless the organization receives a written acknowledgment from the charitable donee by the earlier of the due date (including extensions) for filing the unrelated business income tax return or the date the return is filed.[95] This written acknowledgment must reflect the amount of money contributed, a description of any property contributed, whether the charitable donee provided any goods or services to the donor in consideration for the gift, and a description and good-faith estimate of the value of any goods or services provided to the donor in exchange for the contribution. These rules do not apply, however, if the goods or services have insubstantial value, a statement is included that the goods or services consist wholly of intangible religious benefits, or certain types of benefits are received that are customarily provided in exchange for membership payments of $75 or less annually.

Generally, if a tax-exempt organization makes a charitable contribution of more than $75 and receives something in return—a quid pro quo contribution—the amount of the contribution that is deductible for federal income tax purposes is limited to the amount by which the contribution exceeds the value of the goods or services received.[96] The charitable organization that solicits or receives the contribution must inform the donor of this by written statement and must provide

[88] See § 24.7(a).
[89] See § 21.5.
[90] See § 9.7.
[91] IRC § 170(e). See §§ 4.3–4.5.
[92] See § 9.19.
[93] See § 11.5(a).
[94] IRC § 170(a)(2). See § 6.13.
[95] IRC § 170(f)(8). See § 21.3. This acknowledgment should not be attached to the return but should be maintained as part of the organization's records.
[96] IRC § 6115. See § 22.2.

the donor with a good-faith estimate of the value of the goods or services provided in exchange for the contribution.

Charitable contributions made to an organization conducting lobbying activities are not deductible if the lobbying activities relate to matters of direct financial interest to the donor's trade or business and the principal purpose of the contribution was to avoid federal income tax by obtaining a deduction for activities that would have been nondeductible under the lobbying expense rules[97] if contributed directly by the donor.[98]

§ 24.7 REPORTING OF NONCASH GIFTS IN GENERAL

Both donors to charitable organizations and donees of noncash gifts are generally to report the transactions to the IRS. The filing of the Form 8283 satisfies the reporting requirements for contributors to charities. Tax-exempt donees comply with their noncash contribution filing requirements by filing the Schedule M that accompanies the Form 990.

(a) Form 8283

A donor uses the Form 8283[99] to report required information about the donor's noncash charitable contributions. A donor must file this form if the amount of the claimed charitable contribution deduction for all noncash gifts exceeds $500.[100] The Form 8283 is filed with the tax return for the year in which the property was contributed and the deduction first claimed.

Individuals, corporations, and partnerships file the Form 8283. An individual files the form with his or her Form 1040, the income tax return filed by individuals.[101] A C corporation, other than a personal service corporation or a closely held corporation, files the Form 8283 with its Form 1120,[102] however, only if the amount claimed as a charitable contribution deduction is more than $5,000.

A partnership or S corporation that claims a deduction for noncash gifts of more than $500 must file the Form 8283 with the Form 1120S, in the case of an S corporation,[103] or Form 1065 or Form 1065-B, in the case of a partnership.[104] If the total charitable deduction for any item or group of similar items is more than $5,000, the S corporation or partnership must compute Form 8283, Section B (see below), even if the amount allocated to each shareholder or partner is $5,000 or less. An S corporation or partnership must give a completed copy of Form 8283 to each shareholder or partner receiving an allocation of the contribution deduction shown in Section B of the Form 8283.[105]

---

[97] IRC § 162(e).
[98] IRC § 170(f)(9). See § 10.8.
[99] The current version of this form was revised in December 2006.
[100] IRC § 170(f)(11)(A). This amount is determined before application of the percentage limitations that may limit a charitable deduction in a year (see ch. 7) and after making any required reductions to the fair market value of the property in calculating the deduction (see §§ 4.4(b), 4.5(a), 4.6(b), 9.26(b)).
[101] See § 24.1.
[102] See § 24.2.
[103] See § 24.3.
[104] See § 24.4.
[105] See §§ 6.15, 6.16.

An S corporation or partnership is generally required to provide information to its shareholders or partners about their share of the charitable contribution deduction on the Schedule K-1 accompanying the tax return. An individual who received a copy of the Form 8283 from an S corporation or a partnership must attach a copy of it to his or her tax return. An individual uses the amount shown on the Schedule K-1, not the amount shown on the Form 8283, in reporting the charitable deduction.

If an S corporation or partnership is not required to provide an individual with a copy of its Form 8283, the individual should combine the amount of noncash contributions shown on his or her Schedule K-1 with his or her other noncash contributions to determine whether he or she must file the Form 8283. If it is necessary for an individual in this circumstance to file the Form 8283, he or she does not have to complete all the information requested in Section A of the form for his or her share of the S corporation's or partnership's contributions. The individual need complete only column (g) of line 1 with his or her share of the contribution and enter "From Schedule K-1 (Form 1065 or 1120S)" across columns (c) through (f).[106]

If a person is required to file the Form 8283, he, she, or it will have to complete Section A, Section B, or both, depending on the type of property contributed and the amount claimed as a deduction.

Special rules apply in the case of charitable deductions claimed by certain C corporations for certain contributions of inventory or scientific equipment.[107] To determine whether a corporation of this type must file the Form 8283 or which section to complete, the corporation must use the difference between the amount it claimed as a charitable deduction and the amount it would have claimed as cost of goods sold had the corporation sold the property instead. This rule is only for Form 8283 purposes; it does not change the amount or method of computing the charitable contribution deduction. If a corporation does not have to file the Form 8283 because of this rule, it must attach a statement to the tax return (similar to the one in the example to follow). Also, a statement is to be attached if the corporation must complete Section A, instead of Section B, because of this rule.

EXAMPLE 24.4

A C corporation contributed clothing from its inventory for the care of the needy. The clothing cost the corporation $5,000; the claimed charitable deduction is $8,000. This corporation completes Section A rather than Section B of the form because the difference between the amount claimed as a charitable deduction and the amount that would have been the cost-of-goods-sold deduction is $3,000. This corporation is required to attach a statement to its Form 8283 similar to the following:

Form 8283—Inventory

Contribution deduction	$8,000
Cost of goods sold (if sold, not donated)	−5,000
For Form 8283 filing purposes	$3,000

[106] Form 8283 instructions.
[107] See §§ 9.3, 9.4.

Section A. The donor lists in Section A of the Form 8283 only (1) items (or groups of similar items) for which a charitable deduction of $5,000 or less per item (or group of similar items) is being claimed and/or (2) certain publicly traded securities even if the claimed deduction is more than $5,000. These securities are those (1) listed on an exchange where quotations are published daily, (2) regularly traded in national or regional over-the-counter markets for which published quotations are available, or (3) that are shares of a mutual fund for which quotations are published on a daily basis in a newspaper of general circulation throughout the United States.

The phrase *similar items of property* means items of the same generic category or type, such as coin collections, paintings, books, clothing, jewelry, nonpublicly traded stock, land, or buildings.[108]

Part I of Section A is designed to accommodate reporting of up to five contributions. If more gifts are to be reported, the donor should attach a statement. This part of Section A entails reporting of the name and address of the donee organization (line 1(a)), a description of the contributed property (line 1(b)), the date of the contribution (line 1(c)), the date the property was acquired by the donor (month and year) (line 1(d)), how the donor acquired the property (line 1(e)), the donor's cost or adjusted basis (line 1(f)), the fair market value of the property (line 1(g)), and the method used to determine this fair market value (line 1(h)). If the amount claimed as a deduction for an item is $500 or less, lines (d) through (f) need not be completed.

The description of the property (line 1(b)) should be ''in sufficient detail.'' As the value of the property increases, so too does the amount of detail required. Thus, as the IRS puts the matter, ''for example, a personal computer should be described in more detail than pots and pans.'' In the case of a vehicle,[109] the year, make, model, condition, and mileage at the time of the gift should be reported. A donor that does not know the actual mileage may use a good-faith estimate based on car repair records or similar evidence. In the case of securities, the donor should include the name of the issuer, the type of security, whether it is a share of a mutual fund, and whether the security is regularly traded on a stock exchange or in an over-the-counter market.[110]

As to acquisition of the property (line 1(d)), if it was created, produced, or manufactured by or for the donor, the date it was substantially completed should be reported. As to how the property was acquired (line 1(e)), the likely answers are purchase, gift, inheritance, or exchange. Concerning the matter of basis (line 1(f)), this line should not be completed in the case of property held at least 12 months or publicly traded securities. As to the matter of fair market value (line 1(g)), a statement must be attached to the form if the donor was required by law to reduce the fair market value amount to determine the amount of the charitable deduction[111] or if the gift is a qualified conservation contribution.[112] As to the methods used to determine fair market value (line 1(h)), entries are likely to

[108] Form 8283 instructions.
[109] See § 24.8.
[110] Form 8283 instructions.
[111] See *supra* note 100.
[112] See § 9.7.

include appraisal, thrift-shop value (for clothing or household items[113]), catalog (for stamp or coin collections), or comparable sales (for real estate and most other types of assets).[114]

Part II of Section A of the Form 8283 concerns partial interests[115] and restricted use property.[116] If this part applies to more than one property, a separate statement must be attached (line 2a). Questions 2a through 2e are to be completed if the donor contributed less than the entire interest in a property listed in Part I. The amount claimed as a deduction for the current tax year and in any prior tax year must be reported (line 2b). Also to be reported is the name and address of each organization to which one of these contributions was made in a prior year, if it is different from the donee entity reported in Part I (line 2c). If the property is tangible property, the place where the property is located or kept must be indicated (line 2d). The name of a person, other than the donee organization, that has possession of the property must be reported (line 2e).

Questions 3a through 3c are to be completed if the donor attached restrictions to the right to the income, use, or disposition of the donated property. The donor must indicate whether there is a restriction, either temporary or permanent, on the donee's right to use or dispose of the contributed property (line 3a). The donor must also indicate whether the donor gave to anyone (other than the donee organization or another organization participating with the donee organization in cooperative fundraising) the right to the income from the contributed property or to the possession of the property, including the right to vote contributed securities, to acquire the property by purchase or otherwise, or to designate the person having this type of income, possession, or right to acquire (line 3b). The donor must further indicate whether there is a restriction limiting the donated property for a particular use (line 3c). A statement must be attached to the form explaining the terms of an agreement or understanding regarding a restriction and whether the property is designated for a particular use.[117]

Section B. Section B of the Form 8283 is used to report items of property (or groups of similar items) for which the donor claimed a deduction in excess of $5,000 per item or group. Publicly traded securities reported in Section A should not, however, be reported in Section B.

EXAMPLE 24.5

An individual claimed, with respect to a tax year, a charitable deduction in the amount of $400 for items of clothing, $7,000 for publicly traded securities (where quotations are published daily), and $6,000 for a collection of 15 books. This donor should report the gifts of clothing and securities in Form 8283, Section A, and the gift of the books (a collection of similar items) in Form 8283, Section B.

Generally, items reportable in Section B must be the subject of a written appraisal by a qualified appraiser.[118] An appraisal is not required, however, where

[113] See § 21.7.
[114] Form 8283 instructions.
[115] See § 9.23.
[116] See § 10.4.
[117] Form 8283 instructions.
[118] See § 21.5.

the property is nonpublicly traded stock where the value is $10,000 or less; a vehicle if the deduction for the contribution is limited to the gross proceeds from its sale;[119] intellectual property;[120] certain securities considered to have market quotations readily available;[121] inventory and other property donated by a corporation in the form of qualified contributions;[122] or stock in trade, inventory, or property held primarily for sale to customers in the ordinary course of the donor's trade or business.[123]

In Part I of Section B of the form, the donor must check one or more boxes for the purpose of describing the property or properties contributed (question 4). These boxes pertain to gifts of art[124] (with the form differentiating between contributions in excess of and less than $20,000), collectibles,[125] qualified conservation property,[126] other real estate, intellectual property,[127] equipment, securities, and other property.

If the total charitable deduction for the contribution of art is at least $20,000, the donor must attach a complete copy of the signed appraisal. With respect to individual objects valued at $20,000 or more, a photograph of the property must be provided to the IRS on request. This photograph must be of sufficient quality and size (preferably an 8 × 10-inch color photograph or a color transparency no smaller than 4 × 5 inches) to fully show the object.[128]

A donor must include with the donor's return a qualified appraisal of any single item of clothing or any household item that is not in good used condition or better,[129] that was donated after August 17, 2006, and for which the donor deducted more than $500. This appraisal is required whether the contribution is reportable in Section A or Section B of the Form 8283.[130]

If a donor claims a deduction for a qualified conservation contribution[131] in a tax year beginning after August 17, 2006, for an easement on the exterior of a building in a registered historic district, the donor must include a qualified appraisal, photographs, and certain other information with the donor's tax return.[132]

If a donor claims a deduction of more than $500,000 for an item or group of similar items contributed to one or more donees, the donor must attach a qualified appraisal of the property to the donor's return (unless an exception applies[133]).[134]

A separate qualified appraisal and a separate Form 8283 are required for each item of property except for an item that is part of a group of similar items. Only

---

[119] See § 9.27.
[120] See § 9.28.
[121] See § 4.5(b).
[122] See § 9.3.
[123] Form 8283 instructions.
[124] The term *art* includes paintings, sculptures, watercolors, prints, drawings, ceramics, antiques, decorative arts, textiles, carpets, silver, rare manuscripts, and historical memorabilia (Form 8283 instructions).
[125] The term *collectibles* includes coins, stamps, books, gems, jewelry, sports memorabilia, and dolls but not art (see *supra* note 124) (*id.*).
[126] See § 9.7.
[127] See § 9.28.
[128] Form 8283 instructions.
[129] See §§ 9.25, 21.7.
[130] Form 8283 instructions.
[131] See § 9.7.
[132] Form 8283 instructions.
[133] See text accompanied by *supra* notes 117–123.
[134] Form 8283 instructions.

one appraisal is required for a group of similar items contributed in the same tax year, if it includes all of the required information for each item. The appraiser may group similar items with a collective value appraised at $100 or less. If a donor contributed similar items to more than one donee for which the donor claimed a total deduction of more than $5,000, the donor must attach a separate Form 8283 for each donee.

EXAMPLE 24.6

A donor claimed a deduction of $2,000 for books contributed to College A, $2,500 for books given to College B, and $900 for books given to a public library. This donor must attach a Form 8283 for each donee.

A donor must complete at least line 5(a) and line 5(b) (if applicable) before submitting the Form 8283 to the donee. In line 5(a), the donor must provide a detailed description of the donated property, so that a person unfamiliar with the property can be certain that the property that was appraised is the property that was contributed. The greater the value of the property, the more detail the donor should provide. Line 5(b) requires, where tangible property was contributed, a brief summary of the overall physical condition of the property at the time of the gift. Line 5(c) requires reporting of the appraised fair market value of the property; if the donor was not required to obtain an appraisal, the donor should insert the fair market value amount that the donor determines to be correct. Line 5(d) entails reporting of the date the donor acquired the property (month and year), line 5(e) requires the donor to report on how the property was acquired, line 5(f) requires reporting of the donor's cost or adjusted basis in the property, line 5(g) entails reporting of the amount the donor received in the case of a bargain sale,[135] line 5(h) requires reporting of the amount claimed as a deduction (but only if the donor was not required to obtain an appraisal), and line 5(i) requires reporting of the average trading price of donated securities (in a situation where the securities are those for which market quotations are considered to be readily available because the issue satisfies certain requirements[136]). If the donor has reasonable cause for not providing the information called for on lines 5(d), 5(e), or 5(f), the donor may attach an explanation (in order to preserve the charitable deduction).[137]

Part II of Section B of the Form 8283 is the *Donor Statement*. Here the donor lists (declares) the items that are included in Part I of Section B that have, to the best of the donor's knowledge and belief, an appraised value of no more than $500 per item. Because the donor does not have to report the value of these items in Section B, Part I, of the donee's copy of the Form 8283, the donor is required to "clearly identify" them in Section B, Part II. The result of this is that the donee is not required to file the Form 8282[138] for items valued at $500 or less.[139]

---

[135] See § 9.19.
[136] See § 4.5(b).
[137] Form 8283 instructions.
[138] See § 24.10.
[139] Form 8283 instructions.

The amount of information the donor provides in Section B, Part II, is dependent on the description of the contributed property that is provided in Section B, Part I. If the donor shows a single item as ''Property A'' in Part I and that item is appraised at $500 or less, the entry ''Property A'' in Part II is sufficient. If, however, Property A consists of several items and the total appraised value is over $500, the donor is required to list in Part II any item(s) the donor gave that is valued at $500 or less.[140]

All shares of nonpublicly traded stock or items in a set are considered one item. For example, a book collection by the same author, components of a stereo system, or six place settings of a pattern of silverware are considered one item for purposes of the $500 test.[141]

EXAMPLE 24.7

An individual contributed books, valued at $6,000, to a public charity. The appraisal states that one of the items, a collection of books by author X, is worth $400. On the Form 8283 that this donor is required to provide to the donee, the donor decides to not show the appraised value of all of the books. But the donor also does not want the donee to have to file the Form 8282 if the collection of books is sold within the three-year period following the contribution. If the donor's description of Property A on line 5 includes all the books, the donor should specify in Part II the ''collection of books by X included in Property A.'' But if the donor's Property A description is ''collection of books by X,'' the only required entry in Part II is ''Property A.''

In connection with the foregoing example, the donor may have elected instead to provide a completed copy of the Form 8283 to the donee. The donee would then be aware of the value of the property. If the donor includes all of the books as Property A on line 5 and enters $6,000 on line 5(c), the donor may still want to describe the specific collection in Part II to enable the donor to sell it without filing the Form 8282.[142]

Part III of Section B of the Form 8283 is a *Declaration of Appraiser*. A *qualified appraiser*[143] must prepare this declaration. Thus, the appraiser must declare:

- That he or she is not the donor, the donee, a party to the transaction in which the donor acquired the property, employed by or related to any of the foregoing persons, or married to an individual who is related to any of the foregoing persons.
- If regularly used by the donor, donee, or a party to the transaction, that he or she performed the majority of his or her appraisals during the tax year for other persons.
- That he or she holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis.
- That, because of his or her qualifications as described in the appraisal, he or she is qualified to make appraisals of the type of property being valued.

---

[140] *Id.*
[141] *Id.*
[142] *Id.*
[143] See § 21.5(b).

- That the appraisal fees were not based on a percentage of the appraised property's value.
- That he or she understands that a false or fraudulent overstatement of the property's value, as described in the qualified appraisal or in the Form 8283, may subject him or her to a penalty[144] for aiding and abetting an understatement of tax liability.
- That he or she understands that a substantial or gross valuation misstatement resulting from the appraisal of the property, that he or she knows or reasonably should know would be used in connection with a return or a claim for refund, may subject him or her to a penalty.[145]
- That he or she has not been barred from presenting evidence or testimony by the Department of the Treasury's Office of Professional Responsibility.

Part IV of Section B of the Form 8283 is the *Donee Acknowledgment*, which must be prepared by the donee organization that received the property described in Part I, Section B. Before submitting page 2 of the Form 8283 to the donee for acknowledgment, the donor must report at least the donor's name, identification number, and description of the contributed property (line 5(a)). If tangible property is donated, the donor must also describe the property's physical condition at the time of the gift (line 5(b)). Also, if applicable, the donor must complete Part II of Section B before submitting the Form 8283 to the donee.[146]

By this acknowledgment, the charitable donee acknowledges that it is a qualified organization[147] and reports the date on which it received the donated property as described in Section B, Part I. The donee organization is affirming that, in the event it sells, exchanges, or otherwise disposes of the property described in Section B, Part I (or any portion thereof) within three years after the date it was received, it will file Form 8282 with the IRS and provide the donor with a copy of that form.[148] The acknowledgment states that it does not represent any agreement by the donee with the claimed fair market value of the property. The donee must indicate whether it intends to use the property for an unrelated use.[149]

The individual acknowledging the gift must be an official authorized to sign the tax returns of the donee organization or an individual specifically designated to sign Form 8283. Following completion of this Part IV, the organization must return the Form 8283 to the donor. The donor must provide a copy of Section B of the form to the donee organization. The donor may then complete any remaining information required in Part I. Part III may be completed at this time by the qualified appraiser.[150]

A charitable deduction generally is disallowed if the donor fails to attach a required Form 8283 to the donor's tax return, obtain a required appraisal and complete Section B of the Form 8283, or attach to the donor's return a required appraisal of (1) clothing or household items that are not in good used condition,

---

[144] IRC § 6701(a). See § 10.14, text accompanied by notes 301–303.
[145] IRC § 6695A. See § 21.6, text accompanied by notes 156–158.
[146] Form 8283 instructions.
[147] That is, that it is an entity described in IRC § 170(c). See § 3.3.
[148] See § 24.10.
[149] See § 4.6.
[150] Form 8283 instructions.

(2) an easement on a building in a registered historic district, or (3) property for which the donor claimed a charitable deduction of more than $500,000. Nonetheless, a charitable deduction will not be disallowed if the donor's failure in this regard was due to reasonable cause and not willful neglect or was due to a good-faith omission. If the IRS requests a donor to submit the Form 8283, the donor has 90 days to send a completed Section B of Form 8283 before the donor's deduction is disallowed.[151]

In some instances, it may not be possible to obtain the donee's signature on the Form 8283. The charitable deduction will not be disallowed for that reason if the donor attaches a detailed explanation as to why it was impossible to acquire the requisite signature.[152]

(b) Form 990, Schedule M

Schedule M of the Form 990[153] requires tax-exempt organizations that receive over $25,000 in the reporting year in the form of aggregate noncash contributions, and certain other property irrespective of value[154] (Form 990, Part IV, lines 29 and 30), to provide detail regarding various types of these contributed properties, including 17 specific categories of property (with some categories further subdivided, for a total of 24), plus ''other'' types of property.

(1) Overview of Schedule M. Two parts comprise the Schedule M. Part I is the main portion; Part II is used to report certain supplemental information. Part I of Schedule M includes four columns. Column (a) is a check-the-box column, requiring an organization to report receipt of certain types of property (even if quantity reporting is not required). Column (b) pertains to the number of contributions of types of property or the number of items contributed. Column (c) concerns situations where the property contribution is reported as revenue (Form 990, Part VIII, line 1(g)). Thus, reporting is restricted to ''check-the-box'' and ''number of contributions'' for museums and other organizations that do not report contributions as revenue. Column (d) requires reporting of the method of determining revenues (when that is required). Part I also includes 24 specific questions in relation to the columns and five additional questions.

All tax-exempt organizations, not just charitable entities, must file Schedule M, although public charities will be the primary preparers and filers of the schedule. A contribution is a noncash contribution irrespective of whether it is deductible as a charitable gift. Gifts of services are not noncash gifts for purposes of this schedule.[155]

---

[151] Form 8283 instructions. The IRS, however, cannot extend the period within which a required appraisal must be obtained (see § 21.5(a)).

[152] Form 8283 instructions.

[153] This summary of Schedule M is based on the version of the schedule that accompanies the Form 990 for the 2008 calendar year or a tax year beginning in 2008. See *The New Form 990*, ch. 19.

[154] Namely, contributions of art, historical treasures, or other similar assets, or qualified conservation contributions.

[155] Form 990 (2008), Schedule M instructions. See *New Form 990* § 19.2(a).

(2) Contributions of Works of Art. Schedule M differentiates among contributions of historical treasures, contributions of fractional interests in art, and contributions of other types of works of art (Part I, lines 1–3).

The term *works of art* includes ''paintings, sculptures, prints, drawings, ceramics, antiques, decorative arts, textiles, carpets, silver, photography, film, video, installation and multimedia arts, rare books and manuscripts, historical memorabilia, and other similar objects.''[156] The term includes all contributions of art, other than historical treasures, in which the exempt organization received the donor's entire interest in the property. Thus, art in general does not include fractional interests in art. Also, art in general does not include collectibles.[157] The term *historical treasure* means a ''building, structure, area, or [other] property with recognized cultural, aesthetic, or historical value that is significant in the history, architecture, archeology, or culture of a country, state, or city.''[158]

A donor may take a deduction for a charitable contribution of a fractional interest in tangible personal property as long as the donor satisfies general law requirements for deductibility and, in subsequent years, makes additional charitable contributions of interests in the same property. Recapture of the income and gift tax charitable contribution deduction occurs under certain circumstances, such as where the donor's remaining interest in the property is not contributed to the same charitable donee within 10 years or if the donee does not timely take physical possession of the property or use the property for an exempt use. These rules are applicable for contributions, bequests, and gifts made after August 17, 2006.[159]

A contribution of a *fractional interest* in art is a ''contribution, not in trust, of an undivided portion of a donor's entire interest in a work of art.'' A contribution of a donor's *entire interest* ''must consist of a part of each and every substantial interest or right the donor owns in such work of art and must extend over the entire term of the donor's interest in the property.'' A gift ''generally is treated as a gift of an undivided portion of a donor's entire interest in property if the donee is given the right, as a tenant in common with the donor, to possession, dominion, and control of the property for a portion of each year appropriate to its interest in such property.''[160]

(3) Contributions of Publications. Books and other publications are referenced in the Schedule M (Part I, line 4). These items may be contributed to charity, although the IRS requires contributions of rare books and manuscripts to be regarded separately. (These may be classified as *collections*.) The number of these contributions for the filing year need not be reported.[161]

(4) Contributions of Clothing and Household Goods. Clothing and household gifts are reported on the Schedule M (Part I, line 5). The number of these contributions is not reported. *Household goods* include ''furniture, furnishings, electronics,

[156] *Id*.
[157] See § 24.7(b)(10).
[158] Form 990 (2008), Schedule M instructions.
[159] See § 9.1(b).
[160] Form 990 (2008), Schedule M instructions. See *New Form 990* § 19.2(b).
[161] See *New Form 990* § 19.2(c).

appliances, linens, and other similar items.'' This term does not include food, objects of art, jewelry and gems (other than costume jewelry reportable as clothing), and collectibles.[162]

Generally, a charitable deduction for a gift of clothing or household item is not allowed unless the gift item is in good used condition or better. A deduction may be allowed for a charitable contribution of an item of clothing or household item that is not in good condition or better if the amount claimed for the item is more than $500 and the donor includes with the tax return a qualified appraisal with respect to the property.[163]

(5) Contributions of Vehicles. Contributions of motor vehicles, boats, airplanes, and the like to charitable organizations are reported on the Schedule M (Part I, lines 6 and 7). These types of gifts have vexed Congress and the IRS for many years. Although the principal concern has been and continues to be the matter of valuation, this aspect of charitable giving also potentially involves issues directly affecting the charitable donee: private inurement, private benefit, intermediate sanctions, and the unrelated business rules.[164]

The focus in this context is on motor vehicles ''manufactured primarily for use on public streets, roads, and highways.'' For reporting purposes in this context, the concept of vehicles does not encompass vehicles that are part of the donor's ''stock in trade or property held by the donor primarily for sale to consumers in the ordinary course of a trade or business.''[165]

(6) Contributions of Intellectual Property. Intellectual property gifts are reported on the Schedule M (Part I, line 8). The term *intellectual property* is defined as any ''patent, copyright [with some exceptions], trademark, trade name, trade secret, know-how, software [with an exception], or similar property.''[166]

Congress, in 2004, enacted legislation concerning charitable contributions of intellectual property. This legislation is predicated on the view that excessive charitable contribution deductions enabled by inflated valuations in this context are best addressed by confining the amount of the deduction for gifts of intellectual property to the donor's basis in the property (or, if less, the property's fair market value) while allowing for charitable contribution deductions thereafter if the contributed property generates income for the charitable organization.[167]

(7) Contributions of Securities. Contributions of securities are reflected on the Schedule M (Part I, lines 9–12). A *security* is defined as any ''bond, debenture, note, or certificate or other evidence of indebtedness issued by a corporation or a government or political subdivision, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for,

---

[162] *Id.*
[163] See §§ 9.25, 21.7. See *New Form 990* § 19.2(d).
[164] See § 9.27.
[165] Form 990 (2008), Schedule M instructions. See *New Form 990* § 19.2(e).
[166] *Id.*
[167] See § 9.28. See *New Form 990* § 19.2(f).

temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing.''[168]

The law distinguishes among *publicly traded securities*, which are defined as securities ''for which (as of the date of the contribution) market quotations are readily available on an established securities market''; *closely held stock*, which means ''shares of stock issued by a corporation that is not publicly traded''; interests in a partnership, limited liability company, or trust that are not publicly traded; and other (miscellaneous) securities.[169]

(8) Qualified Conservation Contributions. Qualified conservation contributions are reported on the Schedule M (Part I, lines 13 and 14). A *qualified conservation contribution* is a contribution of a qualified real property interest exclusively for conservation purposes. A *qualified real property interest* means any of these interests in real property: the entire interest of the donor, a remainder interest, or a restriction (such as an easement), granted in perpetuity, on the use that may be made of the real property. A *conservation purpose* means (1) the preservation of land areas for outdoor recreation by, or for the education of, the public; (2) the protection of a relatively natural habitat of fish, wildlife, plants, or similar ecosystems; (3) the preservation of open space (including farmland and forest land) where the preservation is for the scenic enjoyment of the public or is in accordance with governmental conservation policy; or (4) the preservation of an historically important land area or a certified historic structure.[170]

A qualified real property interest may also entail a restriction with respect to the exterior of a certified historic structure. A *certified historic structure* is any ''building or structure listed in the National Register as well as any building [that is] certified as being of historic significance to a registered historic district.''[171]

(9) Contributions of Real Estate. Contributions of real estate are reflected on the Schedule M (Part I, lines 15–17). The law differentiates among residential real estate, commercial real estate, and other real estate interests. The term *personal residence* includes any ''property used by the donor as a personal residence but is not limited to the donor's principal residence'' and a dwelling represented by ''stock owned by the donor as a tenant-stockholder in a cooperative housing corporation if the dwelling the donor is entitled to occupy as a tenant-stockholder is used by the donor as a personal residence.'' This also includes holdings ''(not in trust) of a remainder interest in a personal residence which [is] not the donor's entire interest in the property.''[172]

Commercial real estate includes a commercial office building and a holding (not in trust) of a remainder interest in a farm that is not the donor's entire interest in the property. A *farm* is ''land used for the production of crops, fruits, or other agricultural products or for the maintenance of livestock''; the term includes improvements located on the farm property.[173]

---

[168] Form 990 (2008), Schedule M instructions.
[169] *Id*. See *New Form 990* § 19.2(g).
[170] See § 9.7(c), text accompanied by notes 171–173.
[171] *Id*., text accompanied by notes 187–189. See *New Form 990* § 19.2(h).
[172] Form 990 (2008), Schedule M instructions.
[173] *Id*.

(10) Contributions of Jewelry and Gems. Jewelry and gems are of such specialized nature that it is almost always necessary to obtain an appraisal by a knowledgeable appraiser. The appraisal should include a description of the style of the jewelry, the cut and setting of the gem, and whether the item is now in fashion. If it is not currently in fashion, the possibility of having the property redesigned, recut, or reset should be reported in the appraisal. The stone's coloring, weight, cut, brilliance, and flaws should be analyzed and reported. Sentimental value does not have an impact on the determination of fair value of jewelry or gems. The fact that an item of jewelry was owned or worn by a famous individual may increase the value of the item. Contributions of jewelry and gems may be reported as gifts of works of art or as collectibles.

(11) Contributions of Collectibles. Collectibles are reported on the Schedule M (Part I, line 18). Many of the elements of valuation that apply with respect to works of art apply to collectibles.

Collectibles include ''autographs, sports memorabilia, dolls, stamps, coins, books, gems, and jewelry (other than costume jewelry),'' but not art or historical artifacts.[174] Other items in this category are manuscripts, guns, phonograph records, and natural history items.[175]

(12) Contributions of Inventory. Contributions of food inventory are reflected on the Schedule M (Part I, question 19). As a general rule, when a corporation makes a charitable gift of property from its inventory, the resulting charitable deduction cannot exceed an amount equal to the donor's cost basis in the donated property. In most instances, this basis amount is rather small, being equal to the cost of producing the property. Under certain circumstances, however, corporate donors can receive a greater charitable deduction for gifts made from their inventory. Where the rules are satisfied, the deduction can be equal to cost basis plus one-half of the appreciated value of the property. The charitable deduction may not, in any event, exceed an amount equal to twice the property's cost basis.[176]

(13) Contribution of Drugs and Medical Supplies. Contributions of drugs, medical supplies, and similar items contributed by corporations and other businesses that manufactured or distributed the items are reported on the Schedule M (Part I, line 20).[177]

(14) Contributions of Taxidermy. Contributions of taxidermy are reported on the Schedule M (Part I, line 21). *Taxidermy property* is any ''work of art that is the reproduction or preservation of an animal, in whole or in part; is prepared, stuffed or mounted to recreate one or more characteristics of the animal, and contains a part of the body of the dead animal.'' The amount allowed as a deduction for charitable contributions of taxidermy property that is contributed by the person who prepared, stuffed, or mounted the property is the lesser of the taxpayer's

---

[174] *Id*.
[175] See *New Form 990* § 19.2(j).
[176] See § 9.3. See *New Form 990* § 19.2(k).
[177] See *New Form 990* § 19.2(l).

basis in the property or its fair market value. Most associated indirect costs may not be included in basis.[178]

(15) Contributions of Historical Artifacts. Contributions of historical artifacts are reported on the Schedule M (Part I, line 22). These properties include furniture, fixtures, textiles, and household items of a historic nature.[179] Works of art and historical treasures are reported separately, as are archeological artifacts.[180]

(16) Contributions of Scientific Specimens. Contributions of scientific specimens are reported on the Schedule M (Part I, line 23). The term *scientific specimens* includes ''living plant and animal specimens and objects or materials that are examples of natural and physical sciences, such as rocks and minerals, or that relate to, or exhibit, the methods or principles of science.''[181]

(17) Contributions of Archaeological Artifacts. Contributions of archeological and ethnological artifacts are reported on the Schedule M (Part I, line 24). Works of art, historical treasures, and historical artifacts are reported separately. An *archaeological artifact* is any ''object that is over 250 years old and is normally discovered as a result of scientific excavation, clandestine or accidental digging for exploration on land or under water.'' *Ethnological artifacts* are ''objects which are the product of a tribal or non-industrial society, and important to the culture heritage of a people because of its distinctive characteristics, comparative rarity or its contribution to the knowledge of the origins, development or history of that people.''[182]

(18) Other Types of Property. Other types of property (if any) need to be separately reported on the schedule (see Part I, lines 25–28). This includes items that did not satisfy charitable deduction requirements applicable to the contribution of the type of property but which were contributed to the organization, such as clothing and household goods that were not in good used or better condition[183] and conservation easements that do not constitute qualified conservation contributions.[184] Self-created items, such as personal papers and manuscripts, including archival records, must be separately listed.

The term *archival records* means ''materials of any kind created or received by any person, family, or organization in the conduct of their [sic] affairs that are preserved because of the enduring value of the information they contain or as evidence of the functions and responsibilities of their creator.''[185] Also, contributions of items used by the organization at a charitable auction (other than items sold by the charity at the auction), such as food served at the event or floral centerpieces, may be reported on these lines.

---

[178] See § 9.24. See *New Form 990* § 19.2(m).
[179] See *New Form 990* § 19.2(n).
[180] See §§ 24.7(b)(2), 24.7(b)(17).
[181] Form 990 (2008), Schedule M instructions.
[182] *Id*.
[183] See § 9.25.
[184] See § 9.7.
[185] Form 990 (2008), Schedule M instructions.

(19) Form 8283. Form 8283 is a form that must be filed with a donor's tax return if the claimed total deduction is over $500 for all contributed noncash property.[186] The organization reports on the Schedule M (line 29) the number of these forms it received during the tax year for contributions for which the organization completed the donee acknowledgment portion of that form (Part IV).

(20) Holding Periods. Form 8282 is filed by the donee organizations to report information to the IRS and donors about dispositions of charitable deduction property made within three years after the donor contributed the property. *Charitable deduction property* is contributed property (other than money and publicly traded securities) if the claimed value exceeds $5,000 per item or group of similar items donated to one or more donee organizations.[187]

A donor may impose the requirement that the donee hold the property for at least three years from the date of the contribution, where the property is not obligated for use for exempt purposes for the entire holding period. For each instance in which such a holding period is imposed, the organization must indicate the existence of the arrangement on the Schedule M (line 30a) and describe the arrangement (line 30b; Part II).

(21) Nonstandard Contributions. A *nonstandard contribution* includes a contribution of an item "that is not reasonably expected to be used to satisfy or further the organization's exempt purpose (aside from the need of such organization for income or funds) and for which (a) there is no ready market to which the organization may go to liquidate the contribution and convert it to cash and (b) the value of the item is highly speculative or difficult to ascertain."[188]

For example, the contribution of a person's successor member interest is a nonstandard contribution. Essentially, in this type of transaction, a person acquires a successor member interest in a limited liability company that owns real estate, then transfers the interest more than one year after acquiring it to a charitable organization, claiming a charitable contribution deduction that is significantly greater than the amount the person paid to acquire the interest. In 2007, the IRS launched an examination program pertaining to these contributions, by means of a prototype letter and information document request that the charitable organization must answer.[189]

Reporting organizations are asked whether they have a gift acceptance policy that requires the review of any nonstandard contributions (Schedule M, line 31).

(22) Service Provider Organizations. Reporting organizations are asked whether they hire or use third parties or related organizations to solicit, process, or sell noncash contributions (Schedule M, line 32a). If the answer to this question is yes, the arrangement must be described (line 32b; Part II).

---

[186] See § 24.7(a).
[187] See § 24.10.
[188] Form 990 (2008), Schedule M.
[189] See § 10.15.

(23) Nonreporting of Revenue. If the organization did not report revenue (Schedule M, Part I, column (c)) for a type of property for which receipt is indicated (Part I, column (a)), the reason for this nonreporting must be described (line 33; Part II).

§ 24.8 REPORTING OF GIFTS OF VEHICLES

The federal tax law includes deductibility and substantiation requirements in connection with contributions to charity of motor vehicles, boats, and airplanes—collectively termed *qualified vehicles*.[190] These requirements supplant the general gift substantiation rules[191] where the claimed value of the contributed vehicles exceeds $500.

Pursuant to these rules, a federal income tax charitable contribution deduction is not allowed unless the donor substantiates the contribution by a contemporaneous written acknowledgment of it by the donee organization and includes the acknowledgment with the donor's income tax return reflecting the deduction. This acknowledgment must contain the name and taxpayer identification number of the donor and the vehicle identification number or similar number. If the gift is of a qualified vehicle that was sold by the donee charitable organization without any ''significant intervening use or material improvement,'' the acknowledgment must also contain a certification that the vehicle was sold in an arm's-length transaction between unrelated parties, a statement as to the gross proceeds derived from the sale, and a statement that the deductible amount may not exceed the amount of the gross proceeds. If there is this type of use or improvement, the acknowledgment must include a certification as to the intended use or material improvement of the vehicle and the intended duration of the use, and a certification that the vehicle will not be transferred in exchange for money, other property, or services before completion of the use or improvement. An acknowledgment is *contemporaneous* if the donee organization provides it within 30 days of the sale of the qualified vehicle or, in an instance of an acknowledgment including the foregoing certifications, of the contribution of the vehicle.

The amount of the charitable deduction for a gift of a qualified vehicle depends on the nature of the use of the vehicle by the donee organization. If the charitable organization sells the vehicle without any significant intervening use or material improvement of the vehicle by the organization, the amount of the charitable deduction may not exceed the gross proceeds received from the sale. Where there is a use or improvement, the charitable deduction is based on the fair market value of the vehicle.

The legislative history accompanying this law states that these two exceptions are to be strictly construed. To meet this *significant use* test, the organization must actually use the vehicle to substantially further the organization's regularly conducted activities and the use must be significant. The test is not satisfied if the use is incidental or not intended at the time of the contribution. Whether a use is *significant* also depends on the frequency and duration of use.

[190] See § 9.27.
[191] See § 21.3.

A *material improvement* includes major repairs to a vehicle or other improvements to the vehicle that improve its condition in a manner that significantly increases the vehicle's value. Cleaning the vehicle, minor repairs, and routine maintenance do not constitute a material improvement. Presumably this exception is available only when the donee charitable organization expresses its intent at the outset (at least in part by means of the certification) that the donee plans to materially improve the vehicle.

A donee organization that is required to provide an acknowledgment under these rules must also provide that information to the IRS. A penalty is imposed for the furnishing of a false or fraudulent acknowledgment, or an untimely or incomplete acknowledgment, by a charitable organization to a donor of a qualified vehicle.

The IRS issued guidance concerning these rules for deductible charitable contributions of qualified vehicles. This guidance added a third exception to these rules, which is for circumstances where the charity gives or sells the vehicle at a significantly below-market price to a needy individual, as long as the transfer furthers the charitable purpose of helping a poor or distressed individual who is in need of a means of transportation. The guidance also explains how the fair market value of a vehicle is determined.

The IRS issued a form (Form 1098-C) to be used by donee charitable organizations to report to the IRS contributions of qualified vehicles and to provide the donor with a contemporaneous written acknowledgment of the contribution. A donor of a qualified vehicle must attach Copy B of this form to the donor's income tax return in order to take a deduction for the contribution of the vehicle where the claimed value is in excess of $500. Generally, the donee must furnish Copies B and C of the form to the donor either no later than 30 days after the date of sale or 30 days after the date of the contribution, depending on the circumstances. Copy A of this form is to be filed with the IRS, Copy C is for the donor's records, and Copy D is retained by the charitable donee.[192]

§ 24.9 REPORTING OF GIFTS OF INTELLECTUAL PROPERTY

Specific federal tax rules pertain to charitable contributions of intellectual property.[193] This body of law is predicated on the view that excessive charitable contribution deductions enabled by inflated valuations in this context are best addressed by confining the amount of the deduction for gifts of intellectual property to the donor's basis in the property (or, if less, the property's fair market value) while allowing for charitable contribution deductions thereafter if the contributed property generates income for the charitable organization.

Contributions of certain types of intellectual property are among the list of gifts that give rise to a charitable contribution deduction that is confined to the donor's basis in the property,[194] although, in instances of gifts of intellectual property, there may be one or more subsequent charitable deductions. Collectively, these properties are termed *qualified intellectual property* (except in instances when contributed to private foundations).

---

[192] See Notice 2006-1, 2006-1 C.B. 347, complementing Notice 2005-44, 2005-1 C.B. 1287.
[193] See § 9.28.
[194] See *supra* note 100.

A person who makes this type of gift, denominated a *qualified intellectual property contribution*, is provided a charitable contribution deduction (subject to the annual percentage limitations[195]) equal to the donor's basis in the property in the year of the gift and, in that year and/or subsequent years, a charitable deduction equal to a percentage of net income that flows to the charitable donee as the consequence of the gift of the property. For a contribution to be a qualified intellectual property contribution, the donor must notify the donee at the time of the contribution that the donor intends to treat the contribution as a qualified intellectual property contribution for deduction and reporting purposes. The net income involved is termed *qualified donee income*.

The general reporting requirements rules, concerning certain dispositions of contributed property,[196] encompass qualified intellectual property contributions. A donee that receives or accrues net income during a tax year from a qualified intellectual property contribution is required to prepare an information return (Form 8899).[197] This return is required for a tax year of the donee that includes any portion of the 10-year period beginning on the date of the contribution but not for tax years beginning after the expiration of the legal life of the qualified intellectual property.[198]

This return must include (1) the donee's name, address, and taxpayer identification number; (2) the donor's name, address, and taxpayer identification number; (3) a description of the contributed intellectual property in sufficient detail to identify it; (4) the date of the contribution; and (5) the amount of net income of the donee for the tax year that is properly allocable to the qualified intellectual property.[199] A copy of this return must be furnished to the donor on or before the date the donee is required to file the return with the IRS.[200] The donee is required to file this return on or before the last day of the first full month following the close of the donee's tax year to which net income from the qualified intellectual property is properly allocable.[201] Penalties apply for failure to comply with these rules.[202]

§ 24.10 REPORTING ON DISPOSITIONS OF CONTRIBUTED PROPERTY

An information return must be filed by charitable donees that make certain dispositions of contributed property (known as *charitable deduction property*).[203] Donee charitable organizations are required to report information to the IRS and to donors about dispositions of charitable deduction property contributed to them, made within three years after the date of contribution of the property. *Dispositions* are sales, exchanges, or consumption of the property (with or without

[195] See ch. 7.
[196] See § 24.10.
[197] Reg. § 1.6050L-2T(a).
[198] *Id.*
[199] IRC § 6050L(b); Reg. § 1.6050L-2T(b).
[200] IRC § 6050L(c); Reg. § 1.6050L-2T(c).
[201] Reg. § 1.6050L-2T(d)(2)(i).
[202] IRC §§ 6721–6724.
[203] IRC § 6050L(a)(1).

consideration).[204] *Charitable deduction property* is any property contributed for charitable purposes, other than money and publicly traded securities, if the claimed value is in excess of $5,000 per item or group of similar items given to one or more donee organizations.[205] This is the property listed in Section B of the Form 8283.[206] The form used to report these dispositions is Form 8282. A copy of this donee information return must be provided to the donor and retained by the donee.[207]

These rules pertain to original donees and successor donees. An *original donee* is the first donee to or for which the donor contributed the property. The original donee is required to sign Form 8283, Section B, Part IV, presented by the donor for charitable deduction property. A *successor donee* is any donee of property, other than the original donee.

There are two situations where the Form 8282 does not have to be filed:

1. An organization does not have to file the form if, at the time the original donee signed Section B of the Form 8283, the donor signed a statement on that form that the appraised value of the specific item was not more than $500. If Form 8283 references more than one item, this exception is applicable only to those items that are clearly identified as having a value of $500 or less. For purposes of the donor's determination of whether the appraised value of the item exceeds $500, however, all shares of nonpublicly traded stock or items that form a set are considered one item. For example, a collection of books written by the same author, components of a stereo system, or six place settings of a pattern of silverware are considered one item.[208]
2. An organization does not have to file the form if an item of contributed property is consumed or distributed, without consideration, in fulfillment of the organization's exempt functions. For example, this reporting is not required for medical supplies consumed or distributed by a tax-exempt relief organization in aiding disaster victims.[209]

Generally, the Form 8282 must be filed within 125 days after the date of disposition of the property.[210] If an organization did not file the form because it had no reason to believe these substantiation requirements applied to the donor but the organization later became aware that the substantiation requirements were applicable, the organization must file the Form 8282 within 60 days after the date it became aware of this filing requirement.[211] For example, this exception applies where Section B of Form 8283 is furnished to a successor donee after the date that donee disposed of the charitable deduction property.[212]

[204] Reg. § 1.6050L-1(a)(1).
[205] Reg. § 1.6050L-1(e).
[206] See § 24.7(a).
[207] IRC § 6050L(c).
[208] Reg. § 1.6050L-1(a)(2).
[209] Reg. § 1.6050L-1(a)(3).
[210] Reg. § 1.6050L-1(f)(2)(i).
[211] Reg. § 1.6050L-1(f)(2)(ii).
[212] Form 8282 instructions.

If the Form 8282 is filed by the due date, the organization's name, address, and employer identification number must be provided, and at least Part III, columns 1 through 4, and Part IV must be completed.[213] The organization does not have to complete the remaining items if the information is not available. For example, the organization may not have the information necessary to complete all entries if the donor did not make Section B of Form 8283 available.[214]

If the charitable deduction property is transferred to another charitable organization within the three-year period, the transferor organization must provide the successor donee with (1) the name, address, and federal tax identification number of the organization; (2) a copy of Section B of the Form 8283 that the organization received from the donor (or a preceding donee); and (3) a copy of the Form 8282, within 15 days after the organization files it.[215] The organization must furnish the first and second of these items within 15 days after the latest of the date the organization transferred the property, the original donee signed Section B of the Form 8283, or the organization received a copy of Section B of the Form 8283 from the preceding donee if the organization is also a successor donee.[216]

The successor donee organization to which the organization transferred the property is required to give the transferor organization its name, address, and federal tax identification number within 15 days after the later of the date the organization transferred the property or the date the successor donee received a copy of Section B of the Form 8283.[217] The organization must provide a copy of the Form 8282 to the original donor of the property.[218] The organization must also keep a copy of Form 8283, Section B, in its records.[219]

Thus, if the organization is an original donee, it should complete the *Identifying Information* portion at the top of the Form 8282, and Part I (lines 1a–1d and, if applicable, lines 2a–2d) and Part III. If the organization is a successor donee, it should complete the *Identifying Information* portion of the form and Parts I through III.[220]

Part III of the Form 8282 solicits information about the contributed property. A description of the contributed property and how the organization used the property must be reported (question 1). The form asks whether the disposition involved the organization's entire interest in the property (question 2). A question inquires as to whether the use was related to the organization's exempt purpose or function (question 3). (If the organization sold, exchanged, or otherwise disposed of the property without any use of it, the answer to that question is no.) If the organization answered yes to question 3 and the property was tangible personal property, the organization must describe how the organization's use of the property furthered its exempt purpose or function (question 4).[221] If the organization answered no to question 3 and the property was tangible personal property,

[213] Reg. § 1.6050L-1(b).
[214] Form 8282 instructions.
[215] Reg. § 1.6050L-1(c)(1).
[216] Form 8282 instructions.
[217] Reg. § 1.6050L-1(c)(3).
[218] Reg. § 1.6050L-1(d)(1).
[219] Form 8282 instructions.
[220] Reg. § 1.6050L-1(c)(2).
[221] See § 4.6.

the organization must describe its intended use (if any) at the time of the contribution and indicate whether, if the intended use at the time of the contribution was related to its exempt purposes or function, the intended use became impossible or infeasible to implement (question 4). The organization must also report the date it received the contributed property (question 5); the date the original donee received the property (question 6); the date the property was sold, exchanged, or otherwise disposed of (question 7); and the amount the organization received on disposition of the property (question 8). Part IV of the Form 8282 is a certification to be executed where any property described in Part III is tangible personal property.

An organization may be subject to a penalty (generally $50) if it fails to file the Form 8282 by the due date, fails to include all of the information required to be provided on the form, or fails to include correct information on the form.[222] A penalty ($10,000) may apply to any person who identifies in Part III of the Form 8282 tangible personal property the organization sold, exchanged, or otherwise disposed of as having a use that is related to a purpose or function knowing that the property was not intended for such a use.[223]

§ 24.11 APPLICABLE INSURANCE CONTRACT REPORTING REQUIREMENTS

The government is concerned about transactions involving the acquisition of life insurance contracts using arrangements in which tax-exempt organizations, primarily charitable entities, and private investors have an interest in the contract.[224] In these instances, the exempt organization has an insurable interest in the insured individuals, perhaps because they are donors.[225] Private investors provide the capital used to fund the purchase of the life insurance contracts, sometimes together with annuity contracts. This dual interest in the contracts is manifested by means of trusts, partnerships, or other arrangements for sharing the rights to the contracts. Both the exempt organizations and the private investors receive money in connection with the investment in the contracts while the life insurance is in force or as the insured individuals die.

For reportable acquisitions occurring after August 17, 2006, and on or before August 18, 2008, an applicable exempt organization that engages in a reportable transaction must file an information return.[226] This return must include the name, address, and taxpayer identification number of the organization and of the issuer of the applicable insurance contract.[227] A *reportable transaction* means the acquisition by an applicable exempt organization of a direct or indirect interest in a contract that the exempt organization knows or has reason to know is an applicable insurance contract, if the acquisition is a part of a structured transaction involving a pool of these contracts.[228]

---

[222] IRC § 6721.
[223] IRC § 6720B.
[224] E.g., Davis, "Death-Pool Donations," 143 *Trusts and Estates* (No. 5) 55 (2004).
[225] See § 17.4.
[226] IRC § 6050V(a).
[227] IRC § 6050V(c).
[228] IRC § 6050V(d)(1).

An *applicable insurance contract* is a life insurance, annuity, or endowment contract with respect to which an applicable exempt organization and a person other than an applicable exempt organization have, directly or indirectly, held an interest in the contract (whether or not at the same time).[229] This term does not apply if (1) each person (other than an applicable exempt organization) with a direct or indirect interest in the contract has an insurable interest in the insured individual, independent of any interest of the exempt organization in the contract; (2) the sole interest in the contract of the applicable exempt organization or each person other than the exempt organization is as a named beneficiary; and (3) the sole interest in the contract of each person other than the applicable exempt organization is either (a) as a beneficiary of a trust holding an interest in the contract, but only if the person's designation as a beneficiary was made without consideration and solely on a purely gratuitous basis, or (b) as a trustee who holds an interest in the contract in a fiduciary capacity solely for the benefit of applicable exempt organizations or of persons otherwise meeting one of the first two of these exceptions.[230] An *applicable exempt organization* generally includes charitable organizations, governments or their political subdivisions, and Indian tribal governments.[231]

The Department of the Treasury has been directed to undertake a study on the use by tax-exempt organizations of applicable insurance contracts for the purpose of sharing the benefits of the organizations' insurable interest in insured individuals under these contracts with investors and to determine whether these activities are consistent with exempt purposes.[232] The study may, for example, address whether any of these arrangements are or may be used to improperly shelter income from tax, and whether they should be listed transactions.[233]

§ 24.12 PERSONAL BENEFIT CONTRACT REPORTING REQUIREMENTS

Charitable organizations are required to annually report the amount of premiums paid during the year that is subject to the personal benefit contract excise tax.[234] They must also report the name and taxpayer identification number of each beneficiary under the life insurance, annuity, or endowment contract to which the premiums relate.[235]

These organizations are asked, as part of the annual information return filing requirement, whether they, during the reporting year, (1) received any funds, directly or indirectly, to pay premiums on a personal benefit contract; or (2) paid any premiums, directly or indirectly, on a personal benefit contract.[236]

[229] IRC § 6050V(d)(2)(A).
[230] IRC § 6050V(d)(2)(B).
[231] IRC § 6050V(d)(3).
[232] Pension Protection Act of 2006 § 1211(c).
[233] See § 2.6.
[234] See § 17.6.
[235] See IRC § 170(f)(10)(F)(iii). This report is on Form 8870.
[236] Form 990, Part V, question 7e, f. See *New Form 990*, §§ 4.1(m), 4.2(h).

§ 24.13 SPLIT-INTEREST TRUST FILING REQUIREMENTS

Split-interest trusts, including charitable remainder trusts,[237] pooled income funds,[238] and charitable lead trusts,[239]are required to file an annual information return.[240] Trusts that are not split-interest trusts but that claim a charitable deduction for amounts permanently set aside for a charitable purpose[241] are also required to file this return.[242] These returns are publicly available.[243]

Failure to file the required return (or failure to include any required information or to show the correct information) may result in imposition of a penalty on the trust. This penalty generally is $20 for each day the failure continues, up to the lesser of $10,000 or 5 percent of gross receipts for any one return.[244] In the case of a split-interest trust with gross income in excess of $250,000, however, the penalty is, as to tax returns for tax years beginning after December 31, 2006, $100 for each day the failure continues, up to a maximum of $50,000.[245] Also, if a person who is under a duty to file the return or include required information (any trustee, director, officer, employee, or similar individual) knowingly failed to file the return or include required information, that person is personally liable for such a penalty, which is imposed in addition to the penalty imposed on the organization.[246] Information regarding noncharitable beneficiaries is exempt from the requirement to make information publicly available.[247]

Additionally, split-interest trusts are required to annually file a disclosure form, which requires disclosure of information regarding a trust's noncharitable beneficiaries.[248] The penalty for failure to file this form is calculated on the basis of the amount of tax owed. A split-interest trust generally is not subject to tax and, therefore, in general, a penalty may not be imposed for the failure to file this form. This form need not be made publicly available.

---

[237] See ch. 12.
[238] See ch. 13.
[239] See ch. 16.
[240] IRC § 6034(a). This return is on Form 5227. These trusts no longer file Form 1041-A.
[241] IRC § 642(c).
[242] IRC § 6034(b).
[243] IRC § 6104(b). See *Tax-Exempt Organizations* § 27.9.
[244] IRC § 6652(c)(1)(A).
[245] IRC § 6652(c)(1)(C).
[246] *Id*.
[247] IRC § 6104(b), last sentence.
[248] Form 5227, Schedule A.

CHAPTER TWENTY-FIVE

State Fundraising Regulation

§ 25.1 **State Regulation in General** 711
§ 25.2 **Historical Perspective** 712
§ 25.3 **States' Police Power** 714
§ 25.4 **Basic Definitions** 714
§ 25.5 **Registration Requirements** 715
§ 25.6 **Reporting Requirements** 716
§ 25.7 **Exemptions from Regulation** 716
§ 25.8 **Fundraising Cost Limitations** 717
§ 25.9 **Prohibited Acts** 718
§ 25.10 **Contractual Requirements** 719
§ 25.11 **Disclosure Requirements** 720

The solicitation of charitable contributions in the United States involves practices that are recognized as being forms of free speech protected by federal and state constitutional law. Thus, there are limitations on the extent to which fundraising for charitable, educational, scientific, religious, and like organizations can be regulated by government. Nevertheless, nonprofit organizations in the United States face considerable regulatory requirements at the federal, state, and local levels when they solicit contributions for charitable purposes. The purpose of this chapter is to summarize this body of law.[1]

The process of raising funds for charitable purposes is heavily regulated by the states. At this time, all but four states have some form of statutory structure by which the fundraising process is regulated.[2] Of these states, 39 have formal charitable solicitation acts.

§ 25.1 STATE REGULATION IN GENERAL

The various state charitable solicitation acts generally contain certain features, including:

- A process by which a charitable organization registers or otherwise secures a permit to raise funds for charitable purposes in the state

[1] This body of law is summarized in greater detail in *Fundraising*, particularly ch. 3. Also Hopkins, *Fundraising Law Made Easy* (Hoboken, NJ: John Wiley & Sons, 2009).

[2] The states that have no statutory or other regulatory law in this regard are Alaska, Idaho, Montana, and Wyoming.

- Requirements for reporting information (usually annually) about an organization's fundraising program
- A series of organizations or activities that are exempt from some or all of the statutory requirements
- A process by which a professional fundraiser, professional solicitor, and/or commercial co-venturer registers with, and reports to, the state
- Recordkeeping requirements. applicable to charitable organizations, professional fundraisers, professional solicitors, and/or commercial coventurers
- Rules concerning the contents of contracts between a charitable organization and a professional fundraiser, professional solicitor, and/or a commercial co-venturer
- A series of prohibited acts
- Provision for reciprocal agreements among the states as to coordinated regulation in this field
- A summary of the powers of the governmental official having regulatory authority (usually the Attorney General or Secretary of State)
- A statement of the various sanctions that can be imposed for failure to comply with this law (such as injunctions, fines, and imprisonment)

These elements of the law are generally applicable to the fundraising charitable organization. Nevertheless, several provisions of law are directed at the fundraising professional or the professional solicitor, thus going beyond traditional fundraising regulation.

§ 25.2 HISTORICAL PERSPECTIVE

Until the mid-1950s, the matter of fundraising practices was not addressed by state law. At that time, not much attention was paid to those practices from the legal perspective. Some counties had adopted fundraising regulation ordinances, but there was no state or federal law on the subject.

This began to change about 50 years ago as part of the disclosure and consumer protection movements. North Carolina was the first state to enact a fundraising regulation law. Others soon followed, however, generating a series of laws that came to be known as *charitable solicitation acts*. New York was the second state to enact one of these acts, and this law became the prototype for the many that were to follow.

The New York law and its progeny involved a statutory scheme based on registration and reporting. Charitable organizations are required to register in advance of solicitation and to annually report; bond requirements came later. Subsequently, forms of regulation involving professional fundraisers and professional solicitors were developed. Exceptions evolved, disclosure requirements expanded, and a variety of prohibited acts (see below) were identified.

Today's typical charitable solicitation statute is far more extensive than its forebears of decades ago. When charitable solicitation acts began to develop (as noted, beginning in the mid-1950s), the principal features were registration and

annual reporting requirements. These laws were basically licensing statutes. They gave the states essential information about the fundraising to be conducted, so that they would have a basis for investigation and review should there be suspicion of some abuse.

During the ensuing years, some states decided to go beyond the concept of licensing and began to affirmatively regulate charitable solicitations. This was done in part because of citizen complaints; another part was political grandstanding. The regulation worked its way into the realm of attempting to prevent ''less qualified'' (including out-of-the-mainstream) charities from soliciting in the states.

Structurally, the typical charitable solicitation statute originally did not have much to do with actual regulation of the efforts of either the fundraising institution or the fundraising professional. Rather, the emphasis was on information gathering and disclosure of that information to ostensibly desirous donors. As noted, its requirements were based on the submission of written information (registration statements, reports, and the like) by charitable organizations and their fundraising advisers; the typical statute also contained bond requirements and granted enforcement authority to the attorneys general, secretaries of state, or other governmental officials charged with administering and enforcing the law.

Later, however, law requirements began to creep in that sounded more like ethical precepts. These requirements were more than just mechanics—they went beyond registration requirements, filing due dates, and accounting principles. They went beyond telling the charity and the professional fundraisers when to do something, and entered the realm of telling them how they must conduct the solicitation and what they cannot do in that regard.

From the regulators' viewpoint, the apogee of this form of regulation came when the states could ban charitable organizations with ''high'' fundraising costs. (As noted below, this form of regulation ultimately was found to be unconstitutional.) This application of constitutional law rights to charitable solicitation acts left the state regulators without their principal weapon. In frustration, they turned to other forms of law, those based on the principle of ''disclosure'' (see below).

In this aftermath, more state fundraising law developed. The registration and annual reports became more extensive. The states tried, with limited success, to force charities and solicitors into various forms of point-of-solicitation disclosure of various pieces of information. Some states dictated the contents of the scripts of telephone solicitors. This disclosure approach failed to satisfy the regulatory impulse. More frustration ensued.

The regulators turned to even more ways to have a role in the charitable fundraising process. They started to micromanage charitable fundraising. They began to substitute their judgment for that of donors, charities, and professional fundraisers. Thus, they engendered laws that beefed up the recordkeeping requirements, spelled out the contents of contracts between charities and fundraising consultants and solicitors, stepped into commercial co-ventures, and even injected themselves into matters such as the sale of tickets for charitable events and solicitations by fire and police personnel.

The regulatory appetite still remained unsatisfied. Having accomplished the imposition of just about all of the *law* they could think of, they turned to

principles of *ethics*. For example, in one state, charities that solicit charitable gifts and their professional fundraisers and solicitors are "fiduciaries." This is a role historically confined to trustees of charitable trusts and more recently to directors of charitable corporations.

§ 25.3 STATES' POLICE POWER

Prior to a fuller analysis of state law regulation in this field, it is necessary to briefly reference the underlying legal basis for this body of law: the *police power*. Each state (and local unit of government) inherently possesses the police power. This power enables a state or other political subdivision of government to regulate—within the bounds of constitutional law principles (see below)—the conduct of its citizens and others, so as to protect the safety, health, and welfare of its citizens.

Generally, it is clear that a state can enact and enforce, in the exercise of its police power, a charitable solicitation act that requires a charity planning on fundraising in the jurisdiction to first register with (or secure a license or permit from) the appropriate regulatory authorities and subsequently to file periodic reports about the results of the solicitation. There is nothing inherently unlawful about this type of requirement. It may also mandate professional fundraisers and professional solicitors to register and report, or empower the regulatory authorities to investigate the activities of charitable organizations in the presence of reasonable cause to do so, and impose injunctive remedies, fines, and imprisonment for violation of the statute. It appears clear that a state can regulate charitable fundraising notwithstanding the fact that the solicitation utilizes the federal postal system, uses television and radio broadcasts, or otherwise occurs in interstate commerce. The rationale is that charitable solicitations may be reasonably regulated to protect the public from deceit, fraud, or the unscrupulous obtaining of money under a pretense that the money is being collected and expended for a charitable purpose.

Despite the inherent police power lodged in the states (and local jurisdictions) to regulate the charitable solicitation process, and the general scope of the power, principles of law operate to confine its reach. Most of these principles are based on constitutional law precepts, such as freedom of speech, procedural and substantive due process, and equal protection of the laws, as well as the standards usually imposed by statutory law, which bar the exercise of the police power in a manner that is arbitrary.

§ 25.4 BASIC DEFINITIONS

State law regulation of this nature pertains to fundraising for charitable purposes. The use of the term *charitable* in this setting refers to a range of activities and organizations that is much broader than that embraced by the term as used in the federal tax context. That is, while the term includes organizations that are charitable, educational, scientific, and religious, as those terms are used for federal tax law purposes, it also includes (absent specific exemption) organizations that are civic, social welfare, recreational, and fraternal. Indeed, the general definition is

so encompassing as to cause some of these statutes to expressly exclude fundraising by political action committees, labor organizations, and trade organizations.

Some of this regulation is applicable to a *professional fundraiser* (or similar term). The majority of the states define a *professional fundraiser* as one who, for a fixed fee under a written agreement, plans, conducts, advises, or acts as a consultant, whether directly or indirectly, in connection with soliciting contributions for, or on behalf of, a charitable organization. This definition usually excludes those who actually solicit contributions. Other terms used throughout the states include *professional fundraising counsel*, *professional fundraiser consultant*, and *independent fundraiser*.

Much of this regulation is applicable to those who are *professional solicitors*. Most of the states that use this term define this type of person as one who, for compensation, solicits contributions for or on behalf of a charitable organization, whether directly or through others, or a person involved in the fundraising process who does not qualify as a professional fundraiser. A minority of states define the term as a person who is employed or retained for compensation by a professional fundraiser to solicit contributions for charitable purposes.

There is considerable confusion in the law as to the appropriate line of demarcation between these two terms. Because the extent of regulation can be far more intense for a professional solicitor, it is often very important for an individual or company to be classified as a professional fundraiser rather than a professional solicitor.

Some states impose disclosure requirements with respect to the process known as *commercial co-venturing* or *charitable sales promotions*. This process occurs when a business announces to the general public that a portion (a specific amount or a specific percentage) of the purchase price of a product or service will, during a stated period, be paid to a charitable organization. This activity results in a payment by the business to a charitable organization, the amount of which depends on consumer response to the promotion by, and positive publicity for, the business sponsor.

§ 25.5 REGISTRATION REQUIREMENTS

A cornerstone of each state's charitable solicitation law is the requirement that a charitable organization (as defined in that law and not exempt from the obligation (see below)) that intends to solicit—by any means—contributions from persons in that state must first apply for and acquire permission to undertake the solicitation. This permission is usually characterized as a *registration*; some states denominate it a *license* or a *permit*. If successful, the result is authorization to conduct the solicitation. These permits are usually valid for one year.

These state laws apply to fundraising within the borders of each state involved. Thus, a charitable or like organization soliciting in more than one state must register under (and otherwise comply with) not only the law of the state in which it is located, but also the law of each of the states in which it will be fundraising. Moreover, many counties, townships, cities, and similar jurisdictions throughout the United States have ordinances that attempt to regulate charitable fundraising within their borders.

As noted below, most states' charitable solicitation acts require a soliciting charity (unless exempt) to annually file information with the appropriate governmental agency. This is done either by an annual updating of the registration or the like, or by the filing of a separate annual report.

In many states, professional fundraisers and professional solicitors are required to register with the state.

§ 25.6 REPORTING REQUIREMENTS

Many of the state charitable solicitation acts mandate annual reporting to the state by registered charitable organizations, professional fundraisers, and professional solicitors. This form of reporting can be extensive and may entail the provision of information concerning gifts received, funds expended for programs and fundraising, payments to service providers, and a battery of other information.

These reports are made on forms provided by the states. These forms, and the rules and instructions that accompany them, vary considerably in content. Underlying definitions and accounting principles can differ. There is little uniformity with respect to due dates for these reports. There has been progress in recent years, however, in the development of a uniform reporting form.

In many states, professional fundraisers and professional solicitors are required to file annual reports with the state.

§ 25.7 EXEMPTIONS FROM REGULATION

Many of the states exempt one or more categories of charitable organizations from the ambit of their charitable solicitation statutes. The basic rationale for these exemptions is that the exempted organizations are not part of the objective that the state is endeavoring to achieve through this type of regulation: the protection of the state's citizens from fundraising fraud and other abuse. (Other rationales are the constitutional law limitations involved in the case of churches and the ability of one or more categories of organization to persuade the legislature to exempt them.)

The most common exemption in this context is for churches and their closely related entities. These entities include conventions of churches and associations of churches. Some states broadly exempt religious organizations. These exemptions are rooted in constitutional law principles, barring government from regulating religious practices and beliefs. Some states have run into successful constitutional law challenges when they have attempted to narrowly define the concept of *religion* for this purpose.

Some states exempt at least certain types of educational institutions from the entirety of their charitable solicitation acts. Usually, this exemption applies when the educational institution is accredited. The more common practice is to exempt educational institutions from only the registration or licensing, and reporting, requirements.

Some states, either as an alternative or in addition to the foregoing approach, exempt from the registration and reporting requirements educational institutions that confine their solicitations to their constituency. That is, this type of

exemption extends to the solicitation of contributions by an educational institution to its student body, alumni, faculty, and trustees, and their families. A few states exempt solicitations by educational institutions of their constituency from the entirety of their charitable solicitation laws.

Many educational institutions undertake some or all of their fundraising by means of related foundations. Some states expressly provide exemption, in tandem with whatever exemption their laws extend to educational institutions, to these supporting foundations. A few states exempt alumni associations from the registration requirements.

The rationale for exempting educational institutions from coverage under these laws is the general rationale articulated above. These institutions do not solicit the general public, there have not been any instances of abuses by these institutions of the fundraising process, these institutions already adequately report to state agencies, and the inclusion of these institutions under the charitable solicitation statute would impose an unnecessary burden on the regulatory process.

Some states exempt hospitals (and, in some instances, their related foundations) and other categories of health care entities. Again, the exemption can be from the entirety of the statute or from its registration and reporting requirements. Other exemptions for organizations may include veterans' organizations; police and firefighters' organizations; fraternal organizations; and, in a few states, organizations identified by name. Exemptions are also often available for membership organizations, small solicitations (ranging from $1,000 to $10,000), and solicitations for specified individuals.

Some of these exemptions are available as a matter of law. Others must be applied for, sometimes on an annual basis. Some exemptions are not available or are lost if the organization utilizes the services of a professional fundraiser or professional solicitor.

§ 25.8 FUNDRAISING COST LIMITATIONS

Once, the chief weapon for state regulators in this regard was laws that prohibited charitable organizations with ''high'' fundraising costs from soliciting in the states. Allegedly ''high'' fundraising expenses were defined in terms of percentages of gifts received. These laws proliferated, with percentage limitations extended to the compensation of professional fundraising consultants and professional solicitors. The issue found its way to the Supreme Court, where all of these percentage limitations were struck down as violating the charities' free speech rights. This application of the First and Fourteenth Amendments to the Constitution stands as the single most important bar to more stringent government regulation of the process of soliciting charitable contributions.

As noted, the states possess the police power to regulate the process of soliciting contributions for charitable purposes. The states cannot, however, exercise this power in a manner that unduly intrudes on the rights of free speech of the soliciting charitable organizations and their fundraising consultants and solicitors.

First, the Supreme Court held that a state cannot use the level of a charitable organization's fundraising costs as a basis for determining whether a charity may

lawfully solicit funds in a jurisdiction.[3] Four years later, the Court held that the free speech principles apply, even though the state offers a charitable organization an opportunity to show that its fundraising costs are reasonable, despite the presumption that costs in excess of a specific ceiling are "excessive."[4] Another four years later, the Court held that these free speech principles applied when the limitation was not on a charity's fundraising costs but on the amount or extent of fees paid by a charitable organization to professional fundraisers or professional solicitors.[5] Subsequent litigation suggests that the courts are consistently reinforcing the legal principles so articulately promulgated by the Supreme Court during the 1980s.

§ 25.9 PROHIBITED ACTS

Most states' charitable solicitation laws contain a list of one or more acts in which a charitable organization (and perhaps a professional fundraiser and/or professional solicitor) may not lawfully engage. These acts may be some or all of the following:

- A person may not, for the purpose of soliciting contributions, use the name of another person (except that of an officer, director, or trustee of the charitable organization by or for which contributions are solicited) without the consent of that other person. This prohibition usually extends to the use of an individual's name on stationery or in an advertisement or brochure, or as one who has contributed to, sponsored, or endorsed the organization.
- A person may not, for the purpose of soliciting contributions, use a name, symbol, or statement so closely related or similar to that used by another charitable organization or governmental agency that it would tend to confuse or mislead the public.
- A person may not use or exploit the fact of registration with the state so as to lead the public to believe that the registration in any manner constitutes an endorsement or approval by the state.
- A person may not represent to or mislead anyone, by any manner, means, practice, or device, to believe that the organization on behalf of which the solicitation is being conducted is a charitable organization or that the proceeds of the solicitation will be used for charitable purposes, when that is not the case.
- A person may not represent that the solicitation for charitable gifts is for or on behalf of a charitable organization or otherwise induce contributions from the public without proper authorization from the charitable organization.

In one state, it is a prohibited act to represent that a charitable organization will receive a fixed or estimated percentage of the gross revenue from a solicitation in an amount greater than that identified to the donor. In another state, it is a

[3] *Village of Schaumberg v. Citizens for a Better Environment*, 444 U.S. 620 (1980).
[4] *Secretary of State of Maryland v. Joseph H. Munson Co., Inc.*, 467 U.S. 947 (1984).
[5] *Riley v. National Fed'n of the Blind of North Carolina, Inc.*, 487 U.S. 781 (1988).

prohibited act for an individual to solicit charitable contributions if the individual has been convicted of a crime involving the obtaining of money or property by false pretenses, unless the public is informed of the conviction in advance of the solicitation.

In still another state, the following are prohibited acts for a charitable organization (or, in some instances, a person acting on its behalf):

- Misrepresenting the purpose of a solicitation
- Misrepresenting the purpose or nature of a charitable organization
- Engaging in a financial transaction that is not related to accomplishment of the charitable organization's exempt purpose
- Jeopardizing or interfering with the ability of a charitable organization to accomplish its charitable purpose
- Expending an ''unreasonable amount of money'' for fundraising or for management

Some states make violation of a separate law concerning ''unfair or deceptive acts and practices'' a violation of the charitable solicitation act as well.

§ 25.10 CONTRACTUAL REQUIREMENTS

Many of the state charitable solicitation acts require that the relationship between a charitable organization and a professional fundraiser, and/or between a charitable organization and a professional solicitor, be evidenced in a written agreement. This agreement is required to be filed with the state soon after the contract is executed. These types of requirements are clearly lawful and are not particularly unusual.

A few states, however, have enacted requirements—some of them rather patronizing—that dictate to the charitable organization the contents of the contract. For example, under one state's law, a contract between a charitable organization and a fundraising counsel must contain sufficient information ''as will enable the department to identify the services the fundraising counsel is to provide and the manner of his compensation.'' Another provision of the same law mandates that the agreement ''clearly state the respective obligations of the parties.''

The law in another state requires a contract between a charitable organization and a fundraising counsel to contain provisions addressing the services to be provided, the number of persons to be involved in providing the services, the time period over which the services are to be provided, and the method and formula for compensation for the services.

Under another state's law, whenever a charitable organization contracts with a professional fundraiser or other type of fundraising consultant, the charitable organization has the right to cancel the contract, without cost or penalty, for a period of 15 days. Again, this type of law seems predicated on the assumption that charitable organizations are somehow not quite capable of developing their own contracts and tend to do so impetuously. It can be argued that these laws are forms of overreaching, in terms of scope and detail, on the part of government,

and that charitable organizations ought to be mature enough to formulate their own contracts.

§ 25.11 DISCLOSURE REQUIREMENTS

Many of the states that were forced to abandon or forgo the use of the percentage mechanism as a basis for preventing fundraising for charity (see above) utilize the percentage approach in a disclosure setting. Several states, for example, require charitable organizations to make an annual reporting, either to update a registration or as part of a separate report, to the authorities as to their fundraising activities in the prior year, including a statement of their fundraising expenses. Some states require a disclosure of a charity's fundraising costs, stated as a percentage, to donors at the time of the solicitation—although this requirement arguably is of dubious constitutionality. In a few states, solicitation literature used by a charitable organization must include a statement that, upon request, financial and other information about the soliciting charity may be obtained directly from the state.

Some states require a statement as to any percentage compensation in the contract between the charitable organization and the professional fundraiser and/or the professional solicitor. A few states require the compensation of a paid solicitor to be stated in the contract as a percentage of gross revenue; another state has a similar provision with respect to a professional fundraiser. One state wants a charitable organization's fundraising cost percentage to be stated in its registration statement.

An example of this type of law is a statute that imposed on the individual who raises funds for a charitable organization the responsibility to "deal with" the contributions in an "appropriate fiduciary manner." Thus, an individual in these circumstances owes a fiduciary duty to the public. These persons are subject to a surcharge for any funds wasted or not accounted for. A presumption exists in this law that funds not adequately documented and disclosed by records were not properly spent.

By direction of this law, all solicitations must "fully and accurately" identify the purposes of the charitable organization to prospective donors. Use of funds, to an extent of more than 50 percent, for "public education" must be disclosed under this law. Every contract with a professional fundraiser must be approved by the charitable organization's governing board. Some of the provisions of this law probably are unconstitutional, such as the requirement that professional fundraisers or solicitors must disclose to those being solicited the percentage of their compensation in relation to gifts received.

Another example is some of the provisions of another state's law, which makes an "unlawful practice" the failure of a person soliciting funds to "truthfully" recite, upon request, the percentage of funds raised to be paid to the solicitor. This state, like many other states, is using the concept of prohibited acts (see above) to impose a sort of code of ethics on all who seek to raise funds for charity.

Under one state's law, any person who solicits contributions for a charitable purpose and who receives compensation for the service must inform each person being solicited, in writing, that the solicitation is a "paid solicitation." In another state, when a solicitation is made by "direct personal contact," certain information

must be ''predominantly'' disclosed in writing at the point of solicitation. In another state, the solicitation material and the ''general promotional plan'' for a solicitation may not be false, misleading, or deceptive, and must afford a ''full and fair'' disclosure.

In general, the typical state charitable solicitation act seems immune from successful constitutional law challenge. That is, the constitutional law attacks on these laws prevail only in relation to particularly egregious features of them. The same may be said of local fundraising regulation ordinances. The difficulty with the latter, however, is not so much their content as their number. A charitable organization involved in a multistate charitable solicitation may be expected to comply with hundreds, perhaps thousands, of these ordinances. To date, when responding to complaints by charities as to this burden of regulation, the courts review only the content of each local law, refusing to evaluate the difficulties they pose in the aggregate.

P A R T S E V E N

Appendices

APPENDIX A

Sources of the Law

The law as described in this book is derived from many sources. For those not familiar with these matters and/or wishing to understand precisely what the ''law'' regarding charitable organizations and the tax law of charitable giving is, the following explanation should be of assistance.

FEDERAL LAW

At the federal (national) level in the United States, the U.S. Constitution created three branches of government. Article I of the Constitution established the U.S. Congress as a bicameral legislature, consisting of the House of Representatives and the Senate. Article II of the Constitution established the presidency. Article III of the Constitution established the federal court system.

Congress

Congress created the legal structure underlying the federal law for nonprofit organizations, including the law applicable to charitable organizations, fundraising by them, and those who assist them in the fundraising process. Most of this law is manifested in the tax law and thus appears in the Internal Revenue Code. Other laws written by Congress that can affect fundraising by and for charitable organizations include the antitrust, consumer protection, postal, and securities laws.

Statutory Law in General. Tax laws for the United States must originate in the House of Representatives (U.S. Constitution, Article I § 7). Traditionally, most of the nation's tax laws are formally initially written by the members and staff of the House Committee on Ways and Means, although in recent years the Senate Committee on Finance has been in the forefront in writing tax legislation. A considerable portion of this work is performed by the staff of the Joint Committee on Taxation, which consists of members of the House and Senate. Frequently, these laws are generated by work done at the House subcommittee level, usually the Subcommittee on Oversight or the Subcommittee on Select Revenue Measures. Most tax legislation is the subject of hearings before the House Ways and Means Committee and the Senate Finance Committee. Nearly all of this legislation is finalized by a House-Senate conference committee, consisting of senior members of the House Ways and Means Committee and the Senate Finance Committee.

A Congress sits for two years, which is termed a ''session.'' Each Congress is sequentially numbered. For example, the 110th Congress met during the calendar years 2007–2008. A legislative development that took place in 2008 is referenced as occurring during the 110th Congress, 2nd Session (110th Cong., 2nd Session (2008)).

A bill introduced in the House of Representatives or Senate during a particular Congress is given a sequential number in each house. For example, the 3,000th bill introduced in the House of Representatives in 2008 is cited as ''H.R. 3000, 110th Cong., 2nd Sess. (2008)''; the 2000th bill introduced in the Senate in 2008 is cited as ''S. 2000, 110th Cong., 2nd Sess. (2008).''

A tax bill, having passed the House and Senate, and usually blended by a conference committee, is sent to the president for signature. Once signed, the measure becomes law, causing enactment of one or more new and/or amended Code sections. As is the case with any act that has passed Congress, it is assigned a public law (Pub. L.) number. Thereafter, it is given a United States statutes designation (citation) and becomes part of the United States Code (USC).

Legislative History. A considerable amount of the federal tax law for nonprofit organizations is found in the legislative history of these statutory laws. Most of this history is in congressional committee reports. Reports from committees in the House of Representatives are cited as ''H. Rep.'' (see, e.g., Chapter 1, note 17); reports from committees in the Senate are cited as ''S. Rep.'' (see, e.g., Chapter 3, note 130); conference committee reports are cited as ''H. Rep.'' (see, e.g., *id.*). The IRS wrote that committee reports are ''useful tools in determining Congressional intent behind certain tax laws, and helping examiners apply the law properly.''[1]

Transcripts of the debate on legislation, formal statements, and other items are printed in the Congressional Record (*Cong. Rec.*). The Congressional Record is published every day one of the houses of Congress is in session and is cited as ''___*Cong. Rec.* ___ (daily ed., [date of issue])''. The first number is the annual volume number; the second number is the page in the daily edition on which the item begins. Periodically, the daily editions of the Congressional Record are republished as a hardbound book and are cited as ''___*Cong. Rec.* ___ ([year]).'' As before, the first number is the annual volume number and the second is the beginning page number. The bound version of the Congressional Record then becomes the publication that contains the permanent citation for the item.

Internal Revenue Code. The Internal Revenue Code, the current version of which is the Internal Revenue Code of 1986, as amended, is the primary source of the federal tax law.[2] This Code is officially codified in Title 26 of the USC and referenced throughout this book as the IRC (see Chapter 1, note 6)). (The United States Code consists of 50 titles. The IRC imposes income, estate, gift, generation-skipping, excise, and employment taxes, and includes penalties and other provisions concerning the administration of federal taxation.

[1] Internal Revenue Manual (IRM) 4.75.13.6.2 § 3.

[2] The IRS, in a peculiar understatement, advises its examiners that ''[i]t is often necessary to cite Internal Revenue Code sections in reports and to taxpayers in support of a position on an issue'' (IRM 4.75.13.6.1.2 § 1).

The IRC includes subtitles (of which there are 11), chapters, subchapters, parts, and sections. Code sections are divided into subsections, paragraphs, subparagraphs, and clauses.[3] The most relevant of the subtitles are:

	Subtitle Contents	IRC Sections
A	Income Taxes	1-1563
B	Estate and Gift Taxes	2001-2704
C	Employment Taxes	3101-3510
D	Excise Taxes	4041-5000
F	Procedure and Administration	6001-7873
G	Joint Committee on Taxation	8001-8023

Sections of the IRC are usually arranged in numerical order. When the IRS cites an IRC section, it does not usually reference the title, subtitle, chapter, subchapter, or part. It references a Code section as ''IRC §'' (as does this book). As noted, IRC sections are divided into subsections, paragraphs, subparagraphs, and clauses. For example, IRC § 170(b)(1)(A)(vi) is structured as follows:

1. IRC § 170—Code section, Arabic number
2. Subsection (b)—lowercase letter in parentheses
3. Paragraph (1)—Arabic number in parentheses
4. Subparagraph (A)—capital letter in parentheses
5. Clause (vi)—lowercase Roman numeral in parentheses

Inasmuch as IRC sections are usually arranged in numerical order, this practice sometimes leads to the need to show a Code section number followed by a capital letter that is not in parentheses. An example of this is IRC § 409A. This came about because Congress created an IRC § that needed to immediately follow IRC § 409 and IRC § 410 already existed. There are no IRC sections of this nature within the direct ambit of the law of fundraising.[4]

The IRC is generally binding on the courts. As the IRS has written, the courts ''give great importance to the literal language of the Code, but the language does not solve every tax controversy.''[5] Thus, courts also consider the legislative history underlying a Code section, its relationship to other Code sections, tax regulations, and various IRS pronouncements.

Executive Branch

A function of the Executive Branch in the United States is to administer and enforce the laws enacted by Congress. This ''executive'' function is performed by departments and agencies and ''independent'' regulatory commissions (such as

[3] According to the IRS, this structure results in ''ease of use'' of the IRC (IRM 4.75.13.6.1 § 2).
[4] IRC § 409A is a part of the federal tax law of employee benefits and can be applicable with respect to tax-exempt organizations.
[5] IRM 4.75.13.6.1.

the Federal Trade Commission or the Securities and Exchange Commission). The federal tax laws are administered and enforced overall by the Department of the Treasury.

Tax Regulations. The Code of Federal Regulations (CFR) is a codification of the general and permanent rules published in the Federal Register by the executive departments and agencies of the federal government. The CFR is divided into 50 titles representing broad areas subject to federal regulation. Each title is divided into chapters that usually bear the name of the issuing agency. Each chapter is subdivided into parts covering specific regulatory areas. Title 26 of the CFR consists of the federal tax regulations.

One of the ways in which the Department of the Treasury executes its functions is by the promulgation of regulations (Reg.), which are designed to interpret and amplify the related statute (see, e.g., Chapter 1, note 25). Treasury regulations are the official interpretations of the Department of the IRC; they follow the numbering sequence of IRC sections. Generally, tax regulations are subject to a public notice and comment process (see below).

Tax regulations are written by the Legislative and Regulations Division or Tax Exempt and Government Entities Office of Associate Chief Counsel (Technical), IRS; the Department of the Treasury must approve regulations for them to take effect. There are three classes of tax regulations:

1. **Proposed regulations.** Proposed regulations provide guidance concerning the Treasury Department's interpretation of an IRC section but do not have authoritative weight (because they are in proposed form); thus they are not binding on taxpayers and IRS examiners. The public is accorded an opportunity to comment on a proposed regulation; a public hearing on the proposal may be held if sufficient written requests are received. Proposed regulations become effective when adopted by a Treasury Decision and become final regulations.
2. **Temporary regulations.** Temporary regulations are often issued soon after a major statutory law change to provide guidance to the public and IRS employees with respect to procedural and computational matters. Temporary regulations are authoritative and have the same weight as final regulations. Public hearings are not held on temporary regulations.
3. **Final regulations.** Final regulations are issued after public comments on the regulations in proposed form are evaluated. They supersede any temporary regulations on the point. A final regulation is effective as of the day it is published in the Federal Register as a Treasury Decision, unless otherwise stated.

Tax regulations (like other rules made by other government departments, agencies, and commissions) generally have the force of law, unless they are overly broad in relation to the accompanying statute or are unconstitutional, in which case they can be rendered void by a court. These regulations are not binding on courts; they are, however, binding on the IRS. If temporary and proposed regulations have been issued in connection with the same Code provision, and the text of both is similar, examiners' positions should be based on the temporary

regulations. If neither temporary nor final regulations have been issued, IRS examiners may use a proposed regulation to support a position; they should, however, indicate that the proposed regulation lacks authoritative weight but is the best (at least from the standpoint of the IRS) interpretation of the statutory law involved that is available. Regulations may apply only to a particular time period. Regulations do not always reflect changes in the law.

Pursuant to traditional analysis, there are two types of final tax regulations: legislative and interpretative. The standard of review by a court applicable to a final regulation differs as between these types of regulations. A *legislative regulation* is a final regulation issued under a specific grant of congressional authority to prescribe a method of executing a statutory provision. In this instance, a Code provision will state: ''The Secretary shall provide such regulations. . . .''[6] In contrast, an *interpretative regulation* is promulgated pursuant to the Treasury's general authority to prescribe regulations.[7] Courts accord a higher degree of deference to a legislative regulation than to an interpretative one.

The deference accorded a legislative regulation is so high that the regulation has controlling weight unless it is arbitrary, capricious, or manifestly contrary to the underlying statute.[8] This standard of deference is sometimes referred to as the *Chevron* deference.[9] Thus, when reviewing a legislative regulation, a court ''may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency.''[10]

The foregoing dichotomy as to classification of regulations and the accompanying deference standard seems, today, exceptionally simplistic and is, perhaps, no longer valid. Due in large part to a considerable number of inconsistent court opinions on the point,[11] ''confusion reigns''[12] as to the standards to be applied by courts in determining the validity of a tax (or other) regulation. It may be that the deference standard that is properly applicable with respect to most tax regulations is that enunciated by the Supreme Court in 1979. This test is as follows:

> In determining whether a particular regulation carries out the congressional mandate in a proper manner, we look to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose. A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent. If the regulation dates from a later period, the manner in which it evolved merits inquiry. Other relevant considerations are the length of time the regulation has been in effect, the reliance placed upon it, the consistency of the [IRS] Commissioner's interpretation, and the degree of scrutiny Congress

---

[6] E.g., *Snap Drape, Inc. v. Commissioner*, 98 F.3d 194 (5th Cir. 1996).

[7] IRC § 7805(a).

[8] E.g., *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984); *Fransen v. United States*, 191 F.3d 599 (5th Cir. 1999).

[9] E.g., *Belt* v. *EmCare, Inc.*, 444 F.3d 403, 416, note 35 (5th Cir. 2006); *Klamath Strategic Investment Fund, LLC v. United States*, 2007-1 U.S.T.C. ¶ 50,410 (E.D. Tex. 2007). In *Klamath*, the regulation at issue was held to be an interpretative regulation.

[10] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-844 (1984). E.g., *Littriello v. United States*, 484 F.3d 372 (6th Cir. 2007) (holding that the check-the-box entity classification regulations [*Tax-Exempt Organizations* § 4.1(b)] are valid, using the *Chevron* deference standard).

[11] E.g., *Swallows Holding, Ltd. v. Commissioner*, 515 F.3d 162 (3d Cir. 2008).

[12] Berg, ''Judicial Deference to Tax Regulations: A Reconsideration in Light of *National Cable*, *Swallows Holding*, and Other Developments,'' 61 *Tax Law.* (No. 2) 545 (Winter 2008).

has devoted to the regulation during subsequent re-enactments of the statute.[13]

The Administrative Procedure Act[14] (APA) requires federal government agencies to adhere to notice and comment procedures in the case of rules or regulations that are intended to have the force of law but not in instances of "interpretative rules, general statements of policy, or rules of agency organization, procedure or practice."[15] This is a different dichotomy from the court-fashioned law referenced above.[16] Consequently, it would appear that all tax regulations, whether legislative or interpretative (as defined above), are substantive regulations to which the APA's notice and comment requirements apply.[17] Generally, as noted, the Department of the Treasury follows a notice and comment procedure with respect to its regulations. It has been suggested that the department does this at its discretion, maintaining the position that tax regulations are merely "interpretative" for APA purposes and thus not subject to the APA notice and comment requirements.[18]

A tax regulation may be made retroactive; this type of regulation can be reviewed by a court for abuse of discretion. The IRS "does not have carte blanche" authority to issue retroactive regulations.[19] The efficacy of a retroactive regulation is tested against these factors: whether or to what extent the taxpayer justifiably relied on settled law or policy and whether or to what extent the putatively retroactive regulation alters that law or policy; the extent to which the prior law or policy has been implicitly approved by Congress, as by legislative re-enactment of the pertinent Code provision(s); whether retroactivity would advance or frustrate the interest in equality of treatment among similarly situated taxpayers; and whether according retroactive effect would produce an inordinately harsh result.[20]

Revenue Rulings and Procedures. Within the Department of the Treasury is the Internal Revenue Service (IRS). The IRS is, among its many roles, a tax-collecting agency. The IRS, while headquartered in Washington, D.C. (its National Office), has regional and field offices throughout the country.

The IRS's jurisdiction over tax-exempt organizations is principally lodged within the office of the director, Exempt Organizations, who is responsible for planning, managing, directing, and executing nationwide activities for exempt organizations. The director reports to the commissioner, Tax Exempt Entities/Government Entities Division. The director supervises the activities of

---

[13] *National Muffler Dealers Association v. United States*, 440 U.S. 472, 477 (1979). See Hopkins, *The Tax Law of Associations* §§ 2.4, 2.5, 2.7(b) (Hoboken, NJ: John Wiley & Sons, 2006).

[14] 5 U.S.C. § 551.

[15] *Id*. § 553(b).

[16] The U.S. Tax Court wrote that, "[i]n the case of regulations, tax law has used a different basis to distinguish between legislative and interpretive rules" (*Swallows Holding, Ltd v. Commissioner*, 126 T.C. 96, 176 (2006), *rev'd*, *supra* note 11.

[17] E.g., Hickman, "Coloring Outside the Lines: Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements," 82 *Notre Dame L. Rev.* 1727 (2007); Cummings, Jr., "Treasury Violates the APA?" 117 *Tax Notes* 263 (Oct. 15, 2007).

[18] Berg, *supra* note 12, at 487 (note 23), 510 (note 132), 530.

[19] *Snap Drape, Inc. v. Commissioner*, 98 F.3d 194, 202 (5th Cir. 1996).

[20] E.g., *Anderson, Clayton & Co. v. United States*, 562 F.2d 972 (5th Cir. 1977); *Klamath Strategic Investment Fund, LLC v. United States*, 2007-1 U.S.T.C. ¶ 50,410 (E.D. Tex. 2007).

the offices of Customer Education and Outreach, Rulings and Agreements, and Examinations.

The IRS (from its National Office) prepares and disseminates guidance interpreting tax statutes and tax regulations. This guidance has the force of law, unless it is overly broad in relation to the statute and/or Treasury regulation involved, or is unconstitutional. The Internal Revenue Bulletin (I.R.B.), published weekly, is the publication used by the IRS to announce official IRS rulings and procedures, and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. Every six months, the I. R.B.s are republished as hardbound books, with the resulting publication termed the Cumulative Bulletin (C.B.).

The C.B. is a consolidation of items of a permanent nature first published in the I.R.B.; it consists of four parts:

Part I. This part is divided into two subparts based on provisions of the IRC. Arrangement is sequential according to IRC and regulation sections. The Code section is shown at the top of each page.

Part II. This part is divided into two subparts, one concerning tax conventions and the other pertaining to legislation and related congressional committee reports.

Part III. This part concerns various administrative, procedural, and miscellaneous matters.

Part IV. The preambles and text of proposed regulations that were published in the Federal Register during the six-month period involved are printed in this part. Also included in this portion of the C.B. is a list of individuals disbarred or suspended from practice before the IRS.

The IRS publishes in the I.R.B. all substantive rulings necessary to promote uniform application of the federal tax laws, including rulings that supersede, revoke, modify, or amend rulings previously published in the I.R.B. All published rulings apply retroactively, unless otherwise indicated. Procedures pertaining solely to matters of internal IRS management are not published in the I.R.B. Nonetheless, statements of internal practices and procedures that affect the rights and duties of taxpayers are so published.

IRS public determinations on a point of law usually are in the form of ''revenue rulings'' (Rev. Rul.) (see, e.g., Chapter 3, note 8); those that are rules of procedure are termed ''revenue procedures'' (Rev. Proc.) (see, e.g., Chapter 2, note 16). A Rev. Rul. represents the conclusion(s) of the IRS on application of the law to the facts stated in the ruling. Some Rev. Ruls. are based on positions taken by the IRS in private letter rulings or technical advice memoranda. A Rev. Proc. is issued to assist taxpayers in complying with procedural issues. The purpose of these rulings and procedures is to promote uniform application of the tax laws. IRS employees must follow them; taxpayers may rely on them or appeal their position to the courts. Revenue rulings and revenue procedures are almost never accorded a public notice and comment process.

Revenue rulings and revenue proceedings that have an effect on previous rulings use these terms to describe the effect:

- *Amplified* describes a situation where a change is not being made in a prior published position of the IRS but the prior position is being extended (amplified) to apply to a variation of the original fact situation.
- *Clarified* is used in instances where the language in a prior ruling is being made clearer because the original language has caused or may cause confusion.
- *Distinguished* describes a situation where a ruling makes reference to a previously published ruling and points out one or more essential difference between them.
- *Modified* is used where the substance of a previously published position is being changed.
- *Obsoleted* describes a previously published ruling that is not considered determinative with respect to future transactions. The term is most commonly used in a ruling that lists previously published rulings that are obsolete because of changes in the statutory law or regulations. A ruling may also be rendered obsolete because the substance of it has been included in subsequently adopted regulations.
- *Revoked* describes situations where the position of the IRS in a previously published ruling is not correct, and the correct position is being stated in a new ruling.
- *Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling or rulings. The term is used by the IRS when it is desirable to republish in a single ruling a series of situations and the like that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is being continued without change in part, and the IRS desires to restate the valid portion of the previously published ruling in a new ruling that is self-contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.
- *Supplemented* is used in situations in which a list is published in a ruling and that list is expanded by adding items in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.
- *Suspended* is used in rare situations to show that a previously published ruling will not be applied pending some future action, such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of an IRS study.

The IRS considers itself bound by its revenue rulings and revenue procedures. These determinations are the ''law,'' particularly in the sense that the IRS regards them as precedential, although they are not binding on the courts. Rulings do not have the force and effect of regulations. In applying rulings, the

effects of subsequent legislation, regulations, court decisions, and other rulings and procedures need to be considered.

Thus, as in the case of the IRS, not all agency determinations are in the form of regulations. Agencies charged with applying a statute ''necessarily make all sorts of interpretive choices and . . . not all of those choices bind judges to follow them.''[21] Even where not binding, these agency choices ''certainly may influence courts facing questions the agencies have already answered,'' and, in this type of instance, the ''fair measure of deference to an agency administering its own statute has been understood to vary with circumstances.[22] The weight given to an agency's interpretation in this context depends on the ''degree of the agency's care, its consistency, formality, and relative expertness, and to the persuasiveness of the agency's position.''[23] (This is known as *Skidmore* deference.) It has been held that a revenue ruling is entitled to *Skidmore* (not *Chevron*) deference.[24] The same is the case with respect to a revenue procedure.[25]

Other IRS Pronouncements. The IRS also issues forms of ''public'' law in the name of ''notices'' and ''announcements'' as well as ''Delegation Orders.'' A notice or Delegation Order is initially published in the I.R.B. and then republished in the C.B. An announcement, however, although published in the I.R.B., is not republished in the C.B.

Announcements are public pronouncements on matters of general interest, such as the effective dates of temporary regulations and clarification of rulings and form instructions. They are issued when guidance of a substantive or procedural nature is needed quickly. Announcements can be relied on to the same extent as revenue rulings and revenue procedures, when they include specific language to that effect. Announcements are identified by a two-digit number, representing the year involved and a sequence number (e.g., Ann. 2008-25). Notices are public announcements that are identified in the same manner as announcements (e.g., Notice 2008-50).

Commissioner Delegation Orders formally delegate, by the commissioner of Internal Revenue, authority to perform certain tasks or make certain decisions to specified employees of the IRS. Agreements entered into by IRS personnel pursuant to these orders are binding on taxpayers and the agency. Delegation Orders are identified by a number, sometimes followed by a revision date (e.g., Del. Order 250).

The IRS issues plain-language publications to explain aspects of the federal tax law. They typically highlight changes in the law, provide examples of IRS positions, and include worksheets. These publications, which do not necessarily cover all positions for a given issue, are not binding on the IRS. Although they are a good source of general information, IRS examiners are not supposed to cite to these publications in support of a position.

[21] *United States v. Mead Corporation*, 533 U.S. 218, 227 (2001).
[22] *Id*.
[23] *Id*., citing *Skidmore v. Swift & Co*., 323 U.S. 134 (1944).
[24] *Omohundro v. United States*, 300 F.3d 1065 (9th Cir. 2002).
[25] *Tualatin Valley Builders Supply v. United States*, 522 F.3d 937 (9th Cir. 2008).

Private Determinations. By contrast to these forms of ''public'' law, the IRS (again from its National Office) also issues ''private'' or nonprecedential determinations. These documents principally are private letter rulings and technical advice memoranda. As a matter of law, these determinations may not be cited as legal authority.[26] Nonetheless, these pronouncements can be valuable in understanding IRS thinking on a point of law and, in practice (the statutory prohibition notwithstanding), these documents are cited as IRS positions on issues, such as in court opinions,[27] articles, and books.

The IRS issues private letter rulings in response to written questions (termed ''ruling requests'') submitted to the IRS by individuals and organizations. An IRS district office may refer a case to the IRS National Office for advice (termed ''technical advice''); the resulting advice is provided to the IRS district office in the form of a technical advice memorandum. In the course of preparing a revenue ruling, private letter ruling, or technical advice memorandum, the IRS National Office may seek legal advice from its Office of Chief Counsel; the resulting advice was provided, until recently, in the form of general counsel memorandum. These documents are eventually made public, albeit in redacted form. The chief counsel advice memorandum has replaced the general counsel memorandum.

Private letter rulings and technical advice memoranda are identified by seven- or nine-digit numbers, as in ''Priv. Ltr. Rul. 200726007'' (see, e.g., Chapter 3, note 226). The first two (or four) numbers are for the year involved (here, 2007), the next two numbers reflect the week of the calendar year involved (here, the twenty-sixth week of 2007), and the remaining three numbers identify the document as issued sequentially during the particular week (here, this private letter ruling was the seventh one issued during the week involved).

The agency has, pursuant to court order,[28] also commenced issuance of rulings denying or revoking tax-exempt status. These exemption denial and revocation letters initially were identified by eight numbers, followed by an ''E.'' This practice was discontinued by the IRS, however; these letters are now being issued as private letter rulings.

Judiciary

The federal court system has three levels: trial courts (including those that initially hear cases where a formal trial is not involved), courts of appeal (''appellate'' courts), and the U.S. Supreme Court. The trial courts include the various federal district courts (at least one in each state, the District of Columbia, and the U.S. territories), the U.S. Tax Court,[29] and the U.S. Court of Federal Claims.[30] There are 13 federal appellate courts (the U.S. Court of Appeals for the First through the Eleventh Circuits, the U.S. Court of Appeals for the District of Columbia, and the U.S. Court of Appeals for the Federal Circuit).

---

[26] IRC § 6110(k)(3).

[27] E.g., *Glass v. Commissioner*, 471 F.3d 698 (6th Cir. 2006).

[28] *Tax Analysts v. Internal Revenue Service*, 350 F.3d 100 (D.C. Cir. 2003) (see *The Law of Tax-Exempt Organizations* § 28.8(a)(ii), text accompanied by notes 245–252).

[29] The Tax Court was created in 1942; its predecessor was the Board of Tax Appeals. Some B.T.A. decisions still retain precedential value.

[30] This court was created (renamed) in 1982; its predecessor was the U.S. Claims Court.

Cases involving tax-exempt organization issues at the federal level can originate in any federal district court, the U.S. Tax Court, and the U.S. Court of Federal Claims. Under a special declaratory judgment procedure available only to charitable organizations and farmers' cooperatives,[31] cases can originate only with the U.S. District Court for the District of Columbia, the U.S. Tax Court, and the U.S. Court of Federal Claims. Cases involving tax-exempt organizations are considered by the U.S. Courts of Appeals and the U.S. Supreme Court.

Most opinions emanating from a U.S. district court are published by the West Publishing Company in the "Federal Supplement" series ("F. Supp." or "F. Supp. 2d"). Thus, a citation to one of these opinions appears as "___ F. Supp. ___ " or "___ Supp. 2d ___," followed by an identification of the court and the year of the opinion. The first number is the annual volume number, the other number is the page in the book on which the opinion begins (see, e.g., Chapter 1, note 35). Some district court opinions appear sooner in Commerce Clearinghouse or Prentice Hall publications (see, e.g., Chapter 4, note 399); occasionally, these publications will contain opinions that are never published in the Federal Supplement series.

Most opinions emanating from a U.S. court of appeals are published by the West Publishing Company in the "Federal Reporter" series (usually "F.2d" or "F.3d"). Thus, a citation to one of these opinions appears as "___ F.2d ___"or "___ F.3d ___," followed by an identification of the court and the year of the opinion. The first number is the annual volume number; the other number is the page in the book on which the opinion begins (see, e.g., Chapter 1, note 32). Appellate court opinions appear sooner in Commerce Clearinghouse or Prentice Hall publications; occasionally these publications contain opinions that are never published in the Federal Second or Federal Third series. Opinions from the U.S. Court of Federal Claims are also published in the Federal Second or Federal Third.

Opinions from the U.S. Tax Court are published by the U.S. government (Government Printing Office) and are usually in the form of "regular opinions" and cited as "___ T.C. ___," followed by the year of the opinion (see, e.g., Chapter 3, note 3). Some Tax Court opinions that are of lesser precedential value (because they primarily involve determinations of fact and application of well-established rules of law) are published by the federal government as "memorandum decisions" and are cited as "___ T.C.M. ___" followed by the year of the opinion (see, e.g., Chapter 21, note 7). As always, the first number of these citations is the annual volume number, the second number is the page in the book on which the opinion begins. Commercial publishers publish regular opinions and memorandum decisions.

U.S. district court and Tax Court opinions may be appealed to the appropriate U.S. court of appeals. For example, cases in the states of Maryland, North Carolina, South Carolina, Virginia, and West Virginia are appealable (from either court) to the U.S. Court of Appeals for the Fourth Circuit. Cases from any federal appellate or district court, the U.S. Tax Court, and the U.S. Court of Federal Claims may be appealed to the U.S. Supreme Court.

District courts must follow the decisions of the court of appeals for the circuit in which they are located. If the court of appeals that is potentially involved in a case has not rendered a decision on a particular issue, the district court may reach

[31] IRC § 7428.

its own decision or follow the decision of another circuit court that has rendered a decision on the issue. A circuit court is not bound by a decision of another circuit court.

The U.S. Supreme Court usually has discretion as to whether to accept a case.[32] This decision is manifested as a ''writ of certiorari.'' When the Supreme Court agrees to hear a case, it grants the writ (''*cert. gr.*''); otherwise, it denies the writ (''*cert. den.*'') (see, e.g., Chapter 3, note 3).

In this book, citations to Supreme Court opinions are to the ''United States Reports'' series, published by the U.S. government, when available (''___U.S. ___,'' followed by the year of the opinion) (see, e.g., Chapter 1, note 23). When the United States Reports series citation is not available, the ''Supreme Court Reporter'' series, published by the West Publishing Company, reference is used (''___ S. Ct. ___,'' followed by the year of the opinion). As always, the first number of these citations is the annual volume number, the second number is the page in the book or which the opinion begins. There is a third way to cite Supreme Court cases, which is by means of the ''United States Supreme Court Reports-Lawyers Edition'' series, published by The Lawyers Co-Operative Publishing Company and the Bancroft-Whitney Company, but that form of citation is not used in this book. Supreme Court opinions appear earlier in the Commerce Clearinghouse or Prentice Hall publications.

In most instances, court opinions are available on Westlaw and LEXIS in advance of formal publication.

Decisions made at various levels of the court system are considered to be interpretations of the tax laws and may be used by examiners and taxpayers to support a position. Some court opinions lend more weight to a position than others. An opinion emanating from a case decided by the U.S. Supreme becomes the ''law of the land'' and takes precedence over decisions of lower courts. The IRS must follow Supreme Court decisions. In that sense, Supreme Court decisions have the same weight as the IRC. Decisions made by lower courts are binding on the IRS only for the particular taxpayer and the years litigated. Adverse decisions of lower courts do not require the IRS to alter its position for other taxpayers.

Action on Decisions. It is the policy of the IRS to announce at an early date whether it will follow the holding(s) in certain court cases; such an announcement is an Action on Decision (AOD). An AOD is issued at the discretion of the IRS only on unappealed issues that have been decided adverse to the position of the government. Generally, an AOD is issued when guidance would be helpful to IRS personnel working with the same or similar issues. Unlike a tax regulation or a revenue ruling, an AOD is not an affirmative statement of the IRS's position. It is not intended to serve as guidance to the public and is not to be cited as precedent.

An AOD may be relied on within the IRS only as to the conclusion, applying the law to the facts in the particular case at the time the AOD was issued. IRS examiners are to exercise caution when extending the recommendation of an AOD to another case, where the facts may be different. An AOD may be superseded by legislation, regulations, rulings, court opinions, or a subsequent AOD.

---

[32] The IRS observed that ''[o]nly a limited number of tax cases are heard'' by the Court (IRM 4.75.13.6.8.6 § 1.

An AOD may state that the IRS acquiesces in the holding of a court in a case and that the IRS will follow it in disposing of cases with the same facts; this *acquiescence* indicates neither approval nor disapproval of the reasons relied on by the court for its conclusions. An *acquiescence in result only* indicates IRS disagreement or concern with some or all of those reasons. *Nonacquiescence* signifies that, although no further review was sought, the IRS does not agree with the holding of the court and generally will not follow it in disposing of cases involving other taxpayers. With respect to an opinion of a circuit court of appeals, a nonacquiescence indicates that the IRS will not follow the holding on a nationwide basis; the IRS will, however, recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit court.

AODs are published in the I.R.B. and thereafter in the appropriate C.B. An examiner is required to include in the citation to a court opinion any acquiescence (acq.), acquiescence in result only (''acq. in result''), or nonacquiescence (nonacq.).

STATE LAW

Legislative Branches

Statutory laws in the various states are created by their legislatures. There are no specific references to state statutory laws in this book (although most, if not all, of the states have such forms of law relating, directly or indirectly, to charitable giving, such as those pertaining to deductions and fundraising (see Chapter 24)).

Executive Branches

The rules and regulations published at the state level emanate from state departments, agencies, and the like. For tax-exempt organizations, these departments are usually the office of the state's attorney general and the state's department of state. There are no specific references to state rules and regulations in this book.

Judiciary

Each of the states has a judiciary system, usually a three-tiered one modeled after the federal system. Cases involving nonprofit organizations are heard in all of these courts. There are no references to state court opinions in this book.

State court opinions are published by the governments of each state. The principal ones are published by the West Publishing Company. The latter sets of opinions are published in ''Reporters'' relating to court developments in various regions throughout the country. For example, the ''Atlantic Reporter'' contains court opinions issued by the principal courts in the states of Connecticut, Delaware, Maine, Maryland, New Hampshire, New Jersey, Pennsylvania, Rhode Island, and Vermont, and the District of Columbia, while the ''Pacific Reporter'' contains court opinions issued by the principal courts of Arizona, California, Colorado, Idaho, Kansas, Montana, Nevada, New Mexico, Oklahoma, Oregon, Utah, Washington, and Wyoming (see, e.g., Chapter 3, note 14).

PUBLICATIONS

Articles, of course, are not forms of the ''law.'' They can be cited, however, particularly by courts, in the development of the law. Also, as research tools, they contain useful summaries of the applicable law. In addition to the many law school ''law review'' publications, the following (not an inclusive list) periodicals contain material that is of help in following developments concerning tax-exempt organizations:

Advancing Philanthropy (Association of Fundraising Professionals)
Bruce R. Hopkins' Nonprofit Counsel (John Wiley & Sons, Inc.)
The Chronicle of Philanthropy
Daily Tax Report (Bureau of National Affairs, Inc.)
Exempt Organization Tax Review (Tax Analysts)
Foundation News (Council on Foundations)
Giving USA (Center on Philanthropy, Indiana University)
The Journal of Taxation (Warren, Gorham & Lamont)
The Journal of Taxation of Exempt Organizations (Faulkner & Gray)
The Philanthropy Monthly (Non-Profit Reports, Inc.)
Tax Law Review (Rosenfeld Launer Publications)
The Tax Lawyer (American Bar Association)
Tax Notes (Tax Analysts)
Taxes (Commerce Clearinghouse, Inc.)

APPENDIX B

Internal Revenue Code Sections

Following are the various provisions of the Internal Revenue Code of 1986, as amended, that constitute the statutory framework for the federal tax law of charitable giving:

Section 27—foreign tax credit

Sections 55–59—alternative minimum tax rules

Section 162—income tax deduction for business expenses

Section 170—income tax deduction for charitable contributions, including percentage limitations, deduction reduction rules, and partial-interest gift rules

Section 306—definition of "section 306 stock"

Section 482—rules on reallocation of deductions

Section 501—general requirements for income tax exemption

Section 501(m)—rules concerning commercial-type insurance, including exception for charitable gift annuities

Section 509—definition of public charity and private foundation status

Section 511—imposition of tax on unrelated business income

Section 512—definition of unrelated business taxable income

Section 513—definition of unrelated trade or business

Section 514—unrelated debt-financed income rules

Section 542(b)(2)—charitable contribution deduction in computing undistributed personal holding company income

Section 556(b)(2)—charitable contribution deduction in computing undistributed foreign personal holding company income

Section 642(c)—charitable contribution deduction for certain estates or trusts; rules concerning pooled income funds

Section 664—rules concerning charitable remainder trusts

Section 681—limitations on estate or trust charitable contribution deduction

Sections 861–864—determination of sources of income

Section 1011(b)—allocation of capital gain rules, applicable in bargain sale context

Section 2055—estate tax deduction for charitable contributions

Section 2106(a)(2)(A)—estate tax deduction for charitable contributions for estates of nonresident noncitizens

Section 2522—gift tax deduction for charitable contributions

Section 2601 *et seq.*—generation-skipping transfer tax rules

Section 4941—private foundation self-dealing rules

Section 4942—private foundation mandatory distribution rules

Section 4943—private foundation rules on excess business holdings

Section 4944—private foundation rules on jeopardizing investments

Section 4945—private foundation rules on taxable expenditures

Section 4946—private foundation rules defining disqualified persons

Section 4947—application of private foundation rules to certain nonexempt trusts

Section 4948—private foundation rules as applied to foreign organizations

Section 4958—intermediate sanctions penalties

Section 6033—annual return filing obligations for most charitable and other tax-exempt organizations

Section 6113—rules concerning disclosure of nondeductibility of gifts by noncharitable organizations

Section 6115—disclosure related to quid pro quo contributions

Section 6700—penalty for promotion of abusive tax shelters

Section 6701—penalty for aiding and abetting an understatement of tax liability

Section 6710—penalty for noncompliance with disclosure rules for noncharitable organizations

Section 7520—federal midterm monthly interest rate rules, used in computation of partial interests

APPENDIX C

Form 8283—Noncash Charitable Contributions

Form **8283** (Rev. December 2006) Department of the Treasury Internal Revenue Service

Noncash Charitable Contributions

▶ Attach to your tax return if you claimed a total deduction of over $500 for all contributed property.
▶ See separate instructions.

OMB No. 1545-0908
Attachment Sequence No. 155

Name(s) shown on your income tax return | Identifying number

Note. Figure the amount of your contribution deduction before completing this form. See your tax return instructions.

Section A. Donated Property of $5,000 or Less and Certain Publicly Traded Securities—List in this section only items (or groups of similar items) for which you claimed a deduction of $5,000 or less. Also, list certain publicly traded securities even if the deduction is more than $5,000 (see instructions).

Part I Information on Donated Property—If you need more space, attach a statement.

1	(a) Name and address of the donee organization	(b) Description of donated property (For a donated vehicle, enter the year, make, model, condition, and mileage, and attach Form 1098-C if required.)
A		
B		
C		
D		
E		

Note. If the amount you claimed as a deduction for an item is $500 or less, you do not have to complete columns (d), (e), and (f).

	(c) Date of the contribution	(d) Date acquired by donor (mo., yr.)	(e) How acquired by donor	(f) Donor's cost or adjusted basis	(g) Fair market value (see instructions)	(h) Method used to determine the fair market value
A						
B						
C						
D						
E						

Part II Partial Interests and Restricted Use Property—Complete lines 2a through 2e if you gave less than an entire interest in a property listed in Part I. Complete lines 3a through 3c if conditions were placed on a contribution listed in Part I; also attach the required statement (see instructions).

2a Enter the letter from Part I that identifies the property for which you gave less than an entire interest ▶ ______________ .
If Part II applies to more than one property, attach a separate statement.

b Total amount claimed as a deduction for the property listed in Part I: **(1)** For this tax year ▶ ______________ .
(2) For any prior tax years ▶ ______________ .

c Name and address of each organization to which any such contribution was made in a prior year (complete only if different from the donee organization above):

Name of charitable organization (donee)

Address (number, street, and room or suite no.)

City or town, state, and ZIP code

d For tangible property, enter the place where the property is located or kept ▶ ______________

e Name of any person, other than the donee organization, having actual possession of the property ▶ ______________

		Yes	No
3a	Is there a restriction, either temporary or permanent, on the donee's right to use or dispose of the donated property?		
b	Did you give to anyone (other than the donee organization or another organization participating with the donee organization in cooperative fundraising) the right to the income from the donated property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having such income, possession, or right to acquire?		
c	Is there a restriction limiting the donated property for a particular use?		

For Paperwork Reduction Act Notice, see separate instructions. Form **8283** (Rev. 12-2006)

ISA

STF PKXV1000.1

Form 8283 (Rev. 12-2006) Page 2

Name(s) shown on your income tax return | Identifying number

Section B. Donated Property Over $5,000 (Except Certain Publicly Traded Securities)—List in this section only items (or groups of similar items) for which you claimed a deduction of more than $5,000 per item or group (except contributions of certain publicly traded securities reported in Section A). An appraisal is generally required for property listed in Section B (see instructions).

Part I Information on Donated Property—To be completed by the taxpayer and/or the appraiser.

4 Check the box that describes the type of property donated:

☐ Art* (contribution of $20,000 or more) ☐ Qualified Conservation Contribution ☐ Equipment
☐ Art* (contribution of less than $20,000) ☐ Other Real Estate ☐ Securities
☐ Collectibles** ☐ Intellectual Property ☐ Other

*Art includes paintings, sculptures, watercolors, prints, drawings, ceramics, antiques, decorative arts, textiles, carpets, silver, rare manuscripts, historical memorabilia, and other similar objects.

**Collectibles include coins, stamps, books, gems, jewelry, sports memorabilia, dolls, etc., but not art as defined above.

Note. In certain cases, you must attach a qualified appraisal of the property. See instructions.

5	(a) Description of donated property (if you need more space, attach a separate statement)	(b) If tangible property was donated, give a brief summary of the overall physical condition of the property at the time of the gift	(c) Appraised fair market value
A			
B			
C			
D			

	(d) Date acquired by donor (mo., yr.)	(e) How acquired by donor	(f) Donor's cost or adjusted basis	(g) For bargain sales, enter amount received	See instructions: (h) Amount claimed as a deduction	See instructions: (i) Average trading price of securities
A						
B						
C						
D						

Part II Taxpayer (Donor) Statement—List each item included in Part I above that the appraisal identifies as having a value of $500 or less. See instructions.

I declare that the following item(s) included in Part I above has to the best of my knowledge and belief an appraised value of not more than $500 (per item). Enter identifying letter from Part I and describe the specific item. See instructions. ▶ ____________

Signature of taxpayer (donor) ▶ Date ▶

Part III Declaration of Appraiser

I declare that I am not the donor, the donee, a party to the transaction in which the donor acquired the property, employed by, or related to any of the foregoing persons, or married to any person who is related to any of the foregoing persons. And, if regularly used by the donor, donee, or party to the transaction, I performed the majority of my appraisals during my tax year for other persons.

Also, I declare that I hold myself out to the public as an appraiser or perform appraisals on a regular basis; and that because of my qualifications as described in the appraisal, I am qualified to make appraisals of the type of property being valued. I certify that the appraisal fees were not based on a percentage of the appraised property value. Furthermore, I understand that a false or fraudulent overstatement of the property value as described in the qualified appraisal or this Form 8283 may subject me to the penalty under section 6701(a) (aiding and abetting the understatement of tax liability). In addition, I understand that a substantial or gross valuation misstatement resulting from the appraisal of the value of the property that I know, or reasonably should know, would be used in connection with a return or claim for refund, may subject me to the penalty under section 6695A. I affirm that I have not been barred from presenting evidence or testimony by the Office of Professional Responsibility.

Sign Here Signature ▶ Title ▶ Date ▶

Business address (including room or suite no.) | Identifying number

City or town, state, and ZIP code

Part IV Donee Acknowledgment—To be completed by the charitable organization.

This charitable organization acknowledges that it is a qualified organization under section 170(c) and that it received the donated property as described in Section B, Part I, above on the following date ▶ ____________

Furthermore, this organization affirms that in the event it sells, exchanges, or otherwise disposes of the property described in Section B, Part I (or any portion thereof) within 3 years after the date of receipt, it will file Form 8282, Donee Information Return, with the IRS and give the donor a copy of that form. This acknowledgment does not represent agreement with the claimed fair market value.

Does the organization intend to use the property for an unrelated use? . . . . ▶ ☐ Yes ☐ No

Name of charitable organization (donee)	Employer identification number	
Address (number, street, and room or suite no.)	City or town, state, and ZIP code	
Authorized signature	Title	Date

Form 8283 (Rev. 12-2006)

STF PKXV1000.2

APPENDIX D

Form 8282—Donee Information Return

Form **8282** (Rev. April 2009) Department of the Treasury Internal Revenue Service	**Donee Information Return** (Sale, Exchange, or Other Disposition of Donated Property) ▶ See instructions.	OMB No. 1545-0908 Give a Copy to Donor

Parts To Complete

- If the organization is an **original donee,** complete *Identifying Information,* Part I (lines 1a–1d and, if applicable, lines 2a–2d), and Part III.
- If the organization is a **successor donee,** complete *Identifying Information,* Part I, Part II, and Part III.

Identifying Information

Print or Type	Name of charitable organization (donee)	Employer identification number
	Address (number, street, and room or suite no.) (or P.O. box no. if mail is not delivered to the street address)	
	City or town, state, and ZIP code	

Part I Information on ORIGINAL DONOR and SUCCESSOR DONEE Receiving the Property

1a Name of original donor of the property	1b Identifying number(s)
1c Address (number, street, and room or suite no.) (P.O. box no. if mail is not delivered to the street address)	
1d City or town, state, and ZIP code	

Note. Complete lines 2a–2d only if the organization gave this property to another charitable organization (successor donee).

2a Name of charitable organization	2b Employer identification number
2c Address (number, street, and room or suite no.) (or P.O. box no. if mail is not delivered to the street address)	
2d City or town, state, and ZIP code	

Part II Information on PREVIOUS DONEES. **Complete this part only if the organization was not the first donee to receive the property.** See the instructions before completing lines 3a through 4d.

3a Name of original donee	3b Employer identification number
3c Address (number, street, and room or suite no.) (or P.O. box no. if mail is not delivered to the street address)	
3d City or town, state, and ZIP code	
4a Name of preceding donee	4b Employer identification number
4c Address (number, street, and room or suite no.) (or P.O. box no. if mail is not delivered to the street address)	
4d City or town, state, and ZIP code	

For Paperwork Reduction Act Notice, see page 4. Form **8282** (Rev. 4-2009)

Form 8282 (Rev. 4-2009) Page 2

Part III Information on DONATED PROPERTY

	1. Description of the donated property sold, exchanged, or otherwise disposed of and how the organization used the property. (If you need more space, attach a separate statement.)	2. Did the disposition involve the organization's entire interest in the property?		3. Was the use related to the organization's exempt purpose or function?		4. Information on use of property. • If you answered "Yes" to question 3 and the property was tangible personal property, describe how the organization's use of the property furthered its exempt purpose or function. Also complete Part IV below. • If you answered "No" to question 3 and the property was tangible personal property, describe the organization's intended use (if any) at the time of the contribution. Also complete Part IV below, if the intended use at the time of the contribution was related to the organization's exempt purpose or function and it became impossible or infeasible to implement.
		Yes	No	Yes	No	
A						
B						
C						
D						

		Donated Property			
		A	B	C	D
5	Date the organization received the donated property (MM/DD/YY)				
6	Date the original donee received the property (MM/DD/YY)				
7	Date the property was sold, exchanged, or otherwise disposed of (MM/DD/YY)				
8	Amount received upon disposition	$	$	$	$

Part IV Certification

You must sign the certification below if any property described in Part III above is tangible personal property and:

- You answered "Yes" to question 3 above, or
- You answered "No" to question 3 above and the intended use of the property became impossible or infeasible to implement.

Under penalties of perjury and the penalty under section 6720B, I certify that either: (1) the use of the property that meets the above requirements, and is described above in Part III, was substantial and related to the donee organization's exempt purpose or function; or (2) the donee organization intended to use the property for its exempt purpose or function, but the intended use has become impossible or infeasible to implement.

▶ Signature of officer | Title ▶ Date

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

▶ Signature of officer | Title ▶ Date

Type or print name

Form **8282** (Rev. 4-2009)

APPENDIX E

Inflation-Adjusted Insubstantiality Threshold—$50 Test

Year	Amount	Rev. Proc.
1993	$62	92-102
1994	64	93-49
1995	66	94-72
1996	67	95-53
1997	69	96-59
1998	71	97-57
1999	72	98-61
2000	74	99-42
2001	76	2000-13
2002	79	2001-59
2003	80	2002-70
2004	82	2003-85
2005	83	2004-71
2006	86	2005-70
2007	89	2006-53
2008	91	2007-66
2009	95	2008-66
2010	96	2009-50

APPENDIX F

Inflation-Adjusted Insubstantiality Threshold—$25 Test

Year	Amount	Rev. Proc.
1991	$28.58	92-58
1992	30.09	92-58
1993	31.00	92-102
1994	32.00	93-49
1995	33.00	94-72
1996	33.50	95-53
1997	34.50	96-59
1998	35.50	97-57
1999	36.00	98-61
2000	37.00	99-42
2001	38.00	2000-13
2002	39.50	2001-59
2003	40.00	2002-70
2004	41.00	2003-85
2005	41.50	2004-71
2006	43.00	2005-70
2007	44.50	2006-53
2008	45.50	2007-66
2009	47.50	2008-66
2010	48.00	2009-50

APPENDIX G

Inflation-Adjusted Low-Cost Article Definition

Year	Amount	Rev. Proc.
1991	$5.71	92-58
1992	6.01	92-58
1993	6.20	92-102
1994	6.40	93-49
1995	6.60	94-72
1996	6.70	95-53
1997	6.90	96-59
1998	7.10	97-57
1999	7.20	98-61
2000	7.40	99-42
2001	7.60	2000-13
2002	7.90	2001-59
2003	8.00	2002-70
2004	8.20	2003-85
2005	8.30	2004-71
2006	8.60	2005-70
2007	8.90	2006-53
2008	9.10	2007-66
2009	9.50	2008-66
2010	9.60	2009-50

APPENDIX H

Monthly Federal Interest Rates Used in Valuing Partial Interests (IRC § 7520)

Month	Rate (%)	Rev. Rul.
July 1989	10.6	89-86
Aug. 1989	10.0	89-92
Sept. 1989	9.8	89-105
Oct. 1989	10.2	89-111
Nov. 1989	10.0	89-117
Dec. 1989	9.8	89-127
Jan. 1990	9.6	90-1
Feb. 1990	9.8	90-12
Mar. 1990	10.2	90-22
Apr. 1990	10.6	90-28
May 1990	10.6	90-41
June 1990	11.0	90-48
July 1990	10.6	90-52
Aug. 1990	10.4	90-66
Sept. 1990	10.2	90-75
Oct. 1990	10.6	90-81
Nov. 1990	10.6	90-92
Dec. 1990	10.2	90-99
Jan. 1991	9.8	91-1
Feb. 1991	9.6	91-9
Mar. 1991	9.6	91-15
Apr. 1991	9.6	91-23
May 1991	9.6	91-29
June 1991	9.6	91-35
July 1991	9.6	91-39
Aug. 1991	9.8	91-41
Sept. 1991	9.6	91-48
Oct. 1991	9.0	91-53
Nov. 1991	8.6	91-57
Dec. 1991	8.6	91-62
Jan. 1992	8.2	92-1
Feb. 1992	7.6	92-8
Mar. 1992	8.0	92-13
Apr. 1992	8.4	92-23

(*continued*)

Month	Rate (%)	Rev. Rul.
May 1992	8.6	92-33
June 1992	8.4	92-39
July 1992	8.2	92-50
Aug. 1992	7.8	92-59
Sept. 1992	7.2	92-67
Oct. 1992	7.0	92-87
Nov. 1992	6.8	92-90
Dec. 1992	7.4	92-104
Jan. 1993	7.6	93-1
Feb. 1993	7.6	93-10
Mar. 1993	7.0	93-19
Apr. 1993	6.6	93-23
May 1993	6.6	93-32
June 1993	6.4	93-39
July 1993	6.6	92-42
Aug. 1993	6.4	93-51
Sept. 1993	6.4	93-55
Oct. 1993	6.0	93-64
Nov. 1993	6.0	93-71
Dec. 1993	6.2	93-82
Jan. 1994	6.4	94-1
Feb. 1994	6.4	94-9
Mar. 1994	6.4	94-15
Apr. 1994	7.0	94-22
May 1994	7.8	94-29
June 1994	8.4	94-36
July 1994	8.2	94-44
Aug. 1994	8.4	94-50
Sept. 1994	8.4	94-55
Oct. 1994	8.6	94-61
Nov. 1994	9.0	94-67
Dec. 1994	9.4	94-73
Jan. 1995	9.6	95-3
Feb. 1995	9.6	95-13
Mar. 1995	9.4	95-20
Apr. 1995	8.8	95-27
May 1995	8.6	95-39
June 1995	8.2	95-42
July 1995	7.6	95-48
Aug. 1995	7.2	95-51
Sept. 1995	7.6	95-62
Oct. 1995	7.6	95-67
Nov. 1995	7.4	95-73
Dec. 1995	7.2	95-79
Jan. 1996	6.8	96-6
Feb. 1996	6.8	96-14
Mar. 1996	6.6	96-15
Apr. 1996	7.0	96-19
May 1996	7.6	96-24
June 1996	8.0	96-27

Month	Rate (%)	Rev. Rul.
July 1996	8.2	96-34
Aug. 1996	8.2	96-37
Sept. 1996	8.0	96-43
Oct. 1996	8.0	96-49
Nov. 1996	8.0	96-52
Dec. 1996	7.6	96-57
Jan. 1997	7.4	97-1
Feb. 1997	7.6	97-7
Mar. 1997	7.8	97-10
Apr. 1997	7.8	97-17
May 1997	8.2	97-19
June 1997	8.2	97-24
July 1997	8.0	97-27
Aug. 1997	7.6	97-30
Sept. 1997	7.6	97-36
Oct. 1997	7.6	97-41
Nov. 1997	7.4	97-44
Dec. 1997	7.2	97-49
Jan. 1998	7.2	98-4
Feb. 1998	6.8	98-7
Mar. 1998	6.8	98-11
Apr. 1998	6.8	98-18
May 1998	6.8	98-23
June 1998	7.0	98-28
July 1998	6.8	98-33
Aug. 1998	6.8	98-36
Sept. 1998	6.6	98-43
Oct. 1998	6.2	98-50
Nov. 1998	5.4	98-52
Dec. 1998	5.4	98-57
Jan. 1999	5.6	99-2
Feb. 1999	5.6	99-8
Mar. 1999	5.8	99-11
Apr. 1999	6.4	99-17
May 1999	6.2	99-21
June 1999	6.4	99-25
July 1999	7.0	99-29
Aug. 1999	7.2	99-32
Sept. 1999	7.2	99-32
Oct. 1999	7.2	99-41
Nov. 1999	7.4	99-45
Dec. 1999	7.4	99-48
Jan. 2000	7.4	2000-1
Feb. 2000	8.0	2000-9
Mar. 2000	8.2	2000-11
Apr. 2000	8.0	2000-19
May 2000	7.8	2000-23
June 2000	8.0	2000-28

(*continued*)

Month	Rate (%)	Rev. Rul.
July 2000	8.0	2000-32
Aug. 2000	7.6	2000-38
Sept. 2000	7.6	2000-41
Oct. 2000	7.4	2000-45
Nov. 2000	7.2	2000-50
Dec. 2000	7.0	2000-54
Jan. 2001	6.8	2001-3
Feb. 2001	6.2	2001-7
Mar. 2001	6.2	2001-12
Apr. 2001	6.0	2001-17
May 2001	5.8	2001-22
June 2001	6.0	2001-27
July 2001	6.2	2001-34
Aug. 2001	6.0	2001-36
Sept. 2001	5.8	2001-43
Oct. 2001	5.6	2001-49
Nov. 2001	5.0	2001-52
Dec. 2001	4.8	2001-58
Jan. 2002	5.4	2002-2
Feb. 2002	5.6	2002-5
Mar. 2002	5.4	2002-10
Apr. 2002	5.6	2002-17
May 2002	6.0	2002-25
June 2002	5.8	2002-36
July 2002	5.6	2002-40
Aug. 2002	5.2	2002-48
Sept. 2002	4.6	2002-53
Oct. 2002	4.2	2002-61
Nov. 2002	3.6	2002-74
Dec. 2002	4.0	2002-81
Jan. 2003	4.2	2003-5
Feb. 2003	4.0	2003-16
Mar. 2003	3.8	2003-26
Apr. 2003	3.6	2003-35
May 2003	3.8	2003-45
June 2003	3.6	2003-60
July 2003	3.0	2003-71
Aug. 2003	3.2	2003-94
Sept. 2003	4.2	2003-101
Oct. 2003	4.4	2003-107
Nov. 2003	4.0	2003-114
Dec. 2003	4.2	2003-122
Jan. 2004	4.2	2004-2
Feb. 2004	4.2	2004-9
Mar. 2004	4.0	2004-25
Apr. 2004	3.8	2004-39
May 2004	3.8	2004-44
June 2004	4.6	2004-54
July 2004	5.0	2004-66
Aug. 2004	4.8	2004-84

Month	Rate (%)	Rev. Rul.
Sept. 2004	4.6	2004-69
Oct. 2004	4.4	2004-96
Nov. 2004	4.2	2004-102
Dec. 2004	4.2	2004-106
Jan. 2005	4.6	2005-2
Feb. 2005	4.6	2005-8
Mar. 2005	4.6	2005-13
Apr. 2005	5.0	2005-23
May 2005	5.2	2005-27
June 2005	4.8	2005-32
July 2005	4.6	2005-38
Aug. 2005	4.8	2005-54
Sept. 2005	5.0	2005-57
Oct. 2005	5.0	2005-66
Nov. 2005	5.0	2005-71
Dec. 2005	5.4	2005-77
Jan. 2006	5.4	2006-4
Feb. 2006	5.2	2006-7
Mar. 2006	5.4	2006-10
Apr. 2006	5.6	2006-22
May 2006	5.8	2006-24
June 2006	6.0	2006-29
July 2006	6.0	2006-35
Aug. 2006	6.2	2006-39
Sept. 2006	6.0	2006-44
Oct. 2006	5.8	2006-50
Nov. 2006	5.6	2006-55
Dec. 2006	5.8	2006-61
Jan. 2007	5.6	2007-2
Feb. 2007	5.6	2007-9
Mar. 2007	5.8	2007-15
Apr. 2007	5.6	2007-23
May 2007	5.6	2007-29
June 2007	5.6	2007-36
July 2007	6.0	2007-44
Aug. 2007	6.2	2007-50
Sept. 2007	5.8	2007-57
Oct. 2007	5.2	2007-63
Nov. 2007	5.2	2007-66
Dec. 2007	5.0	2007-70
Jan. 2008	4.4	2008-4
Feb. 2008	4.2	2008-9
Mar. 2008	4.0	2008-11
Apr. 2008	3.4	2008-20
May 2008	3.2	2008-24
June 2008	3.8	2008-28
July 2008	4.2	2008-33
Aug. 2008	4.2	2008-43

(*continued*)

Month	Rate (%)	Rev. Rul.
Sept. 2008	4.2	2008-46
Oct. 2008	3.8	2008-49
Nov. 2008	3.6	2008-50
Dec. 2008	3.4	2008-53
Jan. 2009	2.4	2009-1
Feb. 2009	2.0	2009-5
Mar. 2009	2.4	2009-8
Apr. 2009	2.6	2009-10
May 2009	2.4	2009-12
June 2009	2.8	2009-16
July 2009	3.4	2009-20
Aug. 2009	3.4	2009-22
Sep. 2009	3.4	2009-29
Oct. 2009	3.2	2009-33
Nov. 2009	3.2	2009-35
Dec. 2009	3.2	2009-38

APPENDIX I

Deemed Rates of Return for Transfers to New Pooled Income Funds

Year	Rate (%)
1989 (Jan.–Apr.)	9.0
1989 (May–Dec.)	9.4
1990	9.8
1991	9.8
1992	9.8
1993	9.4
1994	8.4
1995	6.8
1996	7.2
1997	7.2
1998	7.2
2000	6.8
2001	6.6
2002	6.6
2003	6.6
2004	4.0
2005	4.8
2006	3.8
2007	4.8
2008	4.8
2009	4.8

APPENDIX J

Form 1098-C

7878 ☐ CORRECTED

DONEE'S name, street address, city, state, ZIP code, and telephone no.	1 Date of contribution	OMB No. 1545-1959 **2009** Form **1098-C**	Contributions of Motor Vehicles, Boats, and Airplanes
	2 Make, model, and year of vehicle		
DONEE'S federal identification number / DONOR'S identification number	3 Vehicle or other identification number		
DONOR'S name	4a ☐ Donee certifies that vehicle was sold in arm's length transaction to unrelated party		
Street address (including apt. no.)	4b Date of sale		
City, state, and ZIP code	4c Gross proceeds from sale (see instructions) $		**Copy A** For Internal Revenue Service Center File with Form 1096.
5a ☐ Donee certifies that vehicle will not be transferred for money, other property, or services before completion of material improvements or significant intervening use			
5b ☐ Donee certifies that vehicle is to be transferred to a needy individual for significantly below fair market value in furtherance of donee's charitable purpose			For Privacy Act and Paperwork Reduction Act Notice, see the **2009 General Instructions for Forms 1099, 1098, 3921, 3922, 5498, and W-2G.**
5c Donee certifies the following detailed description of material improvements or significant intervening use and duration of use			
6a Did you provide goods or services in exchange for the vehicle? ▶ Yes ☐ No ☐			
6b Value of goods and services provided in exchange for the vehicle $			
6c Describe the goods and services, if any, that were provided. If this box is checked, donee certifies that the goods and services consisted solely of intangible religious benefits ▶ ☐			
7 Under the law, the donor may not claim a deduction of more than $500 for this vehicle if this box is checked ▶ ☐			

Form **1098-C** Department of the Treasury - Internal Revenue Service

Reference Copy, Do Not File

STF KCRW1093.1

☐ CORRECTED (if checked)

DONEE'S name, street address, city, state, ZIP code, and telephone no.			OMB No. 1545-1959 **2009** Form **1098-C**	Attachment Sequence No. **155A** **Contributions of Motor Vehicles, Boats, and Airplanes**
		1 Date of contribution		
		2 Make, model, and year of vehicle		
DONEE'S federal identification number	DONOR'S identification number	3 Vehicle or other identification number		
DONOR'S name		4a ☐ Donee certifies that vehicle was sold in arm's length transaction to unrelated party		
Street address (including apt. no.)		4b Date of sale		**Copy B**
City, state, and ZIP code		4c Gross proceeds from sale (see instructions) $		**For Donor**
5a ☐ Donee certifies that vehicle will not be transferred for money, other property, or services before completion of material improvements or significant intervening use				In order to take a deduction of more than $500 for this contribution, you must attach this copy to your federal tax return.
5b ☐ Donee certifies that vehicle is to be transferred to a needy individual for significantly below fair market value in furtherance of donee's charitable purpose				
5c Donee certifies the following detailed description of material improvements or significant intervening use and duration of use				**Unless box 5a or 5b is checked, your deduction cannot exceed the amount in box 4c.**
6a Did you provide goods or services in exchange for the vehicle? ▶ Yes ☐ No ☐				
6b Value of goods and services provided in exchange for the vehicle $				
6c Describe the goods and services, if any, that were provided. If this box is checked, donee certifies that the goods and services consisted solely of intangible religious benefits ▶ ☐				
7 Under the law, the donor may not claim a deduction of more than $500 for this vehicle if this box is checked ▶ ☐				

Form **1098-C** Department of the Treasury - Internal Revenue Service

☐ CORRECTED (if checked)

DONEE'S name, street address, city, state, ZIP code, and telephone no.			OMB No. 1545-1959 **2009** Form **1098-C**	**Contributions of Motor Vehicles, Boats, and Airplanes**
		1 Date of contribution		
		2 Make, model, and year of vehicle		
DONEE'S federal identification number	DONOR'S identification number	3 Vehicle or other identification number		
DONOR'S name		4a ☐ Donee certifies that vehicle was sold in arm's length transaction to unrelated party		
Street address (including apt. no.)		4b Date of sale		
City, state, and ZIP code		4c Gross proceeds from sale (see instructions) $		**Copy C**
5a ☐ Donee certifies that vehicle will not be transferred for money, other property, or services before completion of material improvements or significant intervening use				**For Donor's Records**
5b ☐ Donee certifies that vehicle is to be transferred to a needy individual for significantly below fair market value in furtherance of donee's charitable purpose				This information is being furnished to the Internal Revenue Service unless box 7 is checked.
5c Donee certifies the following detailed description of material improvements or significant intervening use and duration of use				
6a Did you provide goods or services in exchange for the vehicle? ▶ Yes ☐ No ☐				
6b Value of goods and services provided in exchange for the vehicle $				
6c Describe the goods and services, if any, that were provided. If this box is checked, donee certifies that the goods and services consisted solely of intangible religious benefits ▶ ☐				
7 Under the law, the donor may not claim a deduction of more than $500 for this vehicle if this box is checked ▶ ☐				

Form **1098-C** Department of the Treasury - Internal Revenue Service

☐ CORRECTED

DONEE'S name, street address, city, state, ZIP code, and telephone no.		1 Date of contribution	OMB No. 1545-1959 **2009** Form **1098-C**	**Contributions of Motor Vehicles, Boats, and Airplanes**
		2 Make, model, and year of vehicle		
DONEE'S federal identification number	DONOR'S identification number	3 Vehicle or other identification number		
DONOR'S name		4a ☐ Donee certifies that vehicle was sold in arm's length transaction to unrelated party		
Street address (including apt. no.)		4b Date of sale		**Copy D**
City, state, and ZIP code		4c Gross proceeds from sale (see instructions) $		**For Donee**
5a ☐ Donee certifies that vehicle will not be transferred for money, other property, or services before completion of material improvements or significant intervening use				
5b ☐ Donee certifies that vehicle is to be transferred to a needy individual for significantly below fair market value in furtherance of donee's charitable purpose				For Privacy Act and Paperwork Reduction Act Notice, see the **2009 General Instructions for Forms 1099, 1098, 3921, 3922, 5498, and W-2G.**
5c Donee certifies the following detailed description of material improvements or significant intervening use and duration of use				
6a Did you provide goods or services in exchange for the vehicle? ▶ Yes ☐ No ☐				
6b Value of goods and services provided in exchange for the vehicle $				
6c Describe the goods and services, if any, that were provided. If this box is checked, donee certifies that the goods and services consisted solely of intangible religious benefits ▶ ☐				
7 Under the law, the donor may not claim a deduction of more than $500 for this vehicle if this box is checked ▶ ☐				

Form **1098-C** Department of the Treasury - Internal Revenue Service

APPENDIX K

Selected Bibliography

The professional literature in the field of charitable giving is extensive; thus, most of these materials are collected here, rather than in footnotes throughout the text.

CHAPTER 3 FUNDAMENTAL CONCEPTS

Fuerst, ''Dilemma of Contingent Gifts,'' 16 *Exempt Org. Tax Rev.* (No. 1) 37 (Jan. 1997).

Haims, ''Assignment of Income: Has *Ferguson* Hastened the 'Ripening' Process?,'' 28 *Exempt Org. Tax Rev.* (No. 3) 475 (June 2000).

Hildenbrand, '' 'No, You Still Can't Deduct that Payment to Your Child's Private Religious School:' An Analysis of the Ninth Circuit Decision in *Sklar v. Commissioner,'' 55 Tax Law.* (No. 4) 995 (Summer 2002).

Raby and Raby, ''Religious Tuition as Charitable Contribution,'' 29 *Exempt Org. Tax Rev.* (No. 2) 287 (Aug. 2000).

Walker, ''Gifts of Appreciated Property and the Assignment of Income Doctrine,'' 11 *J. Tax. of Exempt Orgs.* (No. 5) 195 (Mar./April 2000).

CHAPTER 4 GIFTS OF MONEY AND PROPERTY

Caudill and Budyak, ''New IRS Position on Valuation May Result in Reduced Marital and Charitable Deductions,'' 79 *J. Tax.* (No. 3) 176 (Sep. 1993).

Franklin and Shevlin, ''Planning Considerations for Donors and Charities When Making and Accepting Gifts of Restricted Stock,'' 35 *Exempt Org. Tax Rev.* (No. 2) 141 (Feb. 2002).

Freeman and Klein, ''The Economics of Charitable Gift Planning,'' 131 *Trusts & Estates* (No. 8) 22 (Aug. 1992).

Greif, ''Charitable Contributions of Appreciated Long-Term Securities,'' 11 *Exempt Org. Tax Rev.* (No. 6) 1224 (June 1995).

Knauer, ''The Paradox of Corporate Giving: Tax Expenditures, The Nature of the Corporation, and the Social Construction of Charity,'' 11 *Exempt Org. Tax Rev.* (No. 6) 1225 (June 1995).

Krause and Solendert, ''Setting the Ground Rules for Contributions of Real Estate,'' 9 *Tax. of Exempt Orgs.* (No. 3) 121 (Nov./Dec. 1997).

Lyon, ''Charitable Giving–Pledges v. Letters of Intent,'' 42 *Exempt Org. Tax Rev.* (No. 3) 347 (Dec. 2003).

Newman and Cafferata, ''Charitable Gifts of Retirement Plan Assets,'' 9 *Exempt Org. Tax Rev.* (No. 6) 1301 (June 1994).

Puzo and Gardiner, ''Charitable Giving and S Corporations: Problems, Possibilities, and Planning,'' 3 *J. Tax. of Exempt Orgs.* (No. 2) 4 (Summer 1991).

CHAPTER 5 FUNDAMENTALS OF PLANNED GIVING

Allinger, ''Glossary of Terms Used in Planned Giving,'' 11 *Fund Raising Man*. (No. 6) 18 (1980).

Boyle, ''Evaluating Split-Interest Valuation,'' 24 *Ga. L. Rev.* 1 (1989).

Breen, Gertz, and Nyberg, ''Charitable Trusts Are an Alternative to Qualified Plans,'' 20 *Tax'n for Law*. 26 (July/Aug. 1991).

Breen, Gertz, and Nyberg, ''Charitable Trusts Are an Alternative to Qualified Plans,'' 47 *Tax'n for Acct*. 20 (July 1991).

Brown, ''All About Planned Giving,'' 117 *Trusts & Estates* 744 (1978).

Callister, ''Charitable Remainder Trusts: An Overview,'' 51 *Tax Law*. (No. 3) 549 (Spring 1998).

Carmichael, ''Deferred Gifts for Youth: Weigh All Options,'' 16 *Fund Raising Man*. (No. 12) 56 (1986).

Clark, ''The Changing Economics of Charitable Giving: Representative Case Studies,'' Tax-Exempt Charitable Organizations, Amer. Bar Assoc. Section of Taxation (Westlaw: C693 ALI-ABA 151, 1991).

Clark, ''Charitable Giving and Receiving,'' Practicing Law Inst. (Westlaw: 248 PLI/Tax 327, 1986).

Clark, ''Charitable Giving and Receiving: Considerations for the Donor and Donee in Structuring Charitable Gifts from a Tax and Policy Perspective,'' Practicing Law Inst. (Westlaw: 276 PLI/Tax 9, 1988).

Clark, ''Inter-vivos and Testamentary Charitable Trusts Under the Tax Reform Act of 1969 and Regulations,'' 31 *N.Y.U. Inst. Fed. Tax.* 1127 (1973).

Clark, Charitable Remainder Regulations Provide Guidelines for Operation of New Roles,'' 33 *J. Tax.* 214 (1970).

DioGuardi, ''Tax Economics of Charitable Giving.'' 120 *Trusts & Estates* (No. 2) 19 (1981).

Fleming, ''Charitable Trusts Under the Tax Reform Act,'' 48 *Taxes* 757 (1970).

Freeman and Klein, ''The Economics of Charitable Gift Planning,'' 131 *Trusts & Estates* 22 (Aug. 1992).

Fremont-Smith, ''Charitable Scene in Relation to the Tax Reform Act of 1969,'' 5 *Real Prop. Prob. & Trust J.* 393 (1970).

Geary, ''The 'Now' Value of Deferred Gifts,'' 17 *Fund Raising Man*. (No. 12) 62 (1987).

Giese and Murray, ''Planned Giving in A Capital Campaign,'' 18 *Fund Raising Man*. (No. 13) 43 (1988).

Graham, ''Is Planned Giving Dead?,'' 17 *Fund Raising Man*. (No. 12) 48 (1987).

Graham, ''What Fund Raisers Should Know About Planned Giving,'' 16 *Fund Raising Man*. (No. 12) 28 (1986).

Greenberg and Hellige, ''Overall Look at Planned Giving Options'' 16 *Fund Raising Man*. (No. 12) 74 (1986).

Haberman, ''Trusts and the Tax Reform Act,'' 54 *Marq. L. Rev.* 117 (Spring 1971).

Hardingham, ''Trusts Including Charitable and Noncharitable Purposes: Special Statutory Provisions,'' 47 *Austin L. J.* 68 (Feb. 1973).

Higgins, ''Installment Sales, Remainder Interests, Private Annuities, Recapitalizations, and Charitable Lead Trusts,'' Practicing Law Inst. (Westlaw: 174 PLI/Est 637, 1987).

Hobson, ''Deferred Giving: Accent on Planning,'' 16 *Fund Raising Man*. (No. 12) 58 (1986).

Horvitz, ''Planning an Effective Gift Giving Program,'' 10 *Inst. Estate Plan.* 17.1 (1976).

Huffaker, ''Rules for Valuing Partial Interests Updated,'' 78 *J. Tax.* 162 (1993).

Jackson, ''Gifts of Remainder Interests to Charity,'' 47 *Cal. S. B. J.* 22 (1972).

Kannry, ''Giving AFTER the 76 Tax Reform,'' X *Phil. Mon.* (No. 1) 19 (1977).

Kannry, ''Planning Considerations for Charitable Contributions,'' 13 *Real Prop. Probs. & Trust J.* 581 (Fall 1978).

Kanter and Banoff, ''Planning under New Actuarial and Valuation Tables,'' 72 *J. Tax* 126 (Feb. 1990).

Kennedy, ''Ascertainable Standards, Discretionary Powers, and Charitable Remainders,'' 56 *Taxes* 78 (1978).

Lafferty, ''Deferred Giving Developments,'' 117 *Trusts & Estates* 753 (1978).

Lafferty, ''Deferred Giving to Charity.'' XXXIII *Adv. Underwriter* (No. 3) 7 (Mar. 1979).

Lafferty, ''Economic and Tax Ramifications of Charitable Giving Through Split-Interest Trusts.'' 52 *Temp. L. Q.* 1040 (1979).

Laurice, ''New Rules for Valuing Partial Interests Substantially Complicate Transactions,'' 16 *Est. Plan.* 330 (Nov./Dec. 1989).

Livsey, ''Charitable Deductions: Planning Under the New Restrictions,'' 57 *A.B.A. J.* 274 (1971).

McCoy and Moerschbaecher, ''Marital/Charitable Planning Aspects,'' Practicing Law Inst. (Westlaw: 166 PLI/Est. 111, 1986).

Moerschbaecher, ''Planned Caring: Planned Giving of Tomorrow?,'' 20 *Fund Raising Man.* (No. 1) 28 (1989).

Moore, ''Split-Interest Charitable Trusts,'' 7 *Inst. Est. Plan.* 73 (1973).

Myers, ''Charitable Contributions,'' 4 *Ind. Legal Forum* (No. 1) 217 (1970).

Olsen and Gleit, ''Prop. Regs. Clarify Many Aspects of New Complex Charitable Contribution Deduction Rules,'' 35 *J. Tax.* 66 (Aug. 1971).

Osteen, ''Charitable Contributions: State of the Art Techniques in Planned Giving.'' 13 *Exempt Org. Tax Rev.* (No. 6) 945 (June 1996).

Peter, ''Analytic Comparison of the Three Split-Interest Charitable Trust Vehicles,'' 35 *J. Tax.* 240 (1979).

Recer, ''How Planned Charitable Gifts Benefit Heirs,'' 17 *Fund Raising Man.* (No. 12) 38 (1987).

Riband, ''Gifts in Trust of Income and Remainder Interests to Charity,'' 30 *N.Y.U. Inst. Fed. Tax.* 87 (1972).

Rogers, III, Blattmachr, and Rivlin, ''Charitable Trusts Can Avoid Loss of Benefits,'' 18 *Est. Plan.* 292 (1991).

Rosenbloom, Oshereow, and Anderson, ''Taking Advantage of the Opportunities Presented by IRS's 10% Valuation Tables,'' 64 *J. Tax.* 26 (Jan. 1986).

Ruby, ''Three Trust Documents,'' 4 *ALI-ABA Course Materials J.* 37 (April 1980).

Schlesinger and Scheiner, ''Split Interest Charitable Trusts,'' Income Taxation of Estates and Trusts, Practicing Law Inst. (Westlaw: 220 PLI/Est. 203, 1993).

Schlesinger, ''Split Interest Charitable Trusts,'' Income Taxation of Estates and Trusts, Practicing Law Inst. (Westlaw: 175 PLI/Est. 343, 1987).

Schlesinger, ''Split Interest Charitable Trusts,'' Income Taxation of Estates and Trusts, Practicing Law Inst. (Westlaw: 192 PLI/Est. 195, 1990).

Sharpe, ''Planned Gifts Come of Age,'' 20 *Fund Raising Man.* (No. 2) 78 (1989).

Sharpe, Jr., ''Planned Giving: Key to Prosperity, Professionalism,'' 17 *Fund Raising Man.* (No. 12) 69 (1987).

Smith, ''Deferred Giving Letting the Donor Have His Cake While You Eat It Too,'' *Found. News*. 22 (Jan./Feb. 1984).

Stevens, ''Certainty and Charity: Recent Developments in the Law of Trusts,'' 52 *Can. B. Rev.* 379 (1974).

Temple, ''Using Deferred Charitable Gifts to Achieve Maximum Transmission of Family Wealth Tax Free.'' 30 *Tax. for Law*. 216 (1983).

Thomsen, ''Split Interest Gifts to Charity,'' 7 *Real Prop. Prob. & Trust J.* 552 (1972).

Tidd, ''The Use of Tax-Exempt Bonds in Charitable Gift Planning,'' 71 *Taxes* 107 (Feb. 1993).

Tomeo, ''Charitable Deferred Giving,'' 48 *Conn. B. J.* 48 (1974).

Turley, Jr., ''Charitable Deductions, Remainders to Charity, and the Tax Reform Act'' 8 *Houston L. Rev.* 411 (1971).

Weithorn, ''Trusts With Charitable Interests,'' 4 *Real Prop. Prob. & Trust J.* 624 (1969).

Wicker, ''Charitable Trusts,'' 11 *Gonzaga L. Rev.* 1 (1975).

Wyrick, ''Tax Planning With Charitable Trusts,'' 38 *La. B.J.* 401 (April 1991).

CHAPTER 6 TIMING OF CHARITABLE DEDUCTIONS

Raby and Raby, ''Gifts of Stock That Have or Have Not 'Ripened','' 24 *Exempt Org. Tax Rev.* (No. 3) 497 (June 1999).

CHAPTER 7 PERCENTAGE LIMITATIONS

Auster, ''Deducting Charitable Contributions of Capital Gain Property After 1993 Tax Legislation: When to Make the 50 Percent Election,'' 9 *Exempt Org. Tax Rev.* (No. 2) 291 (Feb. 1994).

CHAPTER 8 ESTATE AND GIFT TAX CONSIDERATIONS

Aulino, ''Estate Distributions to Charitable Remainder Trusts,'' 114 *Trusts & Estates* 458 (1973).

Bakija and Gale, ''Effects of Estate Tax Reform on Charitable Giving,'' 41 *Exempt Org. Tax Rev.* (No. 2) 191 (Aug. 2003).

Browder, ''Giving or Leaving: What Is a Will?,'' 75 *Mich. L. Rev.* 845 (April/May 1977).

Burke, ''Charitable Giving and Estate Planning,'' 28 *Tax Law*. 289 (1975).

Caffrey, ''Charitable Bequests: Delegating Discretion to Choose the Objects of the Testator's Beneficence,'' 44 *Tenn. L. Rev.* 307 (1977).

Cowley and Jones, ''Estate and Gift Tax Unification: The Concepts and Selected Giving Problems,'' 36 *N.Y.U. Inst. Fed. Tax*. 273 (1978).

Doti, ''Estate Tax Repeal: Historical Evidence Suggests Philanthropy May Suffer,'' 40 *Exempt Org. Tax Rev.* (No. 2) 151 (May 2003).

Echter, ''Donations Mortis Causa,'' 22 *Loyola L. Rev.* 768 (1976).

Echter, ''Equitable Treatment for the Artist's Estate,'' 114 *Trusts & Estates* 394 (1975).

Engel, ''Pre and Post Mortem Planning for Charitable Giving,'' 116 *Trusts & Estates* 392 (1977).

Fratcher. ''Bequests for Charitable Purposes,'' 56 *Ia. L. Rev.* 773 (1971).

Galant, ''Planning Opportunity: The Gifting of Closely Held Stock to Charitable Organizations,'' 51 *Taxes* 645 (1973).

Gans, Blattmachr, and McCaffrey, ''The Anti-*Hubert* Regulations,'' 28 *Exempt Org. Tax Rev.* (No. 3) 497 (June 2000).

Harrison and Tarlow, ''How to Use Trusts and Estates to Maximize Deductions for Charitable Contributions,'' 13 *Est. Plan.* 66 (Mar./April 1986).

Hicks, ''Estate Planning through Charitable Lead and Remainder Trusts,'' Financial Planning for Lawyers and Their Clients (Westlaw: C469 ALI-ABA 459, 1990).

Johanson, ''Charitable Trusts and Dispositions,'' Postmortem Planning and Estate Administration, Univ. of Miami Law School (Westlaw: C523 ALI-ABA 571, 1990).

Kirchick and Beckwith, ''The Internal Revenue Service Changes the Odds On Death and Taxes,'' 62 *Taxes* 699 (1984).

Lauritzen, ''Charitable Bequests and Powers of Invasion,'' 13 *Tax Coun. Q.* 395 (1969).

Lauritzen, ''Charitable Bequests and Powers of Invasion.'' 14 *Tax Coun. Q.* 1 (1970).

Lauritzen, ''Restrictions on Charitable Testamentary Gifts'' 5 *Real Prop. Prob. & Trusts J.* 290 (1970).

Lemann, ''Charitable Split-Interest Trusts in Estate Planning,'' 18 *La. B. J.* 259 (1971).

Lewis, ''Testamentary Charitable Remainder Trusts Under the Tax Reform Act of 1969,'' 48 *Taxes* 464 (1970).

Mangum, ''Charitable Transfers and Estate Planning,'' 38 *N.Y.U. Inst. Fed. Tax.* 40-1 (1980).

McCaffery and Weigandt, ''Lobbying for Life: Protecting Charitable Giving Without a Death Tax,'' 39 *Exempt Org. Tax Rev.* (No. 2) 195 (Feb. 2003)

Moore, ''Estate Planning Under the Tax Reform Act of 1969: The Uses of Charity,'' 56 *Va. L. Rev.* 565 (1970).

Morrison and Marcus, ''Estate Planning Considerations for Charitable Trusts and Charitable Remainder Trusts Under the Tax Reform Act of 1969,'' 75 *Dick. L. Rev.* 185 (1971).

Myers and Quiggle, ''Charitable Contributions and Bequests by Individuals: The Impact of the Tax Reform Act,'' 39 *Ford. L. Rev.* 185 (1970).

Newman and Cafferata, ''Coordinating Charitable Gifts of Retirement Plan Assets with Lifetime Distribution Requirements,'' 10 *Exempt Org. Tax Rev.* (No. 6) 1335 (Dec. 1994).

Painter and Coplan, ''Charitable Lead Trusts Can Achieve Zero Transfer Tax if Properly Structured,'' 18 *Est. Plan.* 102 (Mar./April 1991).

Perrin, ''The IRA to Charity Technique,'' 135 *Trusts & Estates* (No. 10) 18 (1996).

Raby and Raby, ''Calculating Estate Tax Charitable Deductions,'' 39 *Exempt Org. Tax Rev.* (No. 1) 47 (Jan. 2003).

Schmolka, ''Income Taxation of Charitable Remainder Trusts and Decedents Estates, Sixty-six Years of Astigmatism,'' 40 *Tax L. Rev.* 5 (1984).

Small, ''Understanding the Conservation Easement Estate Tax Provisions,'' 28 *Exempt Org. Tax Rev.* (No. 3) 475 (June 2000).

Snyder, ''Role of charitable Contributions in Estate Planning: How to Eat Part of Your Cake and Keep Almost All of It,'' 9 *Wake Forest L. Rev.* 343 (1973).

Snyder, ''The Tax Reform Act of 1976: Its Impact on the Role of Charitable Contributions to Estate Planning,'' 4 *N. Ky. L. Rev.* 283 (1977).

Sugarman and Thomson, ''Use of Charitable Giving in Estate Planning Under the 1981 Tax Act,'' 3 *Found. News* 66 (Nov./Dec. 1981).

Taylor, ''The Charitable Remainder Trust: A Unique Estate Planning Technique,'' 69 (Taxes) 106 (1991).

Teitell, ''Charitable Contribution Tax Strategies,'' Estate Planning in Depth, Univ. of Wis. Law School (Westlaw: C415 ALI-ABA 763, 1989).

Teitell, ''Philanthropy and Estate Planning,'' 9 *Law Notes* 71 (Spring 1973).

Teitell, ''Philanthropy and Estate Planning,'' Estate Planning in Depth, Univ. of Wis. Law School (Westlaw: C631 ALI-ABA 891, 1991).

Weithorn, ''Using Split-Interest Trusts in Estate Planning,'' Advanced Estate Planning Techniques (Westlaw: C378 ALI-ABA 405, 1989).

CHAPTER 9 SPECIAL GIFT SITUATIONS

Borders and Hughes, ''Corporate Donors May Get an Enhanced Deduction for Gifts of Inventory,'' 4 *J. Tax. of Exempt Orgs.* (No. 4) 19 (Jan./Feb. 1993).

Kaplan and Lederman, ''Bargain Sales Can Benefit Charities and Donor Limited Partnerships,'' 6 *J. Tax. of Exempt Orgs.* (No. 2) 58 (Sep./Oct. 1994).

Levine, ''The Complete Picture on Donations of Art,'' 4 *J. Tax. of Exempt Orgs.* (No. 1) 23 (April 1992).

Newman and Cafferata, ''Coordinating Charitable Gifts of Retirement Plan Assets with Lifetime Distribution Requirements,'' 10 *Exempt Org. Tax Rev.* (No. 6) 1335 (Dec. 1994).

Perrin, ''The IRA to Charity Technique,'' 135 *Trusts & Estates* (No. 10) 18 (1996).

Polisher and Peeler, ''A Collector's Guide to Art, Taxes and Charitable Deductions,'' 136 *Trusts & Estates* (No. 10) 26 (Sep. 1997).

Raby and Raby, ''Charitable Contribution of Collections and Collectibles,'' 34 *Exempt Org. Tax Rev.* (No. 3) 409 (Dec. 2001).

CHAPTER 12 CHARITABLE REMAINDER TRUSTS

Aghdami, ''Payments Out of Post-Mortem Income: Impact on Estate Tax Marital and Charitable Deductions,'' 49 *Tax Law.* (No. 3) 707 (Spring 1996).

Ashby, ''Charitable Remainder Trusts: The New Look,'' 111 *Trusts & Estates* 530 (1972).

Ashby, ''Charitable Remainder Unitrusts as a Refuge for Low Basis Property,'' 117 *Trusts & Estates* 312 (1978).

Bone, ''A Self-Dealing Antidote for 'Income Deferral' NIMCRUTs,'' 16 *Exempt Org. Tax Rev.* (No. 1) 43 (Jan. 1997).

Bone, ''NIMCRUT Income Deferral Strategies Using Deferred Annuities and Other 'Growth Type' Investments Are Not 'Abusive','' 18 *Exempt Org. Tax Rev.* (No. 3) 195 (Dec. 1997).

Cafferata, ''Putting More Flexibility Into the Net Income Limitation on Charitable Remainder Unitrusts,'' 7 *J. Tax. of Exempt Orgs.* (No. 1) 1 (July/Aug. 1995).

Cafferata, ''Reconciling the Self-Dealing Rules with the Trustee-Beneficiary Relationship in Net Income Charitable Remainder Unitrusts,'' 15 *Exempt Org. Tax Rev.* (No. 3) 377 (Dec. 1996).

Cannon, ''Charitable Remainder Trusts: A Study of Current Problems,'' 1975 *Brigham Young U. L. Rev.* 49 (1975).

Clark, ''Charitable Remainder Regulations Provide Guidelines for Operation of New Rules,'' 33 *J. Tax.* 214 (1970).

Colburn, ''Securing Tax Benefits From Charitable Remainder and Charitable Lead Trusts,'' 16 *Est. Plan.* 154 (May/June 1989).

Crockett, ''Charitable Remainder Trusts: New Trust Vehicles for Tax Planning,'' 19 *St. Louis U. L. J.* 161 (1974).

Dryburgh, ''Charitable Remainder Trusts and the Definition of Income: Two Steps Forward, One Step Back,'' 12 *Exempt Orgs. Tax Rev.* (No. 1) 143 (July 1995).

Englebrecht and Selmonosky, ''Contingent Bequests and Estate Tax Charitable Deductions,'' 136 *Trusts & Estates* (No. 10) 26 (Sep. 1997).

Feinman and Britt, ''A Fresh Look At The Benefits of Charitable Remainder Trusts,'' 134 *Trusts & Estates* (No. 8) 41 (Aug. 1994).

Fischer and Jones, ''Charitable Remainder Trusts: Planning and Designing Issues,'' 131 *Trusts & Estates* 45 (Jan. 1992).

Fisher and Jones, ''Charitable Remainder Trusts: Planning and Designing Issues,'' 131 *Trusts & Estates* (No. 1) 45 (Jan. 1992).

Flannery, ''Charitable Remainder Trusts, Pooled Income Funds and the 1976 Tax Reform Act,'' 46 *U.M.K.C. L. Rev.* 357 (1978).

Flannery, ''Variation of the Charitable Remainder Trust,'' 1977 *N.Z. L.J.* 368 (1977).

Fowler, ''Charitable Remainder Trusts and Pooled Income Funds: Using Computer Simulation to Rank the Benefits,'' 11 *Tax Advisor* 68 (1980).

Frimmer, ''Charitable Remainder Trusts and Charitable Lead Trusts,'' Planning Techniques for Large Estates (Westlaw: C743 ALI-ABA 1021, 1992).

Gallo, ''Life Insurance and Estate Planning, Including Use of the Wealth Replacement Insurance Trust in Charitable Gift Planning,'' Uses of Insurance in Estate and Tax Planning, Cal. Continuing Education of the Bar (Westlaw: C782 ALI-ABA 575, 1992).

Garibaldi, ''Some Final Problems for the Charitable Taxpayer: Gift Annuities; Pooled Income Funds; Split Interest Trusts: Valuation of Charitable Gifts,'' 30 *N.Y.U. Inst. Fed. Tax.* 117 (1972).

Gillon, ''In a Strait Jacket on the Bed of Procrustes: Charitable Remainder Trusts Under the Tax Reform Act of 1969,'' 32 *Ala. Law. 243 (1971).*

Gulbrandsen, ''Proposed Changes in CRT Regs.: The Real Issue Is Controlled Deferral,'' 136 *Trusts & Estates* (No. 7) 41 (June 1997).

Hakala, ''Turning Appreciation Into Income: Without Triggering Tax Using a Charitable Remainder Trust,'' 1 *J. Tax. Exempt Orgs.* 15 (Winter 1990).

Hakala, ''Turning Appreciation Into Income—Without Triggering Tax—Using a Charitable Remainder Trust,'' 1 *J. Tax. of Exempt Orgs.* (No. 4) 15 (Winter 1990).

Henry and Hays, ''Ten Charitable Planning Mistakes to Avoid,'' 37 *Exempt Org. Tax Rev.* (No. 3) 453 (Sep. 2002).

Herzfeld, ''Restricting the Flow of Funds from U.S. Charities to International Terrorist Organizations—A Proposal,'' 56 *Tax Law.* (No. 4) 875 (Summer 2003).

Hicks, ''Charitable Remainder Trust May Be More Advantageous Than a Qualified Plan,'' 17 *Est. Plan.* 158 (May/June 1990).

Hoyt, ''Charitable Gifts from Donor's Retirement Plan Accounts,'' 133 *Trusts & Estates* (No. 8) 20 (1994).

Hoyt, ''Transfers from Retirement Plans to Charities and Chritable Remainder Trusts: Laws, Issues, and Opportunities,'' 13 *Va. Tax Rev.* 641 (1994).

Huffaker, ''Charitable Lead and Remainder Trust Rules Explained,'' 70 *J. Tax.* 83 (Feb. 1989).

Ibach and Lehrfeld, ''Dysfunctions in Deferred Giving: Working Out Problems of Unqualified Charitable Remainder Trusts,'' 113 *Trusts & Estates* 372 (1974).

Katzenstein, ''Charitable Remainder Trusts and Pooled Income Funds,'' Charitable Giving Techniques, Amer. Bar Assoc. Sections of Taxation and Real Property, Probate, and Trust Law (Westlaw: C530 ALI-ABA 1, 1990).

Katzenstein, ''Charitable Remainder Trusts and Pooled Income Funds,'' Charitable Giving Techniques, Amer. Bar Assoc., Sections of Taxation and Real Property, Probate, and Trust Law (Westlaw: C626 ALI-ABA 1, 1991).

Kennedy, ''Ascertainable Standards, Discretionary Powers, and Charitable Remainders,'' 56 *Taxes* 78 (Feb. 1978).

Kirkwood, ''Income Tax Planning for Property Transfers to Charitable Trusts and Foundations,'' 66 *Fla. B. J.* 34 (Mar. 1992).

Laurice, ''How to Achieve Reformation of Defective Split-Interest Charitable Trusts,'' 14 *Est. Plan*. 80 (Mar./April 1987).

Levin and Soled, ''Near-Zero CRUT Expands Estate Planning Possibilities of Charitable Remainder Trusts,'' 83 *J. Tax.*, (No. 1) 24 (July 1995).

Lewis, ''Testamentary Charitable Remainder Trusts Under the Tax Reform Act of 1969,'' 48 *Taxes* 464 (1970).

Lichter, ''Highlights of Modern Charitable Remainder Trusts,'' 119 *Trusts & Estates* 46 (1980).

Lochray and Hunt, ''Using Real Estate Options in Charitable Remainder Trusts,'' 131 *Trusts & Estates* (No. 12) 49 (Dec. 1992).

McCoy, ''Tax Planning: Beyond The Charitable Remainder Unitrust,'' 13 *Trusts & Estates* (No. 8) 24 (Aug. 1993).

McCue, ''Attack on Charitable Remainder Trusts Creates Uncertainties'' 133 *Trusts & Estates* (No. 12) 25 (Dec. 1994).

McDonald, ''Charitable Remainder Trusts: Realities and Proper Planning,'' 131 *Trusts & Estates* (No. 7) 45 (July 1992).

McDonald, ''Charitable Remainder Trusts: Realities and Proper Planning,'' 131 *Trusts & Estates* 45 (July 1992).

McKinnon, ''Planning to Meet a Range of Donor Needs with 'Flip' Charitable Remainder Unitrusts,'' 12 *J. Tax. Exempt Orgs.* (No. 6) 253 (May/June 2001).

Mering, ''Combination of Charitable Remainder and Insurance Trusts Can Increase Wealth,'' 17 *Est. Plan. 356 (Nov./Dec. 1990).*

Moerschbaecher, ''Avoiding Prearranged Sales in Planned Giving Through Charitable Remainder Trusts,'' 6 *J. Tax. of Exempt Orgs.* (No. 3) 107 (Nov./Dec. 1994).

Moore, ''Charitable Remainder Unitrusts and Annuity Trusts,'' Practicing Law Inst. (Westlaw: 180 PLI/Est. 431, 1988).

Moore, ''Income Taxation of Charitable Trusts,'' 37 *N.Y.U. Inst. Fed. Tax*. 41.1 (1979).

Moore, ''Split-Interest Charitable Trusts,'' 7 *Inst. Estate Plan*. 73 (1973).

Moyers, Spiegel, and Baum, ''Charitable Remainder Trusts Offer Non-charitable Benefits,'' 58 *Tax. for Accountants* 285 (May 1997).

Myerberg, ''Retirement Fund Assets Can Be Protected Through the Use of Charitable Remainder Trusts,'' 82 *J. Tax.* (No. 1) 38 (Jan. 1995).

Newman and Cafferata, ''Charitable Gifts of Retirement Plan Assets,'' 9 *Exempt Orgs. Tax Rev.* (No. 6) 1301 (June 1994).

Newman, ''Charitable Remainder Trusts Funded With S Corporation Assets,'' 4 *Exempt Org. Tax Rev.* (No. 10) 1320 (1991).

Olsen and Ledwith, ''Charitable Remainder Trusts: How to Comply with the Fiinal Regulations,'' 38 *J. Tax*. 2 (1973).

Olsen and Ledwith, ''Final Regulations Liberalize Income Option Unitrust Treatment,'' 38 *J. Tax*. 142 (1973).

Olsen and Ledwith, ''Final Regulations Point the Way to Effectively Use Charitable Remainder Trusts,'' 37 *J. Tax*. 368 (1972).

Painter and Coplan, ''Annuities and Unitrusts Require Special Attention by Planners,'' 131 *Trusts & Estates* (No. 12) 30 (Dec. 1992).

Peckham and Milstein, ''Charitable Remainder Trusts: Tax Planning and Drafting Considerations,'' 14 *New England L. Rev*. 442 (1979).

Petroff, ''How to Choose the Right Charitable Remainder Trust,'' 114 *Trusts & Estates* 871 (1975).

Pratt, ''Deducting Estate Administration Expenses: Does A Section 642(g) Election Still Make Sense?,'' 11 *Exempt Org. Tax Rev*. (No. 3) 549 (Mar. 1995).

Prince, ''Charitable Estate Planning: the New Magic Bullet,'' 133 *Trusts & Estates* (No. 8) 34 (Aug. 1994).

Prince, ''Charitable Trusts: The Magic Bullet,'' 131 *Trusts & Estates* (No. 2) 45 (Jan. 1992).

Pusey, ''Investment Options of Charitable Remainder Trustees Are Hard to Limit,'' 7 *J. Tax. of Exempt Orgs.* (No. 4) 168 (Jan./Feb. 1996).

Pusey, ''IRS Says Multiple Grantors Make the Charitable Remainder Trust Look Like General Motors,'' 14 *Exempt Org. Tax Rev.* (No. 2) 271 (Aug. 1996).

Pusey, ''Reducing Administration Costs for charitable Remainder Trusts by Maximizing the Use of a Single Trust,'' 13 *Exempt Org. Tax Rev.* (No. 1) 47 (Jan. 1996).

Radowski, ''How Lowering Estate Taxes Will Affect Charitable Giving,'' 19 *Exempt Orgs. Tax Rev.* (No. 1) 31 (Jan. 1998).

Rambler, ''New Developments for International Charitable Giving: The War Against Terrorist Financing,'' 39 *Exempt Org. Tax Rev.* (No. 1) 33 (Jan. 2003).

Recer, ''Using the Charitable Remainder Trust in Real Estate,'' XII *NSFRE J.* (No. 2) 34 (1987).

Sacher, ''Proposed Regs on Charitable Remainder Trusts Point Up Value of Unitrusts,'' *35 J. Tax*. 380 (1971).

Sanders, ''Accumulation Trusts and Charitable Remainder Trusts: A Panel,'' 23 *So. Cal. Tax Inst.* 501 (1971).

Sanders, ''Charitable Remainder Trusts Under the Tax Reform Act of 1969,'' 12 *B.C. Ind. & Com. L. Rev.* 409 (1971).

Sanders, ''Charitable Remainder Trusts Under the Tax Reform Act,'' 6 *Real Prop. Prob. & Trust J.* 384 (1971).

Sanders, ''How to Draft Charitable Remainder Trusts in View of New Proposed Regs,'' 33 *J. Tax.* 258 (1970).

Segal, ''Salvaging Charitable Remainder Trusts,'' 7 *Prob. & Prop.* 4 (Jan./Feb. 1993).

Seymour, ''Charitable Remainder Trusts,'' 37 *Tex. B. J.* 827 (1974).

Seymour, ''Charitable Remainder Trusts,'' 45 *N.Y.S. B. J.* 301 (1973).

Seymour, ''Charitable Remainder Trusts: Reforming and Drafting Split-Interest Trusts Under the New Law,'' 52 *Chi-Kent L. Rev.* 83 (1975).

Seymour, ''Model Charitable Remainder Unitrust,'' 10 *Real Prop. & Trusts* 535 (1975).

Simon, ''Charitable Remainder Trusts,'' 15 *Col. Law.* 1985 (Nov. 1986).

Sneed, ''Charitable Remainder Trusts,'' 25 *So. Cal. Tax Inst.* 87 (1973).

Swados, ''Charitable Remainder Trusts: Drafting and Valuation Guidelines,'' 29 *N.Y.U. Inst. Fed. Tax.* 2023 (1971).

Teitell, "Charitable Remainder Trusts, Pooled Income Funds and the 1976 Tax Reform Act," 46 *U.M.B.C. L. Rev.* 357 (1973).

Teitell, "Charitable Remainder Trusts: Final Regulations," 138 *Trusts & Estates* (No. 8) 44 (July 1999), (No. 9) 36 (Aug. 1999).

Teitell, "Charitable Remainder Unitrusts Under the Tax Reform Act," 111 *Trusts & Estates* 858 (1972).

Teitell, "How to Work With Charitable Remainder Annuity Trusts," 114 *Trusts & Estates* 863 (1975).

Teitell, "Technical Remainder Trust Ruling Reduces Deduction," 119 *Trusts & Estates* 61 (1980).

Thiewes, "Charitable Remainder Trusts," 35 *Mo. B. J.* 107 (1979).

Thomas, "Avoiding the Private Foundation Self-Dealing Penalties in Trust and Estate Administration," 6 *J. Tax. of Exempt Orgs.* (No. 6) 251 (May/June 1995).

Tidd, "Charitable Remainder Trusts: Funding and Investment Considerations," 57 *Taxes* 577 (1979).

Weithorn, "Primer for Charitable Giving: Outright and in Trust," Planning Techniques for Large Estates (Westlaw: C743 ALI-ABA 1021, 1992).

Whaley, "Charitable Remainder Trusts and Pooled Income Funds: Internal Revenue Service Ruling Policy," 3 *J. Coll. & U. L.* 15 (1975).

Whitney, "Unique Funding for Charitable Remainder Trusts," *J. Amer. Soc. CLU & ChFC* 36 (1990).

Wicher, "Charitable Trusts," 11 *Gonzaga L. Rev.* 1 (1975).

Willis "The Unitrust: An Income and Estate Planning Tool," 112 *Trusts & Estates* 821 (1973).

Wren, "Charitable Remainder Trusts: Some Considerations to Draftsmanship," 8 *U. Richmond L. Rev.* 25 (1973).

CHAPTER 13 POOLED INCOME FUNDS

Boggs, "Pooled Income Funds May Now Be the Best Method of Charitable Giving," 35 *J. Tax.* 162 (1971).

Dryburgh, "Community Foundations and Pooled Income Funds: The Right Answer At Last," 15 *Exempt Org. Tax Rev.* (No. 1) 83 (Oct. 1996).

Fowler, "Charitable Remainder Trusts and Pooled Income Funds: Using Computer Simulation to Rank the Benefits," 11 *Tax Advisor* 68 (1980).

Garibaldi, "Charitable Remainder Trusts, Pooled Income Funds and the 1976 Tax Reform Act." 46 *U.M.K.C. L. Rev.* 357 (1973).

Garibaldi, "Pooled Income Funds Under the Internal Revenue Code: Are They Subject to Securities and Exchange Commission Regulation?," 20 *Wayne L. Rev.* 1287 (1974).

Garibaldi, "Some Final Problems for the Charitable Taxpayer: Gift Annuities; Pooled Income Funds; Split Interest Trusts; Valuation of Charitable Gifts," 30 *N.Y.U. Inst. Fed. Tax.* 117 (1972).

Hoyt, "Transfers from Retirement Plans to Charities and Charitable Remainder Trusts: Laws, Issues and Opportunities," 13 *Va. Tax Rev.* 641 (1994).

Huffaker, "Pooled Income Fund Requirement Met Despite Multiple Remainder Beneficiaries," 78 *J. Tax.* 163 (Mar. 1993).

Huffaker, "Pooled Income Funds and Depreciation Reserves," 74 *J. Tax.* 238 (April 1991).

Katzenstein, ''Charitable Remainder Trusts and Pooled Income Funds,'' Charitable Giving Techniques, Amer. Bar Assoc. Sections of Taxation and Real Property, Probate, and Trust Law (Westlaw: C626 ALI-ABA 1, 1991).

Lochray, ''Complying with the New Depreciable Property Requirements for Pooled Income Funds,'' 3 *J. Tax. of Estates & Trusts* (No. 4) 37 (Summer 1991).

Lochray, ''Pooled Income Funds and the Depreciable Property Requirements,'' 3 *J. Tax. Orgs.* 31 (Fall 1991).

Lochray, ''Pooled Income Funds and the Depreciable Property Requirements,'' 3 *J. Tax. of Exempt Orgs.* (No. 2) 3 (Fall 1991).

Steward, ''Pooled Income Funds: The New Spearhead of Deferred Giving,'' 114 *Trusts & Estates* 306 (1975).

Teitell, ''Pooled Income Funds Under the Tax Reform Act,'' 110 *Trusts & Estates* 625 (1971).

Veres, ''Using Pooled Income Funds to Pass ITC and Depreciation Through to Life-Income Donors,'' 61 *J. Tax.* 28 (July 1984).

Whaley, ''Charitable Remainder Trusts and Pooled Income Funds: Internal Revenue Service Ruling Policy,'' 3 *J. Coll. & Univ. L.* 15 (Fall 1975).

CHAPTER 14 CHARITABLE GIFT ANNUITIES

Baglia, ''Dramatic Changes in New Planned Giving Tables: New IRS Tables for Charitable Gift Annuities,'' XVII *Phil. Mon.* (No. 11) 5 (1984).

Berry, ''Charitable Gift Annuities Face Varied State Insurance Regulations,'' 134 *Trusts & Estates* (No. 8) 28 (Aug. 1995).

Berry, ''Federal Tax and State Regulation of Charitable Gift Annuities,'' 3 *J. Tax. Exempt Orgs.* 15 (Summer 1991).

Canter III, ''Charitable Gift Annuity: An Attractive Alternative,'' 16 *Fund Raising Man.* (No. 10) 104 (1986).

Eyre, ''Annuity Agreement: 'Simplicity Itself','' 1977 *B.T.R.* 379 (1977).

Friedman, ''Charitable Gift Annuities Can Be the Best Way to Help Both Charities and Donors,'' 7 *J. Tax. Exempt Orgs.* (No. 6) 261 (May/June 1996).

Friedman, ''Donor Annuity Programs Require Careful Planning by Issuing Charity,'' 8 *J. Tax. Exempt Orgs.* (No. 1) 24 (July/Aug. 1996).

Garibaldi, ''Some Final Problems for the Charitable Taxpayer: Gift Annuities; Pooled Income Funds; Split Interest Trusts; Valuation of Charitable Gifts, 30 *N.Y.U. Inst. Fed. Tax.* 117 (1972).

Havens, ''Taxation of Charitable Gift Annuities: Valuation and Policy Considerations,'' 67 *Va. L. Rev.* 1523 (Nov. 1981).

Johnson, ''Discounting and Compounding: Calculation of the Present Value of an Annuity and the Income Inclusion Amount: Charitable Gift Annuities,'' 12 *S. Ill. U. Law J.* 153 (Fall 1987).

McCue, III, and Luther, ''Gift Annuities: Texas Class Action Suit Threatens Charities,'' 134 *Trusts & Estates* (No. 6) 46 (June 1995).

McCue, III, and Luther, ''Gift Annuities: The Plot Thickens,'' 134 *Trusts & Estates* (No. 12) 56 (Dec. 1995).

Mudry, ''Higher Rates for Charitable Annuities: How Charitable Annuities Work,'' XVI *Phil. Mon.* (No. 8) (1983).

Teitell, ''Federal Tax Implications of Charitable Gift Annuities,'' 113 *Trusts & Estates* 642 (1974).

Teitell, ''Federal Tax Implications of Charitable Gift annuities,'' 19 *N.Y. L. F.* 269 (1973).

Teitell, ''Federal Tax Implications of Charitable Gift Annuities,'' 3 *J. Coll. & Univ. L.* 26 (Fall 1975).

CHAPTER 16 CHARITABLE LEAD TRUSTS

Ashby, ''Uses of Charitable Income Interests in Estate Planning,'' 115 *Trusts & Estates* 12 (1976).

Blattmachr, ''A Primer On Charitable Lead Trusts: Basic Rules and Uses,'' 134 *Trusts & Estates* (No. 4) 48 (April 1995).

Callahan, ''Charitable 'Lead' Trusts: the Forgotten Member of the Trilogy,'' 11 *Inst. Estate & Plan.* 5.1 (1997).

Chiles, ''Nonqualified Charitable Lead and Remainder Trusts: Planning Considerations,'' 66 *Taxes* 777 (1988).

Colbun, ''Securing Tax Benefits From Charitable Remainder and Charitable Lead Trusts,'' 16 *Est. Plan.* 154 (May/June 1989).

Frimmer, ''Charitable Remainder Trusts and Charitable Lead Trusts,'' Planning Techniques for Large Estates (Westlaw: C413 ALI-ABA 469, 1989).

Frimmer, ''Charitable Remainder Trusts and Charitable Lead Trusts,'' Planning Techniques for Large Estates (Westlaw: C743 ALI-ABA 1021, 1992).

Gopman and Mielnicki, ''New Perspectives in Planning with Testamentary Charitable Lead Annuity Trusts,'' 138 *Trusts & Estates* (No. 7) 46 (June 1999), (No. 8) 34 (July 1999).

Grumet and Schnoll-Regun, '''Vulture' Trust Regulations: Hold the Valedictory?,'' 29 *Exempt Org. Tax Rev.* (No. 1) 51 (July 2000).

Huffaker, ''Charitable Lead and Remainder Trust Rules Explained,'' 70 *J. Tax.* 83 (Feb. 1989).

Kalter and Newman, ''The Value of The Family Foundation Charitable Lead Trust,'' 133 *Trusts & Estates* (No. 12) 37 (Dec. 1994).

Kasner, ''Have Your Cake and Eat It, Too? A Look at the Grantor Charitable Lead Trust,'' 6 *Exempt Org. Tax Rev.* (No. 3) 681 (1992).

Lappert and Carter, Jr., ''Making Charitable Gifts of Interests in Closely Held Corporations,'' 7 *J. Tax. of Exempt Orgs.* (No. 4) 159 (Jan./Feb. 1996).

Miller and Schinner, ''Funding of Private Foundations Through Charitable Lead Trusts Given New Impetus by Tax Court,'' 76 *J. Tax.* (No. 4) 214 (April 1992).

Moore, ''Charitable Lead Trusts,'' Practicing Law Inst. (Westlaw: 180 PLI/Est. 413, 1988).

Muchin, Lubelchek, and Grass, ''Charitable Lead Trusts Can Provide Substantial Estate Planning Benefits,'' 49 *J. Tax.* 2 (1978).

O'Brien and Raabe, Jr., ''High Interest Rates Increase Attractiveness of Charitable Lead Annuity Trusts and Unitrusts,'' 9 *Est. Plan.* 130 (1982).

Schumacher, ''How to Design a Charitable Lead Trust,'' 9 *J. Tax. of Exempt Orgs.* (No. 1) 28 (July/Aug. 1997).

Schumacher, ''The Taxation of Charitable Lead Trusts,'' 9 *J. Tax. of Exempt Orgs.* (No. 2) 76 (Sep./Oct. 1997).

Weithorn, ''The Charitable Lead *Nonreversionary* Trust—An Estate Planner's Dream Come True,'' 36 *Exempt Org. Tax Rev.* (No. 1) 31 (April 2002)

Wood, ''Ninth Circuit Validates Private Foundation/Charitable Lead Trust Planning,'' 80 *J. Tax.* (No. 5) 290 (May 1994).

CHAPTER 17 GIFTS OF AND USING LIFE INSURANCE

Alpert, ''Gifts of Life Insurance in Florida,'' 45 *Fla. B. J.* 72 (Feb. 1971).

Chasman, ''Charitable Gifts of Life Insurance,'' 109 *Trusts & Estates* 891 (1970).

Clark, ''The IRS Says 'No' to Charitable Gift of Life Insurance,'' 22 *Cumb. L. Rev.* 299 (1991/1992).

Creedon, ''Lifetime Gifts of Life Insurance,'' 20 *Prac. Law.* 27 (1974).

Dryburgh, ''The Overselling of Charitable Reverse Split-Dollar Insurance,'' 10 *J. Tax. of Exempt Orgs.* (No. 1) 13 (July/Aug. 1998).

Freeman, ''Life Insurance and Charitable Giving,'' Charitable Giving Techniques, Amer. Bar Assoc. Sections of Taxation and Real Property, Probate, and Trust Law (Westlaw: C626 ALI-ABA 73, 1991).

Gordon, Morgan, and White, ''Gone, But Not Forgotten,'' 24 *Fund Raising Man.* (No. 4) 20 (June 1993).

Lane and Frantzreb, ''Life Insurance for Endowment: Great Concept Or Booby Trap?,'' 21 *Fund Raising Man.* (No. 2) 47 (1990).

Luecke and Bauer, ''Charitable Life Insurance: The Ideal Deferred Gift,'' 21 *Fund Raising Man.* (No. 2) 41 (1990).

Murdich, ''IRS Ruling Denies Deductibility of Charitable Gifts of Insurance,'' 3 *J. Tax. of Exempt Orgs.* (No. 2) 26 (Summer 1991).

Murdich, ''IRS Ruling Denies Deduction of Charitable Gifts of Life Insurance,'' 3 *J. Tax. Exempt Orgs.* 26 (Summer 1991).

Raby and Raby, ''What Gets Split With Split-Dollar Life Insurance?,'' 24 *Exempt Org. Tax Rev.* (No. 1) 37 (April 1999).

Schlenger, Madden, and Hayes, ''Charitable Deduction Disallowed for Gift of Life Insurance,'' 18 *Est. Plan.* 239 (July/Aug. 1991).

Schlenger, Madden, and Hayes, ''IRS Revokes Adverse Ruling on Contributions of Life Insurance,'' 19 *Est. Plan.* 177 (May/June 1992).

Sharpe, Sr., ''How to Encourage Gifts of Life Insurance to Nonprofit Institutions,'' *NSFRE Jour.* 16 (Jan. 1993).

CHAPTER 22 DISCLOSURE REQUIREMENTS

Faber, ''Final Regulations Issued on Quid Pro Quo Contributions and Substantiation Requirements,'' 8 *J. Tax. of Exempt Orgs.* (No. 5) 195 (Mar./April 1997).

Friedman, ''How to Meet the IRS Fundraising Guidelines When Seeking Charitable Contributions,'' 4 *J. Tax. of Exempt Orgs.* (No. 2) 26 (Summer 1992).

Gorrin and Honigfeld, ''New Substantiation and Disclosure Rules Increase Burden on Charities and Donors,'' 81 *J. Tax.* (No. 5) 310 (Nov. 1994).

McClure, ''IRS Releases New Guidance on Charitable Gifts and Reporting,'' 2 *J. Tax. of Exempt Orgs.* (No. 1) 5 (Spring 1990).

Tilevitz, ''A New Headache for Charities: Substantiation and Disclosure Rules Under the 1993 Tax Act,'' 9 *Exempt Org. Tax Rev.* (No. 4) 805 (April 1994).

Tilevitz, ''Charitable Substantiation and Disclosure Rules Part II: IRS Issues Proposed Regulations,'' 12 *Exempt Org. Tax Rev.* (No. 3) 593 (Sep. 1995).

CHAPTER 23 SPECIAL EVENTS, CORPORATE SPONSORSHIPS, AND DONOR-ADVISED FUNDS

Crawford, ''IRS Attacks Exempt Organization Income From Corporate Sponsorship Fees,'' 76 *J. Tax.* (No. 4) 230 (April 1992).

Crawford, ''IRS Softens Its Position on Sponsorship as Advertising,'' 79 *J. Tax.* (No. 4) 214 (Oct. 1993).

Simpson, ''When Will Corporate Sponsorship Create UBIT Liability?,'' 4 *J. Tax. of Exempt Orgs.* (No. 3) 3 (Nov./Dec. 1992).

Varley, ''Proposed Regulations for Corporate Sponsorships Put Some New Wine in an Old Skin,'' 12 *J. Tax. Exempt Orgs.* (No. 1) 11 (July/Aug.2000)

Wirtschafter, ''Fourth Quarter Choke: How the IRS Blew the Corporate Sponsorship Game,'' 10 *Exempt Org. Tax Rev.* (No. 3) 501 (Sep. 1994).

Woods, ''Brought to You by the IRS: Prop. Regs. on Corporate Sponsorship,'' 29 *Exempt Org. Tax Rev.* (No. 3) 425 (2000).

Woods, ''Tax Treatment of Corporate Sponsorship Payments to Exempt Organizations: Final Regulations,'' 38 *Exempt Org. Tax Rev.* (No. 2) 205 (Nov. 2002).

Table of Cases

Abood v. *Detroit Board of Education*, § 1.3(c)
Addis v. *Commissioner*, §§ 17.6(a) 21.3(b)
Akers v. *Commissioner*, §§ 10.1(a)
Aldea v. *Commissioner*, § 21.8
Alioto v. *Commissioner*, § 6.13
Alisobhani v. *Commissioner*, § 18.2
Allen v. *Commissioner*, §§ 3.1(d), 10.14
Allis-Chalmers Mfg. Co. v. *United States*, §§ 3.1(b), 8.3(b)
Alman v. *Commissioner*, §§ 3.1(a), 3.1(m)
Alston v. *United States*, § 8.3(b)
American Bible Soc'y v. *Ritchie*, § 14.8
American Council on Gift Annuities v. *Ritchie*, § 14.8
American Guidance Foundation, Inc. v. *United States*, § 3.4(a)
American Party v. *White*, § 1.3(c)
Andrus v. *Burnet*, § 6.7
Angell v. *Commissioner*, §§ 9.1(a), 10.14
Anselmo v. *Commissioner*, §§ 9.1(a), 9.2, 10.1(a)
Arbini v. *Commissioner*, § 10.1(a)
Arbor Towers Assocs. v. *Commissioner*, § 10.1(a)
Arceneaux v. *Commissioner*, § 3.1(b)
Atkinson, Estate of v. *Commissioner*, §§ 8.7(c), 12.1(a), 12.2(b), 12.2(e), 12.3(a), 12.3(e)
Babilonia v. *Commissioner*, § 3.1(b)
Ballantine v. *Tomlinson*, § 8.3(b)
Bass v. *Commissioner*, § 3.1(a)
Beaver v. *Commissioner*, § 10.14
Behrend v. *United States*, § 4.8
Belcher, Estate of v. *Commissioner*, § 6.2
Bennett, Estate of v. *Commissioner*, § 8.7(a)
Bergquist v. *Commissioner*, §§ 6.5, 10.1(a), 10.14
Biagiotti v. *Commissioner*, § 9.1(a)
Bialo v. *Commissioner*, § 9.9
Biedenharn Realty Co. v. *United States*, § 2.16(a)
Bilingual Montessori Sch. of Paris, Inc. v. *Commissioner*, § 18.2
Bischel v. *United States*, § 3.1(e)
Bixby v. *Commissioner*, § 3.7
Blackford, Estate of v. *Commissioner*, § 15.2(a)
Blake v. *Commissioner*, §§ 3.1(b), 4.8
Bob Jones University v. *United States*, § 3.3(b)
Boeshore, Estate of v. *Commissioner*, § 8.3(b)
Bogardus v. *Commissioner*, § 3.1(b)
Bond v. *Commissioner*, § 12.1(c)
Bond v. *United States*, § 3.1(d)
Bonner v. *City of Pritchard*, § 8.3(b)
Boser v. *Commissioner*, § 9.15(e)
Bowman v. *Commissioner*, § 10.3
Boy Scouts of America et al. v. *Dale*, § 1.3(c)
Bradford, Estate of v. *Commissioner*, § 8.3(a)
Bradford v. *Commissioner*, § 10.14
Bragg v. *Commissioner*, § 10.1(a)
Braswell v. *Commissioner*, §§ 10.12, 10.14
Briggs v. *Commissioner*, § 10.4(b)
Brigham v. *Commissioner*, § 10.1(a)
Brinley v. *Commissioner*, § 3.1(a)
Broad v. *Commissioner*, § 10.1(a)
Brotman v. *Commissioner*, §§ 3.1(a), 3.1(b)
Brotzler v. *Commissioner*, § 6.13
Brown v. *Commissioner*, §§ 3.1(a), 21.8
Brown v. *Socialist Workers, '74 Campaign Committee*, § 1.3(c)

Browning v. *Commissioner*, §§ 9.19(a), 10.1(c)(9)
Buckley v. *Valeo*, § 1.3(c)
Buder v. *United States*, § 3.3(b)
Buffalo Tool & Die Mfg. Co. v. *Commissioner*, § 10.1(a)
Bullard, Estate of v. *Commissioner*, § 9.19(c)
Burdick, Estate of v. *Commissioner*, § 8.7(b)
Burke v. *United States*, §§ 3.1(a), 8.3(b)
Burner v. *Harmel*, § 3.1(d)
Burnet v. *Sanford & Brooks Co.*, § 2.17
Campbell v. *Prothro*, § 4.2
Camps Newfound/Owatonna, Inc. v. *Town of Harrison, Maine et al.*, § 1.2
Carey v. *Population Serv. Int'l*, § 1.3(c)
Carrie A. Maxwell Trust, Pasadena Methodist Foundation, Inc. v. *Commissioner*, § 3.3(b)
Carrington v. *Commissioner*, § 4.8
Carter v. *United States*, §§ 3.1(a), 11.4
Casey v. *Commissioner*, § 10.1(a)
Cassidy, Estate of v. *Commissioner*, § 15.2(a)
Cavalaris v. *Commissioner*, §§ 9.15(b), 9.15(c), 9.15(d), 9.15(e), 9.16(a), 9.16 (b), 9.16(c), 21.8
Channing v. *United States*, §§ 3.1(a), 3.1(b)
Chapman v. *Commissioner*, § 3.4(a)
Charleston Chair Co. v. *United States*, § 3.3(b)
Chase v. *Commissioner*, § 6.14
Chiu v. *Commissioner*, § 9.2
Chou v. *Commissioner*, § 10.1(a)
Christensen v. *Commissioner*, § 6.0
Christiansen, Estate of v. *Commissioner*, §§ 8.3(b), 9.31
Chronicle Publ'g Co. v. *Commissioner*, § 7.18(a)
Citizens & S. Nat'l Bank v. *United States*, § 3.1(a)
Cleveland Board of Education v. *LaFleur*, § 1.3(c)
Clopton, Estate of v. *Commissioner*, § 8.7(a)
Cogan v. *Commissioner*, § 3.1(b)
Cohan v. *Commissioner*, § 21.8
Coit v. *Green*, § 1.3(a)
Commissioner v. *Bosch, Estate of*, § 8.7(b)
Commissioner v. *Bradley*, § 6.4
Commissioner v. *Duberstein*, §§ 3.1(a), 3.1(m)
Commissioner v. *Glenshaw Glass Co.*, §§ 2.2, 2.14, 2.14(d)
Commissioner v. *Hubert, Estate of*, § 8.3(b)
Commissioner v. *LoBue*, § 3.1(a)
Commissioner v. *North Am. Bond Trust*, § 12.1(b)
Commissioner v. *Peterman*, § 9.20
Commissioner v. *Proctor*, § 9.31
Commissioner v. *Robertson, Estate of*, § 8.8
Commissioner v. *Sternberger, Estate of*, § 11.4
Commissioner v. *Tufts*, § 9.20
Considine v. *Commissioner*, § 3.1(b)
Continental Ill. Nat'l Bank & Trust Co. v. *United States*, § 8.7(a)
Continental Ill. Nat'l Bank & Trust Co. of Chicago v. *United States*, § 19.2(c)
Cook v. *Commissioner*, § 3.1(a)
Cooley v. *Commissioner*, § 10.1(c)(8)
Corn Prod. Ref. Co. v. *Commissioner*, § 2.16(a)
Cousins v. *Wigoda*, § 1.3(c)
Crane v. *Commissioner*, § 9.20
Crestar Bank v. *IRS*, § 8.3(b)
Crosby Valve & Gage Co. v. *Commissioner*, §§ 3.1(a), 3.1(i)
Daniel v. *Commissioner*, § 21.8
Danz v. *Commissioner*, § 10.3
D'Arcangelo v. *Commissioner*, § 12.1(c)
Dave Inv. Co. v. *Commissioner*, § 3.1(i)
Davidson v. *Commissioner*, § 3.3(b)
Davis v. *Commissioner*, § 3.1(a)
Davis v. *United States*, §§ 3.1(a), 10.3, 10.5
Dayton v. *Commissioner*, § 10.4(a)
DeJong v. *Commissioner*, §§ 3.1(a), 3.1(b), 3.1(m)
Delbridge v. *United States*, § 8.8
Democratic Party v. *Wisconsin*, § 1.3(c)

Denbigh, Estate of v. *Commissioner*, § 11.4
Dennis v. *United States*, § 10.1(a)
Derby v. *Commissioner*, §§ 10.14, 22.2
Dodge, Jr. v. *Commissioner, § 6.13*
Doherty v. *Commissioner*, § 10.1(a)
Dolese v. *Commissioner*, § 10.10
Dorris v. *Commissioner*, § 21.8
Douglas v. *Commissioner*, §§ 3.1(a), 6.13
Dowell v. *United States*, § 3.1(m)
Droz v. *Commissioner*, § 10.1(a)
Dubin v. *Commissioner*, § 9.2
Duffy v. *Birmingham*, § 1.3(a)
Duval v. *Commissioner*, § 4.4(b)
Dyer v. *Commissioner*, § 6.13
Ebben v. *Commissioner*, §§ 9.19(b), 9.20
Edwards v. *Commissioner*, § 3.1(b)
Edwards v. *Phillips*, §§ 19.2(b), 19.2(c)
Ehrhart v. *Commissioner*, § 3.1(b)
885 Inv. Co. v. *Commissioner*, § 10.4(b)
Ellis First Nat'l Bank v. *United States*, § 15.2(a)
Engel v. *Commissioner*, §§ 10.1(a), 10.14
Erhart v. *Commissioner*, § 3.1(b)
ErSelcuk v. *Commissioner*, § 18.2
ESB Financial v. *United States,* § 8.7(c)
Fair v. *Commissioner*, §§ 9.19(a), 9.19(d), 10.1(a), 12.1(c)
Fausner v. *Commissioner*, § 3.1(a)
Feistman v. *Commissioner*, § 3.1(b)
Ferguson v. *Commissioner*, §§ 3.1(h), 6.5
Ferman v. *Commissioner*, § 10.1(a)
Ferrell v. *Commissioner*, § 9.1(a)
Fifth Third Bank v. *Firstar Bank*, § 12.1(b)
First Nat'l Bank v. *Commissioner*, § 10.9
First Trust Co. of St. Paul State Bank v. *Reynolds*, § 8.8
Flanagan v. *United States*, § 8.7(b)
Fox v. *Commissioner*, § 4.8
Frates v. *Commissioner*, § 9.1(a)
Frazee v. *United States*, § 10.1(a)
Freeland v. *Commissioner*, § 9.20
Friedman v. *Commissioner*, § 4.8
Froh v. *Commissioner*, § 11.4
Fund for Anonymous Gifts, The v. *United States*, § 3.1(g)
Gainer v. *Commissioner*, § 10.14
Gajewski v. *Commissioner*, § 10.14
Galloway v. *United States*, § 8.3(b)
Glass v. *Commissioner*, § 9.7(d)
Global Relief Found., Inc. v. *O'Neill*, § 10.11
Glynn v. *Commissioner*, § 6.0
Goldman v. *Commissioner*, § 10.1(a)
Goldman, Estate of v. *Commissioner*, § 10.14
Goldstein v. *Commissioner*, § 10.1(a)
Goodwin v. *United States*, § 3.1(a)
Gookin v. *United States*, § 3.1(a)
Granan v. *Commissioner*, § 6.3
Grant v. *Commissioner*, §§ 9.14, 10.14
Graves v. *Commissioner*, § 3.1(b)
Great N. Nekoosa Corp. v. *United States*, § 9.7(a)
Green v. *Connally*, § 1.3(a)
Greene v. *United States*, §§ 3.1(h), 4.3, 4.8, 9.11, 9.23, 15.3
Greer v. *Commissioner*, § 6.5
Greer v. *United States*, § 8.8
Gregory, Estate of v. *Commissioner*, § 12.4(a)
Griffin v. *Commissioner*, § 6.2
Griffiths v. *Helvering*, § 18.3
Griswold v. *Connecticut*, § 1.3(c)
Grosshandler v. *Commissioner*, § 10.14
Grove v. *Commissioner*, § 4.8
Grynberg v. *Commissioner*, § 7.7
Guardian Indus. v. *Commissioner*, § 2.16(a)
Guest v. *Commissioner*, §§ 6.13, 9.20, 21.8
Guren v. *Commissioner*, § 6.7
Haak v. *United States*, § 3.1(b)
Hall, Estate of v. *Commissioner*, § 8.7(c)
Hamilton v. *Commissioner*, § 3.1(b)
Hamm v. *Commissioner*, § 9.31
Harbison v. *United States*, §§ 8.7(c), 8.8
Harding v. *Commissioner*, § 10.1(a)
Harken v. *Commissioner*, § 9.1(a)
Harrison v. *Schaffner*, § 3.1(h)
Haught v. *Commissioner*, § 10.1(a)
Hay v. *Commissioner*, § 9.19(a)
Hearst Corp. v. *United States*, § 10.1(a)
Helvering v. *Bliss*, § 3.3(b)
Helvering v. *Horst*, § 3.1(h)
Helvering v. *Nat'l Grocery Co.*, § 10.1(a)

Henslee v. *Union Planters Nat'l Bank & Trust Co.*, § 8.8
Herman v. *Commissioner*, § 9.7(d)
Herman v. *United States*, § 10.1(a)
Hernandez v. *Commissioner*, §§ 3.1(a), 3.1(b)
Herter v. *Commissioner*, § 18.2
Hewitt v. *Commissioner*, § 12.1(c)
Hilborn v. *Commissioner*, §§ 9.7(e), 10.1(a)
Hillsboro Nat'l Bank v. *Commissioner*, § 12.4(i)
Hodgdon v. *Commissioner*, § 9.19(d)
Holy Land Foundation for Relief and Dev. v. *Ashcroft*, § 10.11
Hopkins v. *Hopkins*, § 17.4
Howard v. *Commissioner*, § 3.1(a)
Hubert, Estate of v. *Commissioner*, §§ 8.3(b), 8.7(b)
Hudspeth v. *United States*, § 3.1(h)
Hughes v. *Commissioner*, §§ 9.7(d), 10.1(c)(9)
Humacid Co. v. *Commissioner*, § 4.8
Hunter v. *Commissioner*, § 4.4(a)
Hutchinson Baseball Enter., Inc. v. *Commissioner*, § 3.3(b)
Ilfeld v. *Hernandez*, § 10.6
International Reform Federation v. *District Unemployment Board*, § 3.3(b)
Investment Company v. *Commissioner*, § 10.3(b)
Irwin v. *Commissioner*, §§ 3.1(b), 3.6
Ithaca Trust v. *United States*, § 11.3
Ithaca Trust Co. v. *United States*, §§ 8.3(b), 8.8
Jacobs v. *United States*, § 3.1(h)
Jacobson v. *Commissioner*, § 10.1(a)
Jackson, Estate of v. *United States*, § 8.7(c)
Jefferson Mills v. *United States*, § 3.1(b)
Jennings v. *Commissioner*, § 21.8
Jennings, Estate of v. *Commissioner*, § 11.4
Jersig v. *Commissioner*, § 9.16(c)
Johnson, Estate of v. *United States*, §§ 8.3(b), 8.7(c)
Johnson v. *Commissioner*, §§ 9.1(a), 10.1(a)
Johnson v. *United States*, § 6.13
Jones v. *Commissioner*, §§ 3.1(e), 9.12
Jones v. *United States*, § 3.1(h)
Jordan v. *United States*, § 6.1
Judicial Watch, Inc. v. *Rossotti*, § 2.0
Kaltreider v. *Commissioner*, § 2.16(a)
Kamilche Co. v. *United States*, § 3.1(d)
Kaplan v. *Commissioner*, §§ 6.13, 10.1(a), 10.2
Kaplun v. *United States*, § 19.2(c)
Kellahan v. *Commissioner*, § 10.14
Kentucky Bar Foundation, Inc. v. *Commissioner*, § 3.3(b)
Kingsrow Enter., Inc. v. *Metromedia, Inc.*, § 6.6
Kinsey v. *Commissioner*, § 3.1(h)
Kiva Dunes Conservation, LLC v. *Commissioner*, §§ 9.7(d), 10.1(a), 10.1(c)(9)
Klavan v. *Commissioner*, §§ 3.1(d), 10.1(a), 10.14
Knott v. *Commissioner*, § 9.19(a)
Koftinow v. *Commissioner*, § 9.1(a)
Krapf, Jr. v. *United States*, § 10.1(a)
LaGarde v. *Commissioner*, §§ 6.0, 9.16(c)
La Meres, Estate of v. *Commissioner*, § 3.1(a)
Lamphere v. *Commissioner*, § 21.8
Larson v. *Valente*, § 1.3(c)
Leila G. Newhall Trust v. *Commissioner*, § 12.8
Leonard Pipeline Contractors v. *Commissioner*, § 10.1(a)
Levine v. *Commissioner*, § 9.14
Lindberg v. *United States*, § 10.1(a)
Lindsley v. *Commissioner*, § 4.4(a)
Lio v. *Commissioner*, §§ 9.1(a), 10.1(a)
Lippmann v. *Commissioner*, § 6.7
Lockett, Estate of v. *Commissioner*, § 8.8
Logan v. *Commissioner*, § 9.18
Lombardo v. *Commissioner*, § 3.1(b)
Londen v. *Commissioner*, § 6.5
Losch v. *Commissioner*, § 10.1(a)
Lucky Stores v. *Commissioner*, §§ 9.3(a), 9.3(c)
MacMichael v. *Commissioner*, § 9.16(c)
Magnin, Estate of v. *Commissioner*, § 10.1(a)
Magnolia Dev. Corp. v. *Commissioner*, § 4.8
Mann v. *Commissioner*, § 6.0

Manning v. *Commissioner*, § 10.1(a)
Marine, Estate of v. *Commissioner*, § 8.8
Marquis v. *Commissioner*, § 3.1(a)
Martin v. *Machiz*, § 4.8
Mast v. *Commissioner*, § 10.1(a)
May v. *Commissioner*, § 2.5(a)
McAllister, Estate of v. *Commissioner*, § 19.4(a)
McCall v. *United States*, § 6.5
McCarthy v. *United States*, § 6.2
McCord v. *Commissioner*, §§ 9.26, 9.31, 10.1(a)
McGlotten v. *Connally*, § 1.3(a)
McLaughlin v. *Commissioner*, § 3.1(a)
McLendon, Estate of v. *Commissioner*, § 11.4
McLennan v. *United States*, §§ 3.1(a), 9.7(h)
McMillan v. *Commissioner*, § 3.1(b)
Mellon v. *Commissioner*, § 6.0
Merchants Bank v. *Commissioner*, § 8.8
Metzger, Estate of v. *Commissioner*, § 6.2
Meyer v. *Nebraska*, § 1.3(c)
Miami Beach First National Bank v. *United States*, § 11.4
Miller v. *IRS*, § 3.1(a)
Minnesota Tea Co. v. *Helvering*, § 18.3
Mitchell, Estate of v. *Commissioner*, § 10.1(a)
Mobley v. *Commissioner*, § 10.14
Moffet v. *Commissioner*, § 11.4
Moore v. *East Cleveland*, § 1.3(c)
Morgan Guaranty Trust Co. v. *United States*, § 3.1(h)
Morrison v. *Commissioner*, § 6.5
Mose & Garrison Siskin Mem'l Found., Inc. v. *United States*, § 17.5
Mount Mercy Associates v. *Commissioner*, § 3.1(b)
Murphy v. *Commissioner*, §§ 3.1(b), 6.0, 10.14
Musgrave v. *Commissioner*, § 3.1(k)
NAACP v. *Alabama*, § 1.3(c)
NAACP v. *Button*, § 1.3(c)
NAACP v. *Claiborne Hardware Co.*, § 1.3(c)
National Found., Inc. v. *United States*, § 3.1(f)
National Savings & Trust Co. v. *United States*, § 19.2(c)
Neely v. *Commissioner*, § 9.1(a)
Nehring v. *Commissioner*, § 6.1
Newhouse, Estate of v. *Commissioner*, § 10.1(a)
Nicoladis v. *Commissioner*, § 10.1(a)
O'Conner, Estate of v. *Commissioner*, § 16.4
Odd v. *Commissioner*, § 3.1(b)
Oetting v. *United States*, § 8.7(c)
Old Colony Trust Co. v. *United States*, §§ 19.2(a), 19.2(c)
Olmstead v. *United States*, § 1.3(c)
Olson v. *United States*, § 10.1(a)
O'Neil v. *United States*, § 6.7
Oppewal v. *Commissioner*, §§ 3.1(a), 3.1(b)
O'Reilly v. *Commissioner*, §§ 10.1(a), 11.4
Orphanos, Estate of v. *Commissioner*, § 19.2(c)
Orth v. *Commissioner*, §§ 9.1(a), 10.1(a)
Osborne v. *Commissioner*, §§ 9.7(h), 10.1(a)
Ottawa Silica v. *United States*, § 3.1(b)
Ould v. *Washington Hospital for Foundlings*, § 3.3(b)
Oxford Orphanage, Inc. v. *United States*, § 8.7(c)
Ozee v. *American Council on Gift Annuities*, § 14.8
Page v. *Commissioner*, § 3.1(b)
Palmer, Estate of v. *Commissioner*, § 10.1(a)
Palmer v. *Commissioner*, § 4.8
Parker v. *Commissioner*, §§ 3.1(d), 10.1 (a), 10.14
Parks v. *Commissioner*, § 10.1(a)
Parshall Christian Order v. *Commissioner*, § 3.4(a)
Pasqualini v. *Commissioner*, §§ 2.16(a), 4.4(a), 10.1(a)
Patton v. *Commissioner*, § 10.14
Peace v. *Commissioner*, § 10.5
Peerless Indus., Inc. v. *United States*, § 4.9
Pennsylvania Co. for Insurance on Lives v. *Helvering*, § 3.3(b)
Perlmutter v. *Commissioner*, § 3.1(a)

Pescosolido v. *Commissioner*, § 9.9
Peterson Irrevocable Trust #2 v. *Commissioner*, § 3.1(h)
Petty v. *Commissioner*, § 6.7
Phinney v. *Dougherty*, § 3.3(b)
Pierce v. *Society of Sisters*, § 1.3(c)
Pleasant Summit Land Corp. v. *Commissioner*, § 2.16(a)
Poldrugovaz v. *Commissioner*, § 3.1(b)
Pollock v. *Farmers' Loan & Trust Co.*, § 1.3(a)
Portland Golf Club v. *Commissioner*, § 1.3(a)
Primus, in re, § 1.3(c)
Quilloin v. *Walcott*, § 1.3(c)
Rauenhorst v. *Commissioner*, § 3.1(h)
Rebecca K. Crown Income Charitable Fund v. *Commissioner*, § 16.4
Recklitis v. *Commissioner*, § 10.14
Reddert, Estate of v. *United States*, § 8.7(c)
Rent Control Coalition for Fair Housing v. *Berkeley*, § 1.3(c)
Rhoades v. *Commissioner*, § 9.2
Richardson v. *Commissioner*, §§ 3.3(b), 6.5
Richie v. *American Council on Gift Annuities*, § 5.9
Richmond v. *United States*, § 9.7(e)
Riggs v. *Del Drago*, § 8.3(a)
Riley v. *National Federation of the Blind of North Carolina, Inc.*, § 25.8
Rimmer v. *Commissioner*, § 10.1(a)
Rio Properties, Inc. v. *Rio Int'l Interlink*, § 21.3(a)
Ritchie v. *American Council on Gift Annuities*, §§ 5.9, 14.8
Roark v. *Commissioner*, §§ 17.6(a), 21.3(b)
Roberts v. *United States Jaycees*, § 1.3(c)
Robertson v. *United States*, § 3.1(a)
Robinette v. *Helvering*, § 11.4
Robson v. *Commissioner*, § 10.1(a)
Rockefeller v. *Commissioner*, § 10.3
Roman v. *Commissioner*, § 21.8
Rome I Ltd. v. *Commissioner, § 9.7(g)*
Roney, Estate of v. *Commissioner*, § 8.3(b)
Rosen v. *Commissioner*, § 12.4(i)
Roughen v. *Commissioner*, § 6.0
Ruddel v. *Commissioner*, § 3.1(b)
Runyon v. *McCrary*, § 1.3(c)
Ryan v. *Commissioner*, §§ 3.1(a), 3.1(b)
S. C. Johnson & Son, Inc. v. *Commissioner*, §§ 3.1(h), 4.8
Saltzman v. *Commissioner*, §§ 9.15, 9.15(f)
Sammons v. *Commissioner*, § 9.31
Samuel P. Hunt Trust v. *United States*, § 12.1(a)
Sandler v. *Commissioner*, §§ 4.4(a), 10.1(a)
Satullo v. *Commissioner*, § 9.7(d)
Sawade, Estate of v. *Commissioner*, § 6.5
Schachter v. *Commissioner*, § 9.2
Scheffres v. *Commissioner*, § 3.1(b)
Schoellkopf v. *United States*, § 19.2(c)
Schwab v. *Commissioner*, § 10.1(a)
Secretary of State of Maryland v. *Joseph H. Munson Co., Inc.*, § 25.8
Sedam v. *United States*, § 3.1(m)
Seed v. *Commissioner*, §§ 3.1(a), 9.16(c)
Seldin v. *Commissioner*, § 3.1(b)
Sergeant v. *Commissioner*, § 10.1(a)
S & H, Inc. v. *Commissioner*, § 2.16(a)
Shapiro, Estate of v. *Commissioner*, § 11.4
Sheffels v. *United States*, § 9.16(c)
Shelton v. *Tucker*, § 1.3(c)
Sheppard v. *United States*, §§ 4.3, 4.8
Short v. *Commissioner*, § 21.8
Sierra Club, Inc. v. *Commissioner*, § 3.5(g)
Signom v. *Commissioner*, §§ 3.1(a), 3.1(b)
Silver, Estate of v. *United States*, § 19.2(a)
Silverman v. *Commissioner*, § 10.1(a)
Simmons v. *Commissioner*, § 9.7(d)
Singer Co. v. *United States*, § 3.1(b)
Sklar v. *Commissioner*, § 3.1(b)
Skripak v. *Commissioner*, §§ 9.1(a), 10.1(a)
Smith v. *Commissioner*, §§ 6.6, 21.2, 21.5
Smith v. *Organization of Foster Families*, § 1.3(c)
Snyder v. *Commissioner*, §§ 3.1(d), 10.1(a), 10.14
Sound Health Association v. *Commissioner*, § 3.3(b)
South Carolina v. *Baker*, § 1.3(a)
Spiegel, Estate of v. *Commissioner*, § 6.2

St. Louis Union Trust Co. v. *United States*, § 1.3(a)
St. Martin Evangelical Lutheran Church v. *South Dakota*, § 3.4(a)
Stanley v. *Georgia*, § 1.3(c)
Stanley v. *Illinois*, § 1.3(c)
Stanley Works, The v. *Commissioner*, §§ 9.7(e), 10.1(a)
Stark v. *Commissioner*, §§ 9.19(a), 10.1(a)
Stark v. *United States*, § 11.4
Starkey, Estate of v. *United States*, § 8.7(a)
State of South Carolina v. *Baker*, § 1.3(a)
State Police Ass'n v. *Commissioner*, §§ 3.5(f), 10.2
Stjernholm v. *Commissioner*, § 6.0
Story III v. *Commissioner*, § 6.7
Stotler v. *Commissioner*, § 10.1(a)
Strasburg v. *Commissioner*, § 10.1(a)
Strasser v. *Commissioner*, § 10.1(a)
Street, Estate of v. *Commissioner*, § 8.3(b)
Strock, Estate of v. *United States*, § 8.7(b)
Stubbs v. *United States*, § 3.1(b)
Summers v. *Commissioner*, § 3.1(a)
Suna v. *Commissioner*, § 3.1(a)
Symington v. *Commissioner*, § 9.7
Tallal v. *Commissioner*, §§ 10.1(a), 10.14
Tamulis, Estate of v. *Commissioner*, §§ 8.7(c), 12.1(c), 21.2(e)
Tatum v. *Commissioner*, § 4.8
Taylor v. *Commissioner*, §§ 9.14, 21.8
Taynton v. *United States*, § 3.1(m)
Tennessee Baptist Children's Homes, Inc. v. *United States*, § 3.4(a)
Terre Haute First Nat'l Bank v. *United States*, § 8.3(b)
Terrence Investments, Ltd., Deerbrook Construction, Inc. v. *Commissioner*, § 10.1(a)
Thomason v. *Commissioner*, §§ 10.5, 18.3
Tidler v. *Commissioner*, § 6.13
Tobjy v. *Commissioner*, § 18.2
Todd v. *Commissioner*, §§ 4.5(b), 10.1(a), 12.1(c)
Transamerica Corp. v. *United States*, §§ 3.1(a), 3.1(d)
Trinidad v. *Sagrada Orden de Predicadores de la Provincia del Santisimo Rosario de Filipinas*, § 1.3(a)
Tripp v. *Commissioner*, §§ 3.3(b), 10.5
Trompeter, Estate of v. *Commissioner*, § 10.1(a)
True v. *United States*, § 4.8
Turner v. *Commissioner*, § 9.7(d)
Tuttle v. *United States*, § 17.3
U.S. CB Radio Ass'n, No. 1, Inc. v. *Commissioner*, § 23.2
United Cancer Council, Inc. v. *Commissioner*, § 23.1(c)
United States v. *American Bar Endowment*, §§ 3.1(a), 3.1(m)
United States v. *American College of Physicians*, § 3.5(a)
United States v. *Correll*, § 9.15
United States v. *Dean*, §§ 10.4(b), 11.4
United States v. *Freeman*, § 10.14
United States v. *Kattar*, § 8.6(k)
United States v. *Knapp Brothers Shoe Mfg. Corp.*, § 3.1(j)
United States v. *Mitchell*, § 3.1(d)
United States v. *Parker*, § 10.1(a)
United States v. *Proprietors of Social Law Library*, § 3.3(b)
United States v. *Provident Trust Co.*, § 10.4(b)
United States v. *Ryerson*, § 17.1
United States v. *Stapf*, § 8.3(b)
Unvert v. *Commissioner*, § 12.4(i)
Urbauer v. *Commissioner*, § 3.1(b)
Van Zelst v. *Commissioner*, § 10.1(a)
Veterans of Foreign Wars, Dep't of Mich. v. *Commissioner*, § 22.1
Veterans of Foreign Wars of the United States, Dep't of Mo., Inc. v. *United States*, § 22.1
Village of Schaumberg v. *Citizens for a Better Environment*, § 25.8
Walz v. *Tax Commission*, § 1.3(a)
Waranch v. *Commissioner*, § 9.19(a)
Ward v. *Commissioner*, § 9.31
Wardwell, Estate of v. *Commissioner*, §§ 3.1(a), 3.1(b)
Warfield v. *Bestgen*, § 14.9
Warren, Estate of v. *Commissioner*, § 8.7(b)
Watson v. *Commissioner*, § 6.8
Wegner v. *Lethert*, § 3.1(b)

Weiner v. *Commissioner,* §§ 17.6(a), 21.3(b)
Weingarden v. *Commissioner*, § 1.5
Weiss v. *Commissioner*, §§ 3.1(d), 10.1(a), 10.14
Weitz v. *Commissioner*, § 10.1(a)
Welch v. *Helvering*, §§ 2.16(a), 21.8
Well v. *Commissioner*, § 3.1(a)
Wells Fargo Bank v. *United States*, § 8.7(c), 8.8
Welti v. *Commissioner*, § 18.2
Wendy L. Parker Rehabilitation Found., Inc. v. *Commissioner*, § 3.3(b)
Whitaker v. *Commissioner*, § 3.1(a)
White v. *Brodrick*, § 4.2
Winokur v. *Commissioner*, §§ 6.0, 8.2(k), 9.1(a), 9.1(b), 15.2(a)
Winters v. *Commissioner*, § 3.1(a)
Wisconsin v. *Yoder*, § 1.3(c)
Witt, Estate of v. *Fahs*, § 6.2
Wolfe v. *Commissioner*, § 3.1(a)
Wood, Estate of v. *Commissioner*, § 3.1(b)
Woodbury v. *Commissioner*, § 7.7
Wood-Mosaic Co. v. *United States*, § 6.14
Woods v. *Commissioner*, § 6.0
Woodworth, Estate of v. *Commissioner*, § 10.4(b)
Wortmann v. *Commissioner*, § 10.1(a)
Wurtsbaugh v. *Commissioner*, § 6.0
Yoshihara v. *Commissioner*, § 3.1(b)
Young v. *Commissioner,* § 3.1(a)
Zabel v. *United States*, § 8.3(b)
Zablocki v. *Redhail*, § 1.3(c)
Zeidler v. *Commissioner*, § 21.8
Zmuda v. *Commissioner,* § 10.1(a)

Table of IRS Revenue Rulings and Revenue Procedures

Revenue Rulings	Sections
53-194	10.3
54-465	6.2
54-549	3.1(a)
54-580	3.1(a)
55-4	9.15
55-138	4.2
55-192	10.9
55-275	4.2, 10.3
55-410	4.9, 6.0
55-531	4.2
56-403	3.3(b)
56-508	9.15, 9.15(f)
56-509	9.15
57-449	3.3(b)
57-462	9.14
58-240	9.15(b), 9.15(c)
58-261	15.3
58-279	9.15
58-372	17.3
59-160	9.15
59-195	17.3
60-367	3.3(b)
61-46	9.15, 9.15(a)
61-66	10.5
62-113	10.5, 18.4
63-252	18.3, 18.5
64-174	3.3(b)
64-175	3.3(b)
64-182	23.1(c)
65-298	3.3(b)
66-79	18.4
66-302	11.4
67-30	9.17
67-137	3.1(f)
67-236	9.14
67-246	3.1(b), 22.1, 23.1(a)
67-376	6.2
67-246	3.1(b), 22.1, 23.1(a)

Revenue Rulings	Sections
67-446	3.1(c)
68-69	4.2
68-113	9.14
68-174	6.7
68-296	3.1(j)
68-432	3.1(a), 21.3(a)
68-484	10.5
68-504	3.3(b)
69-56	8.3(b)
69-80	20.1
69-90	3.1(c)
69-93	6.0
69-545	3.3(b), 3.4(a)
69-573	3.3(b)
70-452	8.7(a)
70-519	9.15
71-135	9.15(c)
71-216	6.3
72-194	10.4(a)
72-243	12.3(e)
72-395	12.9
73-571	12.1(a)
73-597	9.15
73-610	12.1(a)
74-19	12.3(a)
74-39	12.3(f)
74-149	12.3(e)
74-224	3.4(a)
74-241	15.2(a)
74-246	3.1(c)
74-322	9.17
74-481	12.3(h)
74-523	19.2(c)
74-572	3.4(a)
75-65	18.4
75-66	3.1(c)
75-74	3.3(b)
75-196	3.3(b)

Revenue Rulings	Sections
75-348	6.0
76-38	6.3, 6.7
76-8	12.2(e), 12.3(e)
76-89	9.15
76-96	3.1(i)
76-143	9.23, 17.3
76-165	15.2(a)
76-196	13.2(h)
76-204	3.3(b)
76-232	3.1(b)
76-244	3.3(b)
76-270	12.2(d), 12.3(d)
76-273	3.7
76-280	12.1(a)
76-310	12.3(a)
76-357	15.2(a)
76-371	12.2(g), 12.3(g)
76-416	3.4(a)
76-440	3.4(a)
76-467	12.3(a)
76-543	15.2(a)
77-73	12.2(d), 12.3(d)
77-160	4.9
77-169	15.2(a)
77-217	7.7
77-246	3.3(b)
77-275	16.9
77-285	12.2(d), 12.3(d)
77-305	15.2(a)
77-374	8.7(a), 12.12
77-454	11.4
77-471	12.1(a)
77-491	8.7(b)
78-38	6.3, 6.7
78-80	9.17
78-84	3.3(b)
78-85	3.3(b)
78-95	3.4(a)
78-101	16.5
78-105	12.2(d), 12.3(d), 13.2(b)
78-152	8.7(b)
78-181	6.9
78-189	3.1(a)
78-197	3.1(h), 4.8
78-303	15.2(b)
78-309	3.4(a)
79-81	10.5, 13.2(b), 13.2(c)
79-243	12.2(e)
79-249	10.4(a)
79-256	4.4(a)
79-323	3.1(c)
79-368	12.2(g), 12.3(g)
79-419	4.4(a)
79-428	12.2(a), 12.3(a)
80-38	12.2(g), 12.3(g)
80-69	10.1(a)
80-77	3.1(b), 3.1(c)
80-80	11.4
80-99	9.17
80-104	12.3(a)
80-123	12.1(a), 12.9
80-186	12.4(a)
80-200	3.3(b)
80-233	10.1(a)
80-286	3.3(b)
80-335	6.4
81-163	9.20
81-282	9.23
81-284	3.3(b)
81-307	3.1(c)
82-38	13.5, 13.7
82-105	3.7
82-128	12.2(e), 12.9
82-165	12.1(a), 12.2(e), 12.9
82-197	6.9
83-19	12.1(a)
83-29	9.3(c)
83-104	3.1(b)
83-158	15.2(a)
84-1	9.14
84-61	9.15, 10.3
84-97	15.2(a)
85-8	9.3(c)
85-20	13.11
85-23	8.7(a), 15.2(a)
85-49	16.2
85-57	13.5
85-69	13.2(b)
85-99	10.1(c)(8)
85-184	10.2, 10.9
86-60	8.2(k), 12.2(j)
86-63	3.1(a), 3.1(b)
87-37	15.2(a)
87-127	13.7
88-27	16.3
88-37	9.23, 15.3
88-81	12.1(a), 12.9
88-82	16.7

TABLE OF IRS REVENUE RULINGS AND REVENUE PROCEDURES

Revenue Rulings	Sections
89-31	8.7(b)
89-51	9.13(b), 9.18
89-90	9.7(g)
90-103	13.5, 13.7
92-48	12.1(a)
92-57	12.1(a)
92-107	13.9(a)
92-108	3.1(g), 13.9(b)
93-8	3.1(g), 13.9(b)
96-3	11.4
96-11	6.16
96-38	13.9(b)
98-61	8.2(h), 8.5
2000-43	6.13
2002-20	12.2(d), 12.3(d)
2002-67	9.27(d), 10.1(c)(3), 21.3(a)
2003-28	9.23, 9.28, 9.6(a), 10.1(c), 10.4(a), 15.3
2003-43	6.15
2003-123	9.7, 9.22(a)
2004-5	9.22(a)
2006-58	12.4(k)
2008-16	6.15
2008-41	12.6

Revenue Procedures	Sections
82-23	22.3
82-61	9.15(a)
88-3	13.5
88-53	13.5
88-54	13.5
90-12	22.1
91-3	12.9
92-94	20.4(f)
96-15	10.1(b)
97-52	3.1(c)
97-58	9.14
98-61	2.6, 2.8(a), 2.8(c), 2.15
99-3	13.5
2002-70	2.5(c), 2.6, 2.7(a), 2.7(c), 2.15, 8.2(h), 8.5
2003-53	12.9
2003-54	12.8
2003-55	12.8
2003-56	12.8
2003-57	12.8
2003-58	12.8
2003-59	12.8
2003-60	12.9
2003-76	9.17
2003-85	2.15
2005-24	12.2(d), 12.3(d)
2005-52	12.9
2005-53	12.9
2005-54	12.9
2005-55	12.9
2005-56	12.9
2005-57	12.9
2005-58	12.9
2005-59	12.9
2006-50	9.30
2006-53	App. ES, App. FS, App. GS
2007-45	16.1
2007-46	16.1
2008-45	16.6
2008-46	16.6
2008-66	2.5(c), 2.7(c), 2.15, App. E, App. F, App. G
2009-1	11.3
2009-3	12.9, 13.5
2009-50	2.6, 2.7(a), 8.2(h), App. E, App. F, App. G

Table of IRS Private Determinations Cited in Text

Private Letter Rulings and Technical Advice Memoranda	Sections
7802001	6.14
7842062	12.9
7903079	10.9
7938001	19.2(c)
7944054	10.9
8015017	15.2(a)
8110016	15.2(b)
8202137	15.2(b)
8204220	15.3
8333019	15.3
8408051	18.3
8408054	18.3
8417019	10.9
8420002	6.8
8526015	9.20
8535019	15.3
8536061	12.10
8601033	11.2
8601041	13.5
8605003	8.7(c)
8605008	9.7
8608042	3.1(b)
8616020	13.7
8626065	7.18(a)
8705041	10.9
8706011	6.2
8714050	18.3
8725058	3.1(m)
8736020	16.3
8745013	12.1(a)
8748001	19.2(c)
8817004	8.7(c)
8822035	12.3(a)
8826012	10.9
8832003	22.1
8836033	3.1(g)
8836040	10.9
8839029	18.3
8930001	4.4(a)
9004030	3.1(b)
9015049	9.20
9037021	3.3(a)
9042043	14.3(b)
9101010	12.2(d), 12.3(d)
9110016	17.4
9118012	3.1(b)
9119011	3.1(b)
9143030	12.3(d)
9147007	3.1(f), 23.3(a)
9147040	17.4
9152036	15.3
9204036	12.3(g)
9205031	12.3(f)
9233053	12.10
9237020	9.10(c)
9240017	12.1(a)
9243043	9.15
9247018	4.5(b)
9247030	3.3(b), 10.5
9250041	3.1(g)
9252023	7.14, 12.3(d), 12.3(e)
9303007	7.6(a), 7.7, 8.2(a), 8.2(g), 8.2(k), 10.4(b), 15.3
9309029	12.9
9309034	12.9
9311018	13.2(e), 13.5
9316051	3.3(b)
9321057	9.3(b)
9322025	8.8
9322031	12.1(a)
9327006	8.7(c)
9329017	15.2

TABLE OF IRS PRIVATE DETERMINATIONS CITED IN TEXT

Private Letter Rulings and Technical Advice Memoranda	Sections
9332033	13.3(a)
9335017	9.12, 10.7
9335022	10.9
9335057	6.9
9338015	3.7
9340043	12.3(f)
9341008	12.1(a)
9342026	12.9
9350009	3.1(f)
9351001	8.3(b)
9403030	12.3
9405003	3.1(a)
9406013	13.2(b)
9412004	13.5
9413020	12.3(h)
9417005	12.1(a)
9419021	12.1(a), 12.3(f)
9423001	3.1(b)
9424040	4.5(b)
9431001	9.19(a)
9434018	12.3(a)
9436035	13.7
9443001	3.6
9443004	10.4(b)
9447028	3.1(c)
9452020	4.8
9452026	4.8, 12.4(c)
9501004	12.4(a)
9504012	12.4(b)
9506015	12.3(a)
9511007	12.4(d)
9512016	12.4(e)
9516047	3.3(b)
9522021	12.10
9531003	8.8
9547004	12.1(b)
9550026	9.22(b)
9623035	3.1(i), 6.11, 10.9, 21.1(b)
9631004	3.3(b)
9631005	9.3(b)
9633006	12.1(a)
9633007	12.1(a)
9634019	9.10(c)
9635001	3.5(g)
9642020	13.2(e), 13.11
9642037	13.5
9652004	3.5(g)
9652011	12.1(a)
9702040	3.3(b)
9703028	20.1
9704028	3.3(b)
9714010	12.10
9718030	12.2(d), 12.3(d)
9728022	9.8(c)
9729024	3.1(c)
9733015	10.9
9734057	16.3
9741047	3.3(b)
9743004	12.10
9804036	12.1(a), 12.3(a), 12.4(i)
9818009	9.10(c)
9818027	12.1(a)
9818042	8.2(h)
9821029	12.1(a)
9828001	6.9
9829053	10.9
9838028	9.10(c)
9839024	12.2(d), 12.3(d)
199914040	3.3(b)
199925043	19.2(a)
199927010	3.7
199929050	10.9
199933029	9.7(e), 10.9
199939021	10.9
199952071	12.3(f)
199952035	12.3(a), 12.5(a)
200003005	9.3(b), 9.3(d)
200003013	10.9
200003059	3.7
200004001	3.1(b)
200012061	3.1b)
200020060	17.6(b)
200029031	12.4(b)
200029033	3.7
200034019	12.2(e)
200035014	12.1(b)
200037053	3.1(k)
200038050	12.3(j)
200045038	12.1(b)
200052026	12.3(h), 12.4(i)
200052035	12.2(e)
200108012	9.23
200108035	12.3(a)
200112022	4.5(b)

Private Letter Rulings and Technical Advice Memoranda	Sections
200116007	8.3(b)
200119005	4.4(b), 7.18(a)
200122025	8.2(k), 15.3
200124010	12.7
200127023	12.3(e)
200142011	10.4(b)
200143011	9.7
200202032	10.4(c)
200202034	4.9, 12.1(b)
200204022	12.3(d)
200205008	10.1(a), 12.3(j)
200208019	6.16, 9.6
200208039	12.7
200209020	17.3, 17.4
200213021	3.1(b)
200218008	12.4(i)
200219012	12.4(i)
200223013	9.1(c), 15.3
200228001	3.1(m)
200229046	12.1(b)
200230005	9.27(d), 10.2, 21.3(a)
200223013	9.1(b)
200233005	12.4(i)
200234019	9.10(b)
200241044	4.9
200243050	3.1(l)
200243057	9.27(d), 10.1(c)(3), 10.14
200245058	12.4(b)
200250029	10.5
200251010	12.4(i)
200252026	12.4(i)
200304025	12.7
200306002	8.3(b)
200307084	3.1(a), 3.1(l)
200310024	12.7
200311033	3.4(b)
200312003	9.10
200324023	8.2(k), 12.3(d)
200329031	13.2(e)
200414011	12.3(i), 12.11(c)
200418002	8.3(b)
200445023	3.1(g), 8.2(k)
200525014	12.7
200530007	6.10
200534022	3.1(m)
200601033	12.4(i)
200610017	9.23
200614032	12.7
200702031	4.5(b)
200703037	12.4(j)
200728026	12.6
200735027	12.8
200746010	8.7(c)
200845007	7.18(a)
200922013	12.7
200931059	18.4

General Counsel Memoranda	Sections
35319	18.4
37444	18.4
39664	9.7(g)
39748	3.1(g)
39875	3.1(g)
39877	3.1(b)

Table of IRS Private Letter Rulings, Technical Advice Memoranda, and General Counsel Memoranda

The following pronouncements from the Internal Revenue Service, issued privately in connection with specific cases and referenced to indicate the extent of IRS activity in a particular area and/or to reflect the thinking of the IRS on a particular topic, are coordinated to footnotes of individual chapters. (IRC § 6110(k)(3) states that these determinations are not to be used or cited as precedent.)

Citations are to IRS private letter rulings, technical advice memoranda, and general counsel memoranda directly pertinent to the material discussed. Seven-number items (and, since 1999, nine-number items) are private letter rulings and technical advice memoranda; five-number items are general counsel memoranda.

Chapter 2 The United States Tax System: An Overview

Footnote	
98	9226003

Chapter 3 Fundamental Concepts

Footnote	
71	9528022
78	200004001
79	9423001
85	9119012
100	200335017
124	9233053
157	9807030
179	200445024
195	9413020
208	200142019
209	200817018
249	200837050
267	7909026, 8620017, 8709069, 8733007, 8810048, 9141011, 9325038, 9328033, 9338014, 9342052, 9420035, 9424024, 9426027, 9430039
269	8607037, 8608039, 8617120, 8625056, 8645030, 8645031, 8645032, 8611041, 8647072, 8651031, 8701008, 8713028, 8717020, 8720018, 8721008, 8721063, 8722033, 8740009, 8743007, 8803058, 8806040, 8816063, 8823033, 8828058, 8830073, 8835020, 8837084, 8838052, 8844028, 8844029, 8847061, 9017014, 9018007, 9022008, 9033050, 9041060, 9045045, 9131056, 9136008, 9138010, 9439009, 9625047, 9638019, 9642036, 9718027, 200128005, 200151015

270	8615069, 8622026, 9315002, 200530016, 200743033
277	8705041 (withdrawn (8826012) but not retroactively (8836040)), 8755078, 8730059
278	9429013
296	9733015
381	9402028, 9512015
533	9318017, 9442017
538	9338021

Chapter 4 Gifts of Money and Property

Footnote	
31	9147049
46	200223013, 200223014
52	9247018, 9320007, 9435007, 9440034, 9441032, 9511041, 9513010
55	9435007, 9436042, 9437031, 9441032, 9734034, 9746050, 9812030, 9444029, 9450009, 9450010, 9450024, 9501031, 9509037, 9510050–9510052, 9510063, 9513010, 9734034, 9746050
88	200038050, 200335017
107	9333050

Chapter 5 Fundamentals of Planned Giving

Footnote	
7	200714025

Chapter 6 Timing of Charitable Deductions

Footnote	
49	199915037, 200141018, 200141019, 200202034
53	200112064, 200112065
61	200230029
72	199908039
82	9747040
85	9335022

Chapter 7 Percentage Limitations

Footnote	
26	200223013, 200223014
48	9713017
58	9611047, 9814032
64	9436039

Chapter 8 Estate and Gift Tax Considerations

Footnote	
34	200533001
47	200223013, 200223014, 200324023
49	8725082, 8851030, 9322017, 9430039, 9842004, 199911050, 200747001
57	9331015, 9348012, 9406030, 9407014, 9409017, 9529039, 200149016
67	20445024

94	200120002, 200120003, 200202032, 200223013, 200223014, 200230018, 200252077
104	8704004, 8725082, 8727004, 8751002, 8810004, 8839043, 8851029, 8901007, 9101010, 9101026, 9119006, 9127047, 9145005, 9149005, 9151012, 9244001, 9322026, 9341008, 9351001, 9404002, 9409001, 9430039, 9521011, 9521034, 9532026, 9616001, 9630008, 9634025, 9818009, 9821044, 199925043, 199944038, 200001010, 200024016, 200026010, 200418002, 200505008
107	199903001
108	200733007, 200825014
111	200802010
113	9326003
125	9406013
202	200350012
206	200127038, 200252077
213	9812014
222	200539022
224	8609055, 8617013, 8617016, 8639054, 8639072, 8644048, 8647036, 8649060, 8703069, 8721014, 8730035, 8737088, 8744014, 8749027, 8749071, 8753028, 8805002, 8807013, 8817004, 8821053, 8828054, 8828083, 8834050, 8844033, 8845012, 8849050, 9004011, 9014023, 9019040, 90220020, 9021034, 9038033, 9041074, 9101027, 9107010, 9110044, 9135032, 9137031, 9151022, 9211013, 9312020, 9326049, 93226056, 9339006, 9341003, 9344011, 9345014, 9347013, 9349010, 9407024, 9433022, 9507018, 9515029, 9516040, 9517020, 9517043, 9519028, 9520041, 9523030, 9526031, 9527040, 9529042, 9535025, 95550036, 9611019, 9613012, 9616032, 9635018, 9642010, 9642039, 9648042, 9716019, 9719013, 9725013, 9728007, 9733014, 9736023, 9740008, 9741022, 9745007, 9802036, 9804019, 9811021, 9816002, 9821009, 9845001, 9851023, 9852034, 9853014, 199903015, 199906011, 199915058, 199923013, 199924029, 199927040, 199935046, 199936010, 200020034, 200024014, 200027014, 200027015, 200201026, 200215042, 200227015, 20023022, 200233008, 200234038, 200302029, 200305023, 200306008, 200306009, 200340001, 200402012, 200428013, 200430012, 200532022, 200535006, 200535007, 200605001, 200622005, 200632013, 200726005, 200840030
225	9549016, 199941004, 200122045
227	9252017
232	9243039, 9623019
237	200818033
246	8844033
257	9728026
258	9526027, 9532026
261	9532026
263	9443004
269	9443001

Chapter 9 Special Gift Situations

Footnote	
1	9152036
6	9303007

25	200223014
40	8737002 (withdrawn by 9623006 and revoked by 9734004), 9528022
57	200627002
152	8605008, 8623037, 8625013, 8626029, 8626075, 8630056, 8713016, 8721017, 8722047, 8729061, 8753015, 8810009, 8810024, 9052038, 9239002, 9420008, 199927014, 199933029, 200208019
153	9318017, 9603018, 199927014, 199952037
156	9537018
158	9318017, 9407005, 9420008, 9632003, 9736016
161	9318027
164	200418005
179	9407005
181	9603018
272	9251022
353	9253038, 9341008, 9634019, 9723038
385	9818009, 199939039, 200002011
507	9540002
519	8613047, 8639045, 8713077, 8806084, 8830064, 9528022
527	9329017
653	9436039
660	200108013, 200108014
712	200230007
737	200230007

Chapter 10 Other Aspects of Deductible Giving

Footnote	
94	200207026
133	9029018
160	9303007
168	200223013, 200223014
190	9318017

Chapter 11 Valuation of Partial Interests

Footnote	
19	9342026, 9419006, 9421047, 9424025, 9445010

Chapter 12 Charitable Remainder Trusts

Footnote	
9	9034010, 9831004
14	9252023, 9253055
18	9511007, 9511029
26	9633008–9633013
33	8903019
45	9617036, 9617037
56	200301020, 200333013, 200524013S, 200525008S, 200539008S
67	200045038, 200109006, 200120016, 200143028, 200204022, 200301020
102	9839024

109	9339018
115	9326049, 200204022
116	9252043, 9331043
117	9445010
132	9252023
161	9529039, 9817010
165	8825095, 8828041
166	9434018
172	200150019
173	200002029, 200218008
195	9331015
204	200240012
207	9710008 (rev'g 9619044), 9710009 (rev'g 9619042), 9710010 (rev'g 9619043), 9839024
210	9252023, 9423020, 9442017
212	9339018
220	200304025
221	9252023, 9423020
222	9326049
223	9331043
224	9445010
225	199918046
229	200414011
241	200414011
243	200802024
244	200630006, 200631006, 200633011, 200802024
258	200207026
261	199918046, 200813006, 200813023
274	9629009, 9707027, 9712031, 9827017, 199929033
293	9609009, 9643014 (revised and replaced by 9711013)
297	199907013
303	200811003, 200818002
305	200338006, 200422005, 200441019, 200425027, 200825017
307	200422005, 200447033, 200532022, 200535007, 200601024, 200827011-200827013, 200829015, 200829016, 200831002
309	200704035, 200704036, 200710013–200710016, 200711025–200711039, 200723031, 200732021, 200732022, 200733032, 200733033, 200749023, 200803019, 200803020, 20080619, 200807017, 200810026–200810028, 200810030, 200816034, 200816035, 200817038, 200818025, 200818026, 200821034, 200821035, 200824021, 200824023, 200850048, 200850049, 200904025, 200904037, 200905030, 200905031, 200906053–200906056, 200913063, 200913065, 200919055–200919057, 200922061
310	200702036, 200702040, 200702041, 200703037
332	9818027, 9826021, 9826022, 200244011
333	200229046
334	200233006, 200233007
384	200744019, 200808018
411	200441024, 200552015, 200616035, 200725044, 200733014, 200739004, 200802032, 200802033, 200809044, 200816032,

	200816033, 200817039, 200824022, 200827009, 200833012, 200841040, 200841041, 200846037, 200922014–200922027
416 (last sentence)	8601043, 8602011, 8603026, 8603032, 8603033, 8603037, 8604008, 8604034, 8604053, 8605009, 8605017, 8606016, 8606043, 8606046, 8607109, 8608034, 8609057, 8609064, 8609065, 8610019, 8610020, 8610026, 8610030, 8610067, 8611017, 8611062, 8613006 (re 7842062), 8613016, 8613030, 8614015, 8614023, 8616013, 8617036, 8618013, 8618015, 8618016, 8618028, 8618037, 8620026, 8621005, 8621032, 8622009, 8622027, 8622037, 8623020, 8624013, 8625030, 8625032, 8625043, 8626099, 8628016, 8629016, 8629055, 8630012, 8631015, 8631024, 8631034, 8632026, 8633032, 8633045, 8634010, 8634017, 8634024, 8634044, 8636027, 8636048, 8636050, 8636099, 8637071, 8637073, 8637079, 8637084, 8638021, 8638037, 8638058, 8639015, 8639025, 8639027, 8641040, 8642076, 8642095, 8643058, 8644013, 8644014, 8644042–8644044, 8644063, 8644064, 8644069, 8645039, 8645048, 8645058, 8647007, 8647008, 8647027, 8649041, 8649059, 8650029, 8650031, 8650050, 8560064, 8651030, 8651063, 8651073, 8652041, 8652069, 8701035, 8701039, 8702011, 8702018, 8702038–8702041, 8702044, 8703024, 8703029, 8704011, 8704031, 8704032, 8705023, 8705024, 8706027, 8706029, 8706046, 8706054, 8707023, 8707052, 8708009, 8708019, 8708026, 8708047, 8708062, 8709017, 8709031, 8709041, 8709050, 8709057, 8709059, 8710040, 8710041, 8712029, 8712037, 8712038, 8712014, 8713017, 8713063–8713065, 8714040, 8715024, 8715025, 8715034, 8715043, 8720035, 8721007, 8721024, 8722044, 8722071, 8722105, 8723015, 8723020, 8723040, 8724011, 8724012, 8724032, 8725023, 8727022, 8727023, 8727029, 8727032, 8727034–8727036, 8727038–8727040, 8727053, 8727067, 8729015, 8729017, 8729031, 8729032, 8730027, 8730030–8730032, 8730066, 8731050, 8731051, 8731061, 8731062, 8732026, 8733016, 8733026, 8735027, 8737012, 8737088, 8739021, 8739022, 8740016, 8740018, 8742023, 8743006, 8743066, 8744039, 8745015, 8748063, 8749052, 8750012, 8752012, 8753009, 8801004, 8801016, 8803028, 8803073, 8804032, 8805022, 8805036, 8805037, 8805055, 8806045, 8807014, 8807020, 8807021, 8808013, 8808021, 8808039, 8808043, 8808079, 8809036–8809039, 8809045, 8809048, 8809058, 8810037, 8811012, 8811013, 8816058, 8816059, 8817021–8817024, 8818021, 8819014, 8819021, 8819023–8819025, 8819035, 8820037, 8820065, 8821007, 8821014, 8821019, 8822022, 8822023, 8823019, 8823020, 8823031, 8823047, 8825074, 8825075, 8826031, 8828036, 8828038, 8828040, 8828042, 8828053, 8830085, 8836018, 8836022, 8836029, 8837037, 8837038, 8837041, 8838032, 8838065, 8839023, 8839064, 8841049, 8841051, 8844034, 8845016, 8646035, 8847027–8847029, 8847046, 8847069, 8849068, 8850019–8850023, 8852008, 8903041, 8903042, 8903050, 8903064, 8903069, 8904009, 8906046, 8907013, 8909042, 8909058, 9001058, 9002048, 9004010, 9005066, 9006010, 9008012, 9008044, 9008046, 9009018, 9009019, 9009040, 9009047, 9009048, 9012052, 9012056, 9014033, 9015025, 9015027, 9016015, 9016016, 9016068, 9016069, 9018015, 9018041, 9019016, 9019035, 9019043, 9020024, 9021018, 9021044, 9022014, 9022049, 9023013, 9023031, 9023033, 9024030, 9024033, 9025008, 9027023, 9028001, 9029006, 9031004, 9032020, 9032029, 9033009, 9034011, 9034035, 9035043, 9040048, 9042009, 9042056, 9043025, 9043038,

	9044048, 9045042, 9048006, 9048050, 9051013, 9052054, 9104034, 9106008, 9110047, 9127030, 9132043, 9133012, 9134014, 9138024
429	9339018, 9413020, 9452020
433	9442017
441	9623018
460	8601093, 8604053, 8609060, 8616090, 8616012, 8616014, 8616089, 8617062, 8621049, 8643046, 8649022, 8712008, 8736021, 8736022, 8806029, 9023033, 9143038, 9216006

Chapter 13 Pooled Income Funds

Footnote	
37	200214017, 200214018
65	9248017
62 (last sentence)	8601046–8603031, 8603043, 8603045, 8603055, 8603068, 8604052, 8604071, 8607014, 8607036, 8609056, 8609058, 8609066, 8609068, 8610021, 8611033, 8611051, 8611061, 8613021, 8614017, 8615012, 8615016, 8615017, 8615019, 8615020, 8615029, 8617009, 8617020, 8617021, 8618014, 8618029, 8618038, 8620009, 8620032, 8621031, 8621045, 8621046, 8621051, 8621053, 8622008, 8622014, 8622035, 8623014, 8624027, 8624030, 8624036, 8624057, 8625021, 8625024, 8627026, 8627028, 8627031, 8629017, 8629034, 8630077, 8631020, 8632015, 8633033, 8634042, 8634043, 8634047, 8647094, 8638018, 8638064, 8641043, 8642048, 8643063, 8647009, 8647014, 8648065, 8648067, 8649047, 8649048, 8650032, 8650034, 8650036, 8652060, 8652062, 8702042, 8702043, 8703035, 8703063, 8703070, 8704012, 8704013, 8704016, 8705020, 8705028, 8706017, 8706026, 8706047, 8706056, 8706064, 8707048, 8707053, 8708010, 8708034, 8709040, 8710036, 8710038, 8710042, 8710048, 8710069, 8710070, 8712015, 8712016, 8712030–8712032, 8712040, 8713050, 8713079, 8714041, 8715015, 8715016, 8715028, 8718033, 8718052, 8720036, 8720064,8721051, 8721054, 8721064, 8722018, 8722055, 8722058, 8723014, 8724016, 8724031, 8725059, 8727052, 8729007, 8729033, 8729046, 8730015, 8730028, 8730034, 8731006, 8731018, 8731019, 8731049, 8732032, 8737051, 8737066, 8739028, 8739029, 8741013, 8741031, 8741056, 8742024, 8743036, 8743040, 8743042, 8744008, 8744037, 8745009, 8745020, 8747063, 8753010, 8801023, 8803027, 8803032, 8803036, 8803037, 8803039, 8804041, 8804074, 8804076, 8805027, 8805030, 8805031, 8805039, 8805040, 8807019, 8807068, 8807069, 8807077, 8808020, 8808022, 8808024, 8809046, 8809054, 8809056, 8810025, 8810038, 8810063, 8810083, 8811014, 8811022, 8811035, 8811042, 8812030, 8812053, 8812056, 8815007, 8815039, 8816049, 8817035, 8807067, 8817068, 8818014–8818016, 8818018, 8818020, 8818024, 8819031, 8819036, 8820011, 8820025, 8820038, 8820042, 8821010, 8821011, 8821013, 8821016, 8821031–8821038, 8821040–8821043, 8821045, 8821048–8821052, 8821055, 8822007, 8823046, 8823048, 8823055, 8823080, 8823083, 8823090, 8825072, 8825076, 8828037, 8828039, 8828044, 8828052, 8830028, 8834035, 8834036, 8834038, 8834049, 8834053, 8834058, 8836021, 8836043, 8836044, 8837032, 8837040, 8837051, 8838031, 8839055–8839057, 8839063, 8839074, 8839086, 8845013, 8846026, 8846027, 8846034,

62 (last sentence) (*continued*)	8846036, 8847022, 8847031, 8847057, 8847058, 8847062, 8849063, 8849065, 8849066, 8903067, 8903070, 8904013, 8904055, 8904056, 8906019, 8909015, 8909033, 8911038, 9002042, 9128023, 9402020, 9412004
67	9402030, 9412004
76	8712046, 8713044–8713048, 8736008, 8752048, 8803042, 8823082, 8828068, 8830042, 8830044–8830045, 8831023–8831024, 8838033, 9026017, 9027036, 9029053, 9030041–9030042, 200608002, 200608003
80	9334020
96	9542011
97	9345007

Chapter 14 Charitable Gift Annuities

Footnote	
17	39826
26	200847014
28	9042043, 9407007
31	200847014
33	9407007, 9527033, 200230018

Chapter 15 Other Gifts of Remainder Interests

Footnote	
7	9436039, 9538040
9	9436039, 9714017
44	9728016, 200438028
65	200223014

Chapter 16 Charitable Lead Trusts

Footnote	
13	9304020, 9311029, 9335014, 9331015, 9348012, 9402026, 9406030, 9407014, 9501036, 9533017, 9534004, 9539009, 9604015, 9604016, 9624029, 9629009, 9631021, 9633027, 9642039, 9713017, 9716023, 9718032, 9721006, 9725012, 9737023, 9750020, 9808031, 9808035, 9810019, 9821030, 199903045, 199908002, 199917068, 199922007, 199927010, 199927031, 199936031, 199947022, 199952044, 200011012, 200021020, 200043029, 200043039, 200108032, 200138018, 200149016, 200218029, 200240027, 200339018, 200516005S, 200536013S, 200648025S
27	9331015, 9748009
55	9326049, 9331015
58	9415009, 9431051
62	8736020

Chapter 18 International Giving by Individuals During Lifetime

Footnote	
23	8622011
26	9250041

Chapter 19 International Giving by Individuals through Estates

Footnote	
19	200252032, 200302005, 200901023, 200905015
39	200905015
57	200226012

Chapter 21 Receipt, Recordkeeping, and Reporting Requirements

Footnote	
28	9528022

Chapter 22 Disclosure Requirements

Footnote	
50	9315001

Table of Cases Discussed in *Bruce R. Hopkins' Nonprofit Counsel*

Note: The following cases, referenced in the text, are discussed in greater detail in one or more issues of the author's monthly newsletter, *Bruce R. Hopkins' Nonprofit Counsel*, as indicated.

Case	Book Section(S)	Newsletter Issue
Addis v. *Commissioner*	3.1, 17.6(a), 22.3(b)	Sept. 2002, Sept. 2004
Akers v. *Commissioner*	10.1(a)	Dec. 1986
Allen v. *Commissioner*	3.1(d), 10.14	Apr. 1991
Anselmo v. *Commissioner*	9.1(a), 9.2, 10.1(a)	Apr. 1984, June 1985
Arbini v. *Commissioner*	10.1(a)	Sept. 2001
Atkinson, Estate of v. *Commissioner*	8.7(c)	Oct. 2000, Dec. 2002
Bergquist v. *Commissioner*	6.5, 10.1(a), 10.14	Sept. 2008
Biagiotti v. *Commissioner*	9.1(a)	Dec. 1986
Bischel v. *United States*	3.1(e)	May 2006
Bond v. *Commissioner*	12.1(c)	May 1993, June 2009
Brinley v. *Commissioner*	3.1(a)	Aug. 1984, Apr. 1986
Broad v. *Commissioner*	10.1(a)	Dec. 1986
Bruzewick v. *United States*	21.3, 21.4	June 2009
Burke v. *United States*	3.1(a), 8.3(b)	Aug. 1993
Chiu v. *Commissioner*	9.2	July 1985
Christiansen, Estate of v. *Commissioner*	8.3(b), 9.31	May 2008
Crown Income Charitable Fund, Rebecca K. v. *Commissioner*	16.4	May 1992, Dec. 1993
Davis v. *United States*	3.1(a), 10.3	July 1990
Derby v. *Commissioner*	3.1(b), 10.14, 22.2	May 2008
Dolese v. *Commissioner*	10.10	Aug. 1984
Dubin v. *Commissioner*	9.2	Dec. 1986
ESB Financial v. *United States*	8.7(c)	Dec. 2008
Ferguson v. *Commissioner*	3.1(h), 6.5	June 1999
Galloway v. *United States*	8.3(b), 8.7	Sept. 2007
Glass v. *Commissioner*	9.7(d)	Sept. 2005, Mar. 2007
Grant v. *Commissioner*	9.14, 10.14	June 1985

Case	Book Section(S)	Newsletter Issue
Great Northern Nekoosa Corporation and Subsidiaries v. *United States*	9.7(a)	Oct. 1997
Greene v. *United States*	3.1(h), 4.3, 4.8, 9.11, 9.23, 15.3	Apr. 1993, Mar. 1994, Nov. 1997, Sept. 1999
Grynberg v. *Commissioner*	7.7	Oct. 1984
Hall, Estate of v. *Commissioner*	8.7(c)	Feb. 1990
Harbison v. *United States*	8.7(c), 8.8	May 2001
Hearst Corporation, The v. *United States*	10.1(a)	Aug. 1993, Sept. 1993
Herman v. *United States*	10.1(a)	Jan. 2000
Hill v. *Commissioner*	10.10	Sept. 2004
Hopkins v. *Hopkins*	17.4	Dec. 1992
Hubert, Estate of v. *Commissioner*	8.7(b)	Dec. 1993, May 1997, Jan. 1998, Mar. 1999
Hughes v. *Commissioner*	10.1	July 2009
Hunter v. *Commissioner*	4.4(a)	Nov. 1986
Jackson of Estate of v. *United States*	8.7(c)	Mar. 2006
Johnson, Estate of v. *United States*	8.7(c)	Dec. 1991
Jones v. *Commissioner*	3.1(e), 9.12	Jan. 2008, June 2009
Kamilche Company v. *United States*	3.1(d)	Mar. 1993
Kaplan v. *Commissioner*	2.8, 6.13	Apr. 2006
Kiva Dunes Conservation, LLC v. *Commissioner*	9.7, 10.1, 10.14	Sept. 2009
Klavan v. *Commissioner*	3.1(d), 10.1(a), 10.14	Sept. 1993
Koftinow v. *Commissioner*	9.1(a)	Dec. 1986
Krapf v. *United States*	10.1(a)	Nov. 1992
La Meres, Estate of v. *Commissioner*	3.1(a)	Apr. 1992
Logan v. *Commissioner*	9.18	Oct. 1994
Mast v. *Commissioner*	10.1(a)	June 1989
McLennan v. *United States*	3.1(a), 9.7(h)	July 1991, Dec. 1991, Aug. 1993
Mitchell, Estate of v. *Commissioner*	10.1(a)	July 2001
Musgrave v. *Commissioner*	3.1(k)	Dec. 2000
Newhall Unitrust, Leila G. v. *Commissioner*	12.8	Mar. 1997
Osborne v. *Commissioner*	9.7(h), 10.1(a)	Dec. 1986
Oxford Orphanage, Inc. v. *United States*	8.7(c)	Dec. 1985
Richardson v. *Commissioner*	3.3(b), 6.5	Feb. 1985
Rio Properties, Inc. v. *Rio International Interlink*	21.3(a)	May 2002
Roark v. *Commissioner*	3.1, 17.6(a), 21.3(b)	Feb. 2005
Rockefeller v. *Commissioner*	10.3	June 1984
Rome I Ltd v. *Commissioner*	9.7(g)	July 1991
Sandler v. *Commissioner*	4.4(a), 10.1(a)	Dec. 1986

Case	Book Section(S)	Newsletter Issue
Signom v. *Commissioner*	3.1(a), 3.1(b)	Sept. 2000
Silver, Estate of v. *Commissioner*	19.2	July 2003
Sklar v. *Commissioner*	3.1(b)	Apr. 2002, Mar. 2006, Feb. 2009
Skripak v. *Commissioner*	9.1(a)	Apr. 1985
Smith v. *Commissioner*	6.6, 21.2, 21.5	Dec. 1986, Feb. 2008
Starkey, Estate of v. *Commissioner*	8.7(a)	July 1999, Nov. 2000
Strock, Estate of v. *United States*	8.7(b)	June 1987
Tamulis, Estate of v. *Commissioner*	12.1(c), 21.2(e)	Jan. 2008
Terrene Investments, Ltd., Deerbrook Construction, Inc. v. *Commissioner*	10.1(a)	Oct. 2007
Todd v. *Commissioner*	4.5(b), 10.1(a), 12.1(c)	July 2002
Transamerica Corporation v. *United States*	3.1(a), 3.1(d)	June 1990
Turner v. *Commissioner*	9.7(d)	Aug. 2006
Warren, Estate of v. *Commissioner*	8.7(b)	May 1993
Weingarden v. *Commissioner*	1.5	June 1986, Oct. 1987
Wells Fargo Bank v. *United States*	8.7(c), 8.8	July 1991, Oct. 1993
Whitehouse Hotel Limited Partnership, QHR Holdings—New Orleans, Ltd. v. *Commissioner*	10.1, 10.14	Jan. 2009
Winokur v. *Commissioner*	9.1(a), 15.2(a)	Oct. 1988
Woodbury v. *Commissioner*	7.7	May 1990
Wortmann v. *Commissioner*	10.1(a)	Mar. 2006

Table of Revenue Rulings Discussed in *Bruce R. Hopkins' Nonprofit Counsel*

Note: The following IRS revenue rulings, referenced in the text, are discussed in greater detail in one or more issues of the author's monthly newsletter, *Bruce R. Hopkins' Nonprofit Counsel*, as indicated.

Rev. Rul.	Book Section(s)	Newsletter Issue
82-38	13.5, 13.7	June 1985
82-128	12.9	Apr. 1993
84-1	9.14	Feb. 1984
84-132	3.1(b)	Oct. 1984
85-8	9.3(c)	Mar. 1985
85-23	8.7(a), 15.2(a)	Apr. 1985
85-49	16.2	July 1985
85-57	13.5	June 1985
85-69	13.2(b)	July 1985
85-99	10.1(c)(8)	Sept. 1985
86-60	8.2(k), 12.2(j)	June 1986
86-63	3.1(a), 3.1(b)	June 1986
88-37	9.23, 15.2(a)	Sept. 1988
88-81	12.1(a), 12.9	Dec. 1988
88-82	16.7	Dec. 1988
89-31	8.7(b)	Apr. 1989
89-51	9.13(b), 9.18	July 1989
90-103	13.5, 13.7	Feb. 1991
92-107	13.9(a)	Feb. 1993
92-108	3.1(g), 13.9(b)	Feb. 1993
93-8	3.1(g), 13.9(b)	Feb. 1993
2002-67	9.25, 10.1(c), 21.1(b)	Jan. 2003
2003-28	9.23, 9.28, 10.1(c), 10.4(a), 15.3	Apr. 2003
2008-41	12.6	Sept. 2008

Table of Private Letter Rulings and Technical Advice Memoranda Discussed in *Bruce R. Hopkins' Nonprofit Counsel*

Note: The following IRS private letter rulings and technical advice memoranda, referenced in the text, are discussed in greater detail in one or more issues of the author's monthly newsletter, *Bruce R. Hopkins' Nonprofit Counsel*, as indicated.

PLR/TAM	Book Section(s)	Newsletter Issue
8536061	12.10	Dec. 1985
9110016	17.4	May 1991
9250041	3.1(g)	Jan. 1993
9252023	7.14, 12.3(d), 12.3(e)	Apr. 1993
9506015	12.3(a)	Mar. 1995
9703028	20.1	Apr. 1997
9733015	10.9	Oct. 1997
9818009	9.10(c)	July 1998
9818042	8.2(h)	July 1998
9828001	6.9	Nov. 1998
199929050	10.9	Oct. 1999
200004001	3.1(b)	May 2000
200012061	3.1(b)	June 2000
200020060	17.6 (b)	Aug. 2000
200112022	4.5(b)	May 2001
200119005	4.4(b) 7.18 (a)	July 2001
200230005	9.27(d), 10.2, 21.3(a)	Oct. 2002
200251010	12.4(i)	Feb. 2003
200306002	8.3(b)	June 2003
200307084	3.1(a), 3.1(l)	Apr. 2003
200329031	13.2(e)	Sep. 2003
200341002	8.2	Dec. 2003
200408031	12.8	Apr. 2004
200414011	12.3, 12.11(c)	June 2004
200418002	10.1(a)	July 2004
200438028	15.3	Dec. 2004
200445023	3.1(9), 8.2(k)	Jan. 2005
200445024	3.1(f), 8.2(k)	Jan. 2005
200524014	8, 12	Sept. 2005
200525008	8, 12	Sept. 2005
200530007	6.10	Dec. 2005
200533001	8.2(g), (h), (k)	Nov. 2005
200534022	3.1(m)	Nov. 2005

200610017	9.23, 10.4	May. 2006
200649027	12.4(i)	Feb. 2007
200702031	4.5(b)	Mar. 2007
200703037	12.4(j)	Mar. 2007
200905015	8.3(b)	April 2009

Index

Absence of value transferred, § 3.1(d)
Accounting method, § 2.10
Accounting period, annual, § 2.9
Accrual method of accounting, §§ 2.10, 6.14
Accumulated earnings taxes, § 2.22
Acquisition indebtedness, § 14.6
Adjusted basis, § 2.14(b)
Adjusted gross income, § 2.4
Advertising, § 3.1(f)
Agents, gifts by means of, § 10.2
Allocation:
  of basis (bargain sales), § 9.19(b)
  pooled income funds, income from
    charity, partial allocation to, § 13.3(b)
    units of participation, § 13.3(a)
  reallocation of deductions, § 10.10
Alternative minimum tax, §§ 2.18, 10.6
American Jobs Creation Act of 2004, §§ 21.1, 21.5
Annual accounting period, § 2.9
Annual gift tax exclusion, § 8.2(h)
Annuities, charitable gift, *see* Charitable gift annuities
Annuities, gross estate, § 8.3(a)
Annuity interest, §§ 5.7(a), 5.4(b), 9.23, 16.2
Annuity trusts, charitable remainder, *see* Charitable remainder annuity trusts
Anticipatory income assignments, § 3.1(h)
Antitrust laws, § 14.8
Applicable insurance contracts:
  in general, § 17.7
  reporting requirements, § 24.11
Appointment, powers of:
  general power, § 8.2(d)
  gross estate, § 8.3(a)
Appraisals:, §§ 2.14
  requirements, § 21.5
  value, appraised, § 2.14
Appreciated property gifts, §§ 5.2, 7.1
Appreciation, §§ 2.14(e), 4.2
Archaeological artifacts, contributions of, § 24.7(b)(17)
Arm's length transactions, § 2.14
Art, works of:
  as gifts, §§ 9.1(a), 24.7(b)(2)
  fractional interests in, § 9.1(b)
  as loans, §§ 8.2(g), 9.1(c)
  valuation of, § 10.1(b)
Arts, promotion of the, § 3.2(b)
Ascertainability, § 8.8
Assets, capital, § 2.16(a)
Assignment:
  of income, § 3.1(g)
  of pooled income fund units, § 5.5(b)
Associations, §§ 2.8, 3.3(a)
Auctions, charity, *see* Charity auctions
Audit guidelines, IRS:
  checksheet, § 23.1(c)
  guidance, audit, § 23.1(d)
  historical background, § 23.1(a)
  Special Emphasis Program, § 23.1(b)
Automobile expenses, deductibility of, § 9.17
Auxiliaries (of churches), § 3.4(a)

Bargain sales, § 3.1(b)
  basis, allocation of, § 9.19(b)
  and carryover rules, § 9.19(d)
  and deduction reduction rule, § 9.19(c)
  definition, § 9.19(a)
Basis:
  adjusted, § 2.14(b)
  for bargain sales, § 9.19(b)
  definition of, § 2.14(a)
  of gifted property, § 8.2(j)
  of transferred property, § 8.3(d)
Benefit events, § 23.2
Benefits, incidental, § 3.1(c)
Boorstin, Daniel J., § 1.3(a)
Brackets, income tax, § 2.15
Burden of proof rules, § 21.8
Business, § 3.4(b)
Business expense deductions, §§ 2.5(a), 10.7
Business leagues, § 1.3(b)

C corporations, §§ 2.8, 3.2, 6.14, 24.2, 24.7(a)
Calendar year, § 2.9
Capital assets, §§ 2.16(a), 7.6(a)
Capital gains, §§ 2.16(b), 2.20
Capital losses, § 2.16(b)
Carrybacks, § 2.17
Carryovers, § 2.17
Charitable family limited partnerships, § 9.26
Charitable Gift Annuity Antitrust Relief Act of 1995, § 14.8
Charitable remainder annuity trusts:
  additional contributions, § 12.2(h)
  annuity amount, maximum, § 12.2(c)
  annuity amount, minimum, § 12.2(b)
  annuity amount, payment of, § 12.2(a)
  annuity, period of payment, § 12.2(f)
  charitable deduction, §§ 12.2(j); 12.12(a)
  permissible income recipients, § 12.2(d)
  permissible remainder interest beneficiaries, § 12.2(g)
  remainder interest, minimum value of, § 12.2(i)
Charitable remainder trusts:
  distributions, tax treatment of, § 12.5
  division of, § 12.6
  early termination of, § 12.7
  estate tax aspects of, § 5.4(h)
  general rules for, § 5.4(a)

Charitable remainder trusts: (*Continued*)
gift amount, determination of, § 12.4(h)
gift tax aspects of, § 5.4(g)
income recipients, permissible, §§ 12.2(d), 12.3(d)
international transfers, § 19.2(d)
issues, § 12.4
life insurance, § 17.6(c)
mandatory provisions, § 12.9
options, transfers of, § 12.4(a)
period of payment, §§ 12.2(f), 12.3(f)
pooled income funds vs., § 13.10
private foundation rules, § 12.10
in real estate investment trusts, § 12.4(k)
remainder interest, minimum value of, §§ 12.2(i), 12.3(i)
scriveners' errors, § 12.4(i)
tangible personal property, transfers of, § 12.4(c)
taxation of, § 12.8
tax treatment of distributions from, § 12.5
terminology of, § 12.1(a)
time for paying income amount, § 12.4(g)
trustees, change of, § 12.4(b)
trust requirement for, § 12.1(b)
university endowment investment sharing, § 12.4(j)
unmarketable assets, valuation of, § 12.4(f)
wealth replacement trusts, § 12.11
Charitable remainder unitrusts:
additional contributions, § 12.3(h)
charitable deduction, §§ 12.3(j); 12.12(a)
permissible income recipients, § 12.3(d)
permissible remainder interest beneficiaries, § 12.3(g)
remainder interest, minimum value of, § 12.3(i)
unitrust amount, maximum § 12.3(c)
unitrust amount, minimum, § 12.3(b)
unitrust amount, payment of, § 12.3(a)
unitrust amount, period of payment, § 12.2(f)
types of, § 12.3(a)
Charitable sales promotions, § 25.4
Charitable sector, statistical profile of, § 1.4
Charitable split-dollar life insurance plans:
deduction denial rules, § 17.6(b)
in general, § 17.6(a)
IRS notice regarding, § 17.6(c)
penalties, § 17.6(b)
Charitable tax shelters, § 1.6
Charities, § 3.2(b)
Charity auctions:
acquirers of items, deduction for, § 9.13(c)
as businesses, § 9.13(a)
donors of items, deduction for, § 9.13(b)
quid pro quo rules for, § 9.13(e)
reporting rules for, § 9.13(g)
sales tax rules for, § 9.13(f)
substantiation rules for, § 9.13(d)
Check, money gifts by, § 6.2
Churches, §§ 1.3(a), 3.3(a)
Circular gifts, § 3.1(d)
Clothing:
gifts of, §§ 9.25, 24.7(b)(4)
substantiation requirements, § 21.7
Collectibles, contributions of, § 24.7(b)(11)
Commercial co-venturing, § 25.4
Commingling, in pooled income funds, § 13.2(c)
Commission on Private Philanthropy and Public Needs (Filer Commission), §§ 1.3(a), 1.4
Commodity futures contracts, contribution of, § 9.11
Common fund foundations, § 3.3(b)
Community beautification and maintenance, § 3.2(b)
Community foundations, § 3.3(a)
Community trusts:
in general, § 3.3(a)
pooled income funds of, § 13.9(b)
Completion, requirement of, § 3.1(k)
Computer technology and equipment, contribution of, § 9.5
Conditional gifts:
material conditions
deductibility, § 10.4(c)
nondeductibility, § 10.4(a)
negligible conditions, § 10.4(b)
Conduit foundations, § 3.3(b)
Conduit restriction, § 18.3
Conservation easements, permanent, § 8.3(b)
Conservation purposes, gifts of real property for:
definition of conservation purpose, § 9.7(c)
and donative intent, § 9.7(h)
exclusivity requirement, § 9.7(d)
organizations, qualified, § 9.7(b)
qualified real property interests, § 9.7(a)
rehabilitation tax credit, relationship to, § 9.7(g)
substantiation requirement, § 9.7(f)
valuation, fair market, § 9.7(e)
Consideration, § 3.1(a)
Contemporaneous written acknowledgment, § 21.3(a)
Contributed property, reporting on dispositions of, § 24.10
Contribution base, § 7.2
Conventions (of churches), § 3.3(a)
Copyright interest, timing of gifts of, § 6.6
Cornuelle, Richard C., § 1.3(a)
Corporate distributions, taxation of, § 2.21
Corporate sponsorship rules, § 23.3
Corporations:
appraisal requirements, § 21.5
C corporations, §§ 2.8, 3.2, 6.14, 24.2, 24.7(a)
foreign affiliates, giving by, § 20.2
gifts by, § 6.13
international giving by
charitable organizations, grants to, § 20.4(e)
charitable purpose, § 20.4(b)
from foreign affiliate to overseas charity, § 20.2
funds from U.S. corporation-related foundation to foreign charity, grant of, § 20.4
goods/services, gift of, § 20.3
grantee categories, overseas, § 20.4(d)
IRS simplified procedure, § 20.4(f)
non-charitable organizations, grants to, § 20.4(g)
responsibility, expenditure, § 20.4(c)
taxable expenditures, § 20.4(a)
to U.S. charity for overseas use, § 20.1
as legal fictions, § 2.8
and percentage limitations
carryover rules, §§ 7.18(b), 7.19(a)

general rules, § 7.18(a)
taxable income, § 7.3
S corporations, § 3.2
sponsorship rules
in general, § 23.3(a)
qualified payments, § 23.3(b)
as taxpaying entity, § 2.8(b)
tax rate system for, § 2.15
timing of gifts by, § 6.13
transfers to foreign, § 19.2(a)
Cost basis, § 2.14(a)
Cost method, § 2.13
Cost or market method, § 2.13
CRATs, *see* Charitable remainder annuity trusts
Creations of donor, gifts of, § 9.12
Credit card(s):
money gifts by, § 6.3
rebate plans, §§ 3.1(h), 6.11
Credits tax:
foreign, § 2.21
in general, § 2.20
CRTs, *see* Charitable remainder trusts
CRUTs, *see* Charitable remainder unitrusts
Curti, Merle, § 1.3(a)
Curtesy interests (in estate), § 8.3(a)

Death taxes, § 12.4(e)
Debt:
forgiveness of, § 3.1(d)
gifts of property subject to, § 9.20
Debt-financed property, § 14.6
Deductions:
automobile, § 9.27
business expense, § 2.5(a)
charitable. *See also* Timing
business expense deduction, interrelationship with, § 10.7
in general, § 1.1
definition of, § 2.5(a)
itemized, § 2.5(c)
personal expense, § 2.5(b)
reallocation of, § 10.10
standard, § 2.6
Deduction reduction rule, §§ 4.4(b), 4.5(a), 9.19(c)
Deferred giving, § 5.3
Deferred payment gift annuities:
in general, § 14.3(a)
tuition annuity programs, § 14.3(b)
Democracy in America (Alexis de Tocqueville), § 1.3(a)
Dependent exemption, § 2.7(b)
Depreciation:
deduction for, § 2.19
passthrough of (pooled income funds), § 13.7
Destination of income test, § 3.4(a)
De Tocqueville, Alexis, § 1.3(a)
Disclosure requirements:
in general, § 22.1
non-charitable organizations, § 22.3
quid pro quo contributions, § 22.2
state, § 25.11
Discounts, § 3.1(b)
Dividends, §§ 2.20, 3.1(i)
Donative intent, §§ 3.1(a), 9.7(h)
Donees:
charitable, § 3.3(b)
gift reporting by, § 24.5
Donee Information Return (Form 8282), App. D
Donor, meaning of, § 3.2
Donors, identification of, § 18.2(g)
Donors' creations, gifts of, § 9.12
Donor-advised funds, §§ 3.1(f), 23.4
Donor-directed funds, § 3.1(f)
Donor ownership, absence of, § 3.1(e)
Donor recognition, § 3.1(e)
Double taxation, § 2.8
Dower interests (in estate), § 8.3(a)
Drugs, contributions of, § 24.7(b)(13)

Earmarking restriction, § 18.3
Easements, gifts of, § 9.7
Economic development corporations, local, § 3.2(b)
Economic Growth and Tax Relief Reconciliation Act of 2001, §§ 2.5(c), 2.7(c), 2.15, 8.4, 8.5
Education, advancement of, § 3.2(b)
Educational institutions, § 3.3(a)
Educational organizations, § 3.2(b)
Effective rate of taxation, § 2.15
Election:
doctrine of, § 7.7(b)
timing of, § 7.7(f)
Electronic substantiation, § 21.3(a)
Employees, in nonprofit sector, § 1.4
Employee benefit programs, § 1.3
Employee hardship programs, § 3.1(l)
Employee Retirement Income and Security Act (ERISA), § 9.10(c)
England, § 1.3(a)
Entire interest in property, gift of undivided portion of, § 15.3
ERISA (Employee Retirement Income and Security Act), § 9.10(c)
Estate(s):
administration expenses, § 8.3(b)
balancing, estate, § 8.6(f)
and credit maximizing trusts/transactions, § 8.6(e)
freezing of, § 8.6(b)
gross, §§ 8.3(a), 8.3(c)
reduction of, § 8.6(a)
retained life, § 8.3(a)
special valuation rules for, § 8.6(b)
as taxpaying entity, § 2.8(c)
Estate tax:
and ascertainability, § 8.8
and basis of transferred property, § 8.3(d)
charitable gift annuities, § 14.4
with charitable remainder trusts, § 5.4(h)
deferral of, § 8.6(c)
in general, § 8.1
gross estate under, §§ 8.3(a), 8.3(c)
international giving charitable remainder trusts, testamentary, § 19.2(d)
foreign corporation, transfer to,§ 19.2(a)
foreign government, transfer to,§ 19.2(b)
noncitizen residents, giving by, § 19.4
trustee, transfer to, § 19.2(c)
and remainder interests
in general, § 8.7(a)
reformations, § 8.7(c)

Estate tax: (*Continued*)
will contests, § 8.7(b)
retirement plan accounts, charitable contributions from, § 9.10(e)
taxable estate under, § 8.3(b)
and timing of valuation, § 8.3(c)
Exchanges:
like kind, § 2.14(f)
of stock, § 2.14(f)
Exclusions from income, § 2.3
Executive branch, App. A
Exemption(s):
dependent, § 2.7(b)
personal, § 2.7(a)
phaseout of, § 2.7(c)
from state regulation, § 24.7
Expenditure responsibility, § 20.4(c)
Expenditure test, § 3.3(b)

Factors affecting deductibility, § 3.6
Facts and circumstances test, § 3.3(a)
Fair market value, §§ 2.14, 4.2, 9.7(e), 10.1
Fairness, § 1.6
Farm, contribution of remainder interests in, § 15.2(b)
Farmers, conservation contribution deduction for, § 9.7(j)
Federal tax law, incentives for charitable giving in, § 1.6
FIFO (first-in, first-out) method, § 2.13
$50 Test, App. E
Fifty percent limitation:
carryover rules for, § 7.5(b)
electable, § 7.7
general rules for, § 7.5(a)
and general thirty percent limitation, § 7.10
and special thirty percent limitation, § 7.9
Filer Commission, *see* Commission on Private Philanthropy and Public Needs
First Amendment, § 1.3(c)
First-in, first-out (FIFO) method, § 2.13
Fiscal year, § 2.9
Flat tax, § 1.6
Flip charitable remainder unitrusts (FLIP-CRUTs), §§ 12.1(a), 12.3(a), 12.4(h)
Food, Drug, and Cosmetic Act, 9.3(e)
Food and Energy Security Act of 2008, §§ 9.7(i), 9.7(j)
For use of charity, gifts, §§ 7.13, 10.3
Foreign charities, *see* International giving
Foreign tax credits, §§ 2.24, 9.29
Forms:
990, §§ 24.5, 24.5(a), 24.7(b)
990-EZ, §§ 24.5, 24.5(b), 24.5(c)
990-N, § 24.5
990-PF, § 24.5
990-T, § 24.6
1040, §§ 24.1, 24.7(a)
1041, § 24.5(a)
1041-A, § 24.13
1065, §§ 24.4, 24.7(a)
1065-B, §§ 24.4, 24.7(a)
1098-C, §§ 24.5(a), 24.8
1120, §§ 24.2, 24.7(a)
1120S, §§ 24.3, 24.7(a)
5227, § 24.13
8282, §§ 24.5(a), 24.7(a), 24.7(b)(20), 24.10, App. D
8283, §§ 24.6, 24.7, 24.7(a), 24.7(b)(19), 24.10, App. C
8871, § 24.5(c)
8872, § 24.5(c)
8899, §§ 24.5(a), 24.9
For-profit entities, § 1.2
Foundations:
common fund, § 3.3(b)
community, § 3.3(a)
conduit, § 3.3(b)
private, *see* Private foundations private operating, § 3.3(b)
supporting, § 3.3(a)
Fractional interests, gifts of, §§ 9.1(b), 15.3(b)
Fragmentation rule, § 3.4(b)
Fraternal beneficiary organizations, § 1.3(b)
Freedom of association, § 1.3(c)
Freedom of expressive association, § 1.3(c)
Freedom of intimate association, § 1.3(c)
Freezes, estate, § 8.6(b)
Fundraising:
cost limitations, § 25.8
IRS audit guidelines, § 23.1
special events, § 23.2
state regulation of
contractual requirements, § 25.10
cost limitations, fundraising, § 25.8
disclosure requirements, § 25.11
exemptions from, § 25.7
in general, § 25.1
historical background, § 25.2
police power of states, § 25.3
prohibited acts, § 25.9
registration requirements, § 25.5
reporting requirements, § 25.6
terminology, § 25.4
Future interests, in tangible personal property, § 9.21

Gain(s), § 2.14. *See also* Capital gains and losses
and adjusted basis, § 2.14(b)
and appreciation, § 2.14(e)
and basis, § 2.14(a)
determination of, § 2.14(c)
and realization of income, § 2.14(d)
recognition of, § 2.14(f)
rollover of, § 2.14(f)
Gardner, John W., § 1.3(a)
Gems, contributions of, §§ 9.2, 24.7(b)(10)
General power of appointment, § 8.2(d)
Generation-skipping transfer (GST) tax, § 8.5
Generation-skipping transfers, § 8.6(d)
Ghoul trusts, § 16.8(a)
Gift(s):
of art works, § 9.1(a)
circular, § 3.1(d)
of commodity futures contracts, § 9.11
completed, § 3.1(j)
of computer technology and equipment, § 9.5
conditional
material conditions, §§ 10.4(a), 10.4(c)
negligible conditions, § 10.4(b)
of creations of donor, § 9.12
definition of, §§ 3.1, 8.2(a)
earmarking of, § 10.5

factors affecting deductibility of charitable, § 3.6
of gems, § 9.2
in general, § 1.1
of insurance, § 17.3
of inventory
amount of reduction of charitable contribution, § 9.3(f)
basic rules for, § 9.3(a)
book inventory, special rules, § 9.3(i)
Food, Drug, and Cosmetic Act, compliance with, § 9.3(e)
food inventory, special rules, § 9.3(h)
recapture, exclusion of, § 9.3(g)
transfer of contributed property, restrictions on, § 9.3(c)
use, restrictions on, § 9.3(b)
written statement requirement, § 9.3(d)
mandatory, § 3.1(l)
money, §§ 4.1, 6.2, 6.3, 6.4
to non-charitable organizations, § 10.9
of partial interests, § 9.23
planned, *see* Planned giving
of property, *see* Property
rules for, § 3.1(a)
of scientific research property, § 9.4
of stock, §§ 9.8, 9.9
taxable, §§ 8.2(f), 8.2(g)
and terrorism, § 10.11
for use of charity, § 10.3
Gift acceptance policy, § 24.7(b)(21)
Gift annuities, charitable, *see* Charitable gift annuities
Gift reporting:
by C corporations, § 24.2
on dispositions of property, § 24.10
by donees in general, § 24.5
by individuals, § 24.1
intellectual property, § 24.9
of noncash gifts, § 24.7
by partnerships, § 24.4
by S corporations, § 24.3
in unrelated business context, § 24.6
vehicles, § 24.8
Gift tax:
annual exclusion, § 8.2(h)
basis of gift property for, § 8.2(j)
charitable gift annuities, § 14.4
with charitable remainder trusts, § 5.4(g)
and deductions from taxable gifts, § 8.2(k)
and definition of gift, § 8.2(a)
disclaimers under, § 8.2(a)
exclusions under, § 8.2(g)
in general, § 8.1
imposition of, § 8.2(b)
international giving, §§ 19.3, 19.4(b)
liability for, § 8.2(l)
non-gift transfers, § 8.2(e)
and powers of appointment, § 8.2(d)
scope of, § 8.2(c)
split gifts between spouses, § 8.2(m)
taxable gifts under, § 8.2(f)
valuation of transfers for, § 8.2(i)
Good will, § 2.12(d)
Government(s):
entities, governmental, § 1.2
lessening of burdens of, § 3.3(b)
transfers to foreign, § 19.2(b)
units, governmental, § 3.4(a)
Grantor trust rules, § 3.7
Gravesites, § 3.1(d)
Gross estate:
in general, § 8.3(a)
timing of valuation of, § 8.3(c)
Gross income:
adjusted, § 2.4
in general, §§ 1.6, 2.1, 2.2
Group-term life insurance, § 17.2(b)
GST (generation-skipping transfer) tax, § 8.5
Guaranteed annuity interests, § 9.22(c)

Health, promotion of, § 3.2(b)
Health care institutions, § 3.3(a)
Henle, Robert J., § 1.3(a)
Historical artifacts, contributions of, § 24.7(b)(15)
Hospitals, § 3.3(a)
Household items:
gifts of, §§ 9.25, 24.7(b)(4)
substantiation requirements, § 21.7

IDEA (Individuals with Disabilities Education Act), § 3.1(d)
Incidental benefits, § 3.1(c)
Income:
adjusted gross, § 2.4
anticipatory assignments of, § 3.1(g)
concept of, § 2.1
exclusions from, § 2.3
gross, §§ 2.1, 2.2
ordinary, § 2.16(b)
pooled, *see* Pooled income funds
realization of, § 2.14(d)
of tax-exempt organizations, § 1.4
tax treatment of, § 2.15
taxable, § 2.7
taxation of, § 2.15
trust definition of, §§ 12.3(a)(iv), 12(d), 13.8
unrelated business, *see* Unrelated business income rules
Income in respect of decedent (1RD), §§ 9.10(a), 9.10(b)
Income interest:
charitable lead trusts, § 16.2
in property, § 5.3
Income tax, §§ 1.1, 9.10(c)
Income Tax Treaty (Canada-United States), § 18.6
Individuals:
gift reporting by, § 24.1
as taxpayers, § 2.8(a)
Individuals with Disabilities Education Act (IDEA), § 3.1(d)
Institutions, § 3.3(a)
Insubstantiality threshold, inflation-adjusted:
$50 Test, App. E
Insufficient consideration, transfers for, § 8.3(a)
$25 Test, App. F
Insurable interest, § 17.4
Intangible personal property, § 2.12(d)
Intangible religious benefit, § 21.3(a)
Intellectual property:
gift reporting by, § 24.9
gifts of, §§ 9.28, 24.7(b)(6)

Interest rates, monthly federal, App. H
Internal Revenue Code sections, App. B
International giving:
by corporations
charitable organizations, grants to, § 20.4(e)
charitable purpose, § 20.4(b)
from foreign affiliate to overseas charity, § 20.2
funds from U.S.-corporation related foundation to foreign charity, grant of, § 20.4
goods/services to foreign charity, gift of, § 20.3
grantee categories, overseas, § 20.4(d)
IRS simplified procedure, § 20.4(f)
non-charitable organizations, grants to, § 20.4(g)
responsibility, expenditure, § 20.4(c)
taxable expenditures, § 20.4(a)
to U.S. charity for overseas use, § 20.1
estate tax rules
charitable remainder trusts, testamentary, § 19.2(d)
foreign corporation, transfer to, § 19.2(a)
foreign government, transfer to, § 19.2(b)
noncitizen residents, giving by, § 19.4
trustee, transfer to, § 19.2(c)
foreign corporation, transfer to, § 19.2(a)
gift tax rules, §§ 19.3, 19.4(b)
by individuals during lifetime
conduit restriction, § 18.3
earmarking restriction, § 18.3
foreign donees, control over, § 18.4
in general, §§ 18.1, 18.5
legislative background, § 18.2
treaty provisions, § 18.6
by individuals through estates
estate tax rules, §§ 19.2, 19.4(a)
in general, § 19.1
gift tax rules, §§ 19.3, 19.4(b)
noncitizen residents, giving by, § 19.4
Internet, gifts by means of, § 6.17
Itemized deduction limitation, § 2.5(c)
Inventory, gifts of:
amount of reduction of charitable contribution, § 9.3(f)
basic rules for, § 9.3(a)
book inventory, § 9.3(i)
Food, Drug, and Cosmetic Act, compliance with, § 9.3(e)
food inventory, § 9.3(h)
in general, §§ 2.13, 24.7(b)(12)
recapture, exclusion of, § 9.3(g)
transfer of contributed property, restrictions on, § 9.3(c)
use, restrictions on, § 9.3(b)
written statement requirement, § 9.3(d)
Investment Advisors Act of 1940, § 5.9
Investment Company Act of 1940, §§ 5.9, 14.9
Involuntary conversions, § 2.14(f)
IRD, *see* Income in respect of decedent
Itemized deductions, limitation on, § 2.5(c)

Jewelry, contributions of, § 24.7(b)(10)
Jobs and Growth Tax Relief Reconciliation Act of 2003, §§ 2.15, 2.16(b)
Joint interests, § 8.3(a)
Judiciary branch, App. A

Land transfers, § 3.1(b)
Last-in, first-out (L1FO) method, §§ 2.13, 9.3(f)
Law firms, public interest, § 3.2(b)
Lead trusts, charitable, *see* Charitable lead trusts
Letters of credit, timing of gifts of, § 6.8
Library of Congress, § 3.1(d)
License to use patent, gifts of, § 9.6
Life income interests (pooled income funds):
in general, § 13.2(b)
termination of interest, § 13.2(h)
Life insurance:
charitable deduction for gifts related to, § 17.3
charitable gift annuities, § 17.6(b)
charitable remainder trusts, § 17.6(b)
charitable split-dollar plans
charitable deduction denial rules, § 17.6(b)
in general, § 17.6(a)
IRS notice regarding, § 17.6(c)
penalties, § 17.6(b)
in general, § 17.1
gross estate, § 8.3(a)
interest, insurable, § 17.4
partial interests, § 17.6(b)
policies, § 17.2(a)
types of, § 17.2(b)
and unrelated debt-financed income, § 17.5
valuation of, § 17.2(c)
LIFO method, *see* Last-in, first-out method
Like kind exchanges, § 2.14(f)
Limited liability companies, § 2.8
Liquidity, § 2.14
Loans, of art works, §§ 8.2(g), 9.1(b)
Lobbying activities, denial of deduction for, § 10.8
Local economic development corporations, §3.2(b)
Long-term capital gains, § 2.16(c)
Long-term capital gain property, gifts of, §§ 4.3, 7.1
Lotteries, payments for, § 3.1(b)
Low-cost article definition, inflation-adjusted, App. G
Lyman, Richard W., § 1.3(a)

Mandatory payments, § 3.1(l)
Marital estate tax deductions, § 8.3(b)
Marital gift tax deduction, § 8.2(k)
Medical care, §§ 3.3(a), 8.2(g)
Medical research organizations, § 3.3(a)
Medical supplies, contributions of, § 24.7(b)(13)
Mill, John Stuart, § 1.3(a)
Money gifts:
in general, §§ 4.1, 6.1
timing of
check, gifts by, § 6.2
credit card, gifts by, § 6.3
telephone, gifts by, § 6.4
Multi-organization pooled income funds:
community trusts, § 13.9(b)
national organizations, § 6 13.9(a), 13.9(c)

Neilsen, Waldemar A., § 1.3(a)
Net income charitable remainder unitrusts (NICRUTs), §§ 12.1(a), 12.3(a), 12.4(g), 12.4(h)

Net income make-up charitable remainder unitrusts (NIMCRUTs), §§ 12.1(a), 12.3(a), 12.4(g), 12.4(h)
NICRUTs, *see* Net income charitable remainder unitrusts
NIMCRUTs, *see* Net income make-up charitable remainder unitrusts
Nominal appreciation, § 2.14(e)
Noncash Charitable Contributions (Form 8283)
Noncash contributions:
  reporting requirement, §§ 10.16, 24.7
  substantiation requirements, § 21.4
Noncharitable organizations:
    deductible gifts to, § 10.9
  disclosure by, § 22.3
  international giving by corporations to, § 20.4(g)
Nonprofit Almanac: Dimensions of the Independent Sector, § 1.4
Nonprofit organizations, § 1.3
  for-profit organizations, § 1.2
  public policy rationale for tax-exempt status of, § 1.3(a)
  rationales for tax-exemption eligibility of, § 1.3
  rules for creation of, § 1.2
  as sector of society, § 1.2
  tax-exempt organizations vs., § 1.2
Nonstandard contributions, § 24.7(b)(21)
Nontaxable entities, § 2.8
Notes, timing of gifts by means of, § 6.7

O'Connell, Brian, § 1.3(a)
Omnibus Budget Reconciliation Act of 1993, § 10.6
One taxpayer rule, § 20.2
On Liberty (John Stuart Mill), § 1.3(a)
Operating expenditures (nonprofit organizations), § 1.4
Option, property subject to, § 6.9
Ordinary income:
  element, ordinary income, § 4.4(b)
  in general, § 2.16(b)
  gifts of ordinary income property deduction reduction rule, § 4.4(b)
    definition, § 4.4(a)
    in general, § 4.4
    inapplicability, special rules of, § 4.4(c)

Partial interests:
  gifts of, §§ 5.3, 9.23
  life insurance, § 17.6(d)
  monthly federal interest rates used in valuation of, App. H
  valuation of
    general actuarial valuations, § 11.3
    nonstandard actuarial factors, § 11.4
    standard actuarial factors, § 11.2
    statutory law, § 11.1
Partnerships:
  in general, § 2.8
  gift reporting by, § 24.4
  gifts by, §§ 6.16, 24.7(a)
Payroll deduction plans:
  in general, 3.1(a)(i)
  recordkeeping requirements, § 21.3(a)
Penalties, §§ 10.14, 17.6(c)
Pension Protection Act of 2006, §§ 3.4, 6.15, 9.10(e), 17.7, 21.1, 21.5, 21.6
Pension rights, waiver of, § 8.2(g)
Percentage limitations:
  blending of, § 7.14
  carryback rules for, § 7.15(b)
  carryover rules for
    corporations, §§ 7.18(b), 7.19(a)
    fifty percent limitation, § 7.5(b)
    in general, § 7.4(b)
    net operating losses, § 7.15(a)
    thirty percent limitation, §§ 7.6(b), 7.8(b)
    twenty percent limitation, § 7.12(b)
  charitable lead trusts, § 16.6
  and contribution base of individual, § 7.2
  corporations
    carryover rules for, §§ 7.18(b), 7.19(a)
    general rules for, § 7.18(a)
    taxable income of, § 7.3
  fifty percent limitation
    carryover rules for, § 7.5(b)
    electable, § 7.7
    general rules for, § 7.5(a)
    and general thirty percent limitation, § 7.10
    and special thirty percent limitation, § 7.9
  in general, § 7.1
  general rules for, § 7.4(a)
  information requirements, § 7.17
  net operating loss carryovers
    carryback rules, §§ 7.15(b), 7.19(b)
    carryover rules, §§ 7.15(a), 7.19(a)
    for corporations, §§ 7.19(a), 7.19(b), 7.19(c)
    for individuals, §§ 7.15(a), 7.15(b)
  spouses, rules for, § 7.16
  thirty percent limitation
    carryover rules for, §§ 7.6(b), 7.8(b)
    and fifty percent limitation, §§ 7.9, 7.10
    general, §§ 7.8(a), 7.8(b), 7.10, 7.11
    general rules for, §§ 7.6(a), 7.8(a)
    special, §§ 7.9, 7.11
  twenty percent limitation
    carryover rules for, § 7.12(b)
    general rules for, § 7.12(a)
  use of charity gifts for, § 7.13
Permanent conservation easements, § 8.3(b)
Perpetual conservation restrictions, § 9.6(a)
Personal benefit contracts, reporting requirements, § 24.12
Personal exemption, § 2.7(a)
Personal expense deductions, § 2.5(b)
Personal holding company taxes, § 2.22
Personal property, § 2.12(b)
  intangible, § 2.12(d)
  tangible, § 2.12(c)
    future interests in, § 9.21
    timing of gifts of, § 6.11
Personal residence, contribution of remainder interests in, § 15.2(a)
Phaseout of exemptions, § 2.7(c)
Philanthropy, § 1.3(a)
Philanthropy Protection Act of 1995, § 5.9
Planned giving, § 1.1
  alternative forms of, § 5.8
  appreciated property gifts, § 5.2
  charitable gift annuities, *see* Charitable gift annuities

Planned giving, § 1.1 (*Continued*)
charitable lead trusts, *see* Charitable lead trusts
charitable remainder trusts, *see* Charitable remainder trusts
core concepts, § 5.3
in general, § 5.1
pooled income funds, *see* Pooled income funds
and securities laws, § 5.9
types of planned gifts, § 5.3
Pleasure, limitation on deduction due to, § 9.16
Pledges, charitable, § 4.9
Pluralism, § 1.3(a)
Police power (of states), § 25.3
Political organizations, transfers to, § 8.2(g)
Pooled income funds:
allocation of income from
charity, partial allocation to, § 13.3(b)
units of participation, § 13.3(a)
beneficiaries, tax status of, § 13.8
charitable contribution deduction for transfers to, § 13.11
charitable deduction, determination of, § 5.5(d)
charitable remainder trusts vs., § 13.10
commingling of property in, § 13.2(c)
deemed rates of return for transfers to new, App. I
depreciation, pass-through of, § 13.7
distributions from, §§ 5.5(c), 5.5(e)
exempt securities, prohibition on, § 13.2(d)
in general, § 5.5(a)
income of beneficiaries of, § 13.2(g)
instruments for creation of, § 5.5(g)
life income interest, termination of, § 13.2(h)
life income interests, § 13.2(b)
maintenance of, § 13.2(e)
mandatory provisions with, § 13.5
multi-organization
community trusts, § 13.9(b)
national organizations, §§ 13.9(a), 13.9(c)
and private foundation rules, § 13.6
remainder interests, § 13.2(a)
seeding of, § 5.5(h)
tax status of, § 13.8
tax treatment of, § 5.5(e)
termination of life income interest, § 13.2(h)
terminology of, § 13.1(a)
transfers, recognition of gains/losses on, § 13.4
trustee, selection of, § 5.5(f)
trustees, prohibition on, § 13.2(f)
units of, valuation/assignment of, § 5.5(b)
Poverty, relief of, § 3.2(b)
Powers of appointment (gross estate), § 8.3(a)
Preamble to the Statute of Charitable Uses, § 1.3(a)
Premiums, life insurance, § 17.2(a)
Principal-agent doctrine, §§ 6.15, 9.25, 10.2
Prior-month election rule, § 11.1
Private foundations, § 3.4(c)
charitable lead trust as, §§ 5.7(f), 16.7
charitable remainder trusts as, § 12.10
pooled income funds, rules for, § 13.6
Private inurement doctrine, § 1.2
Private operating foundations, § 3.4(b)
Private voluntary organizations, § 20.1
Profits, § 1.2
Progressivity (of tax law), § 1.6
Prohibited material restrictions, § 3.1(f)
Property:
appreciation element in gifts of, § 4.2
capital gain, gifts of
general deduction reduction rule, § 4.5(a)
long-term capital gain, §§ 4.3, 7.1
stock, qualified appreciated, § 4.5(b)
contributions of use of, § 9.18
debt, subject to, § 9.20
debt-financed, § 14.6
fair market value of, § 4.2
future interests in tangible personal, § 9.21
in general, §§ 2.12, 4.2
gifts of, §§ 4.2–4.6
intangible personal, § 2.12(d)
ordinary income
deduction reduction rule, § 4.4(b)
definition, § 4.4(a)
in general, § 4.4
inapplicability, special rules of, § 4.4(c)
personal, § 2.12(b)
pledges, charitable, § 4.9
real, § 2.12(a)
scientific research, § 9.4
and step transaction doctrine, § 4.8
tangible personal, § 2.12(c)
future interests in, § 9.21
timing of gifts of, § 6.11
for unrelated use
definition of unrelated use, § 4.6(b)
general rule, § 4.6(a)
use of, § 9.18
valuation of, *see* Valuation
variations in application of rules for gifts of, § 4.7
Public associations, § 1.3(a)
Public charitable organizations, §§ 3.4(a), 7.1
Public interest law firms, § 3.3(b)
Public international organizations, § 20.4(d)
Publications, contributions of, § 24.7(b)(3)
Publicly supported organizations, § 3.4(a)
Public policy doctrine, §§ 1.3(a), 3.3(b), 9.31

QTIP (qualified terminable interest property), § 8.3(b)
Qualified appraisal, § 21.5(a)
Qualified appraiser, § 21.5(b)
Qualified appreciated stock, § 4.5(b)
Qualified conservation contributions, § 24.7(b)(8)
Qualified conservation easements, § 8.3(b)(iv)
Qualified disclaimers, § 8.2(n)
Qualified elementary or secondary educational contributions, § 9.5
Qualified employer securities, §§ 12.2(g), 12.3(g)
Qualified gratuitous transfers, §§ 12.2(g), 12.3(g)
Qualified mineral interests, § 9.7(d)
Qualified terminable interest property (QTIP), § 8.3(b)
Quid pro quo contribution rules:
charity auctions, § 9.13(e)
disclosure requirements, §§ 22.1, 22.2
in general, § 3.1(b)

Raffles, payments for, § 3.1(b)
Ranchers, conservation contribution deduction for, § 9.7(j)

Real appreciation, § 2.14(e)
Realization of income, § 2.14(d)
Reallocation of deductions, § 10.10
Real property, gifts of:
  for conservation purposes
    definition of conservation purpose, § 9.7(c)
    and donative intent, § 9.7(h)
    exclusivity requirement, § 9.7(d)
    organizations, qualified, § 9.7(b)
    qualified real property interests, § 9.7(a)
    rehabilitation tax credit, relationship to, § 9.7(g)
    substantiation requirement, § 9.7(f)
    valuation, fair market, § 9.7(e)
  in general, §§ 2.12(a), 3.1(d), 24.7(b)(9)
  timing of, § 6.12
Rebates, credit card, §§ 3.1(h), 6.11
Recapture:
  of charitable deduction, § 4.6(c)
  of contributions by trust, § 9.22(f)
  inventory, gifts of, § 9.3(g)
Receipt requirements:
  $250 or more, contributions of, § 21.3(a)
  less than $250, contributions of, § 21.2
Recipients, charitable, § 1.1
Recognition, §§ 2.14(f), 3.1(e)
Recommendatory rights, § 3.1(f)
Registered historic districts, structure or area in, § 9.7(c)
Registration requirements, state, § 25.5
Regularly carried on, § 3.4(c)
Rehabilitation tax credit, § 9.7(g)
Relation-back doctrine, § 6.2
Religion, advancement of, § 3.2(b)
Religious organizations, § 3.2(b)
Remainder interests:
  beneficiaries of remainder interests
    CRATs, § 12.2(g)
    CRUTs, § 12.3(g)
  entire interest in property, undivided portion of, § 15.3
  in farm, § 15.2(b)
  in general, §§ 5.3, 8.7(a), 15.1
  minimum value of remainder interest
    CRATs, § 12.2(i)
    CRUTs, § 12.3(i)
  in personal residence, § 15.2(a)
  pooled income funds, § 13.2(a)
  reformations, § 8.7(c)
  will contests, § 8.7(b)
Remainder trusts, charitable, *see* Charitable remainder trusts
Reporting requirements:
  charity auctions, § 9.13(g)
  federal, ch. 24
  state, § 25.6
Residence:
  contribution of remainder interests in, § 15.2(a)
  rollover of gain in, § 2.14(f)
Retained life estates, § 8.3(a)
Retirement plan accounts, charitable contributions from:
  income in respect of decedent, § 9.10(a)
  planning for, § 9.10(b)
  potential problems and solutions with, § 9.10(c)
Revenue Act of 1913, § 1.3(a)
Revenue Act of 1936, § 18.2
Revenue Act of 1938, § 18.2
Revenue Act of 1939, § 18.2
Revenue Act of 1992, § 20.2
Revocable transfers (gross estate), § 8.3(a)
Rockefeller, John D., § 1.3(a)
Rollover, of gain in residence, § 2.14(f)

S corporation stock, gifts of:
  donee, consideration for, § 9.8(c)
  donor, considerations for, § 9.8(b)
  in general, §§ 9.8(a), 9.8(d)
S corporations, §§ 2.8, 3.2, 6.13, 6.15, 7.18(a), 9.8, 24.3, 24.7(a)
Sales tax rules (charity auctions), § 9.13(f)
Schedule M, Form 990, § 24.7(b)
Science, advancement of, § 3.3(b)
Scientific organizations, § 3.3(b)
Scientific research property, gifts of, § 9.4
Scientific specimens, contributions of, § 24.7(b)(16)
Scrivener's errors, § 12.4(i)
SCRUTs, *see* Standard charitable remainder unitrusts
SEC (Securities and Exchange Commission), § 5.9
Section 306 stock, gifts of, §§ 4.4(a), 9.9
Securities. *See also* Stock
  in general, § 2.12(d)
  gifts of, § 24.7(b)(7)
  prohibition on exempt, in pooled income funds, § 13.2(d)
  timing of gifts of, § 6.5
Securities and Exchange Commission (SEC), § 5.9
Securities Exchange Act of 1934, §§ 5.9, 14.9
Securities laws, §§ 5.9, 14.9
Seeding, of pooled income funds, § 5.5(h)
Service provider organizations, § 24.7(b)(22)
Services, contributions of, §§ 9.14, 20.3
Short-term capital gains, § 2.16(c)
Social clubs, § 1.3
Social welfare, promotion of, § 3.2(b)
Sole proprietorships, § 2.8
Special Emphasis Program, § 23.1(b)
Special events, § 23.2
Special valuation rules (estates), § 8.6(b)
Split-dollar life insurance plans, § 17.6
Split-interest trusts:
  filing requirements, § 24.13
  in general, §§ 5.3, chs. 12, 13, 16, 21.3
Spouses:
  elective share laws, §§ 12.2(d), 12.3(d)
    and marital estate tax deductions, § 8.3(b)
  and marital gift tax deduction, § 8.2(k)
  and percentage limitations, § 7.16
  split gifts between, § 8.2(m)
Standard charitable remainder unitrusts (SCRUTs), §§ 12.1(a), 12.3(a)
Standard deduction, § 2.6
State laws and regulations:
  fundraising
    contractual requirements, § 25.10
    cost limitations, fundraising, § 25.8
    disclosure requirements, § 25.11
    exemptions from, § 25.7

State laws and regulations: (*Continued*)
in general, § 25.1
historical background, § 25.2
police power of states, § 25.3
prohibited acts, § 25.9
registration requirements, § 25.5
reporting requirements, § 25.6
terminology, § 25.5
sources of, App. A
Statute of limitations, § 10.12
Stepped-up basis, § 2.14(a)
Step transaction doctrine, §§ 4.8, 9.8(b)
Stock:
exchanges of, § 2.14(f)
qualified appreciated, § 4.5(b)
Stock options, gifts of, § 6.10
Stockholders, dividends paid to charities as, § 3.1(i)
Subsistence whaling expenses, § 9.30
Substantial compliance doctrine, §§ 12.1(c), 21.2(e)
Substantial part test, § 3.3(b)
Substantiation:
$250 or more, contributions of, § 21.3
appraisal requirements, § 21.5
burden of proof rules, § 21.8
charity auctions, § 9.13(d)
clothing and household items, § 21.7
conservation purposes, gifts of real property for, § 9.7(f)
disclosure requirements, *see* Disclosure requirements
electronic, § 21.3
less than $250, contributions of, § 21.2
noncash contributions, § 2l.4
reporting requirements, § 21.7
Successor member interests, gifts of, § 10.15
Supporting foundations, § 3.4(a)
Supporting organizations, § 3.4(a)
Survivorship whole life insurance, § 17.2(b)
Sweepstakes, gifts in connection with, § 3.1(b)

Tangible personal property, § 2.12(c)
future interests in, § 9.21
timing of gifts of, § 6.11
transfers of (CRTs), § 12.4(c)
Taxable estate, § 8.3(b)
Taxable gifts:
exclusions from, § 8.2(g)
in general, § 8.2(f)
Taxable income, concept of, § 2.7
Tax benefit rule, § 12.4(i)
Tax brackets, § 2.15
Tax credits:
foreign, §§ 2.24, 9.29
in general, § 2.23
Tax Extenders and Alternative Minimum Tax Relief Act of 2008, §§ 6.15, 9.3(h), 9.3(i), 9.5, 9.10(e)
Tax-exempt organizations:
categories of, § 1.5
defined, § 1.2
examples of, § 3.3(a)
retirement plan accounts, charitable contributions from, § 9.10(c)
statistical profile of, § 1.4
Tax-exempt status, § 3.3(a)
Taxpayers, § 2.1
Tax preferences, § 1.6
Tax Reform Act of 1986, § 2.16(b)
Tax shelters, § 1.6
Tax year, § 2.9
Taxable entities, § 2.8
Taxidermy, contribution of, §§ 9.24, 24.7(b)(14)
Telephone, money gifts by, § 6.4
Term life insurance, § 17.2(b)
Terrorism, funding of, § 10.11
Thirty percent limitation:
carryover rules for, §§ 7.6(b), 7.8(b)
general limitation
and fifty percent limitation, § 7.10
general rules, § 7.8(b)
and special thirty percent limitation, § 7.11
general rules for, §§ 7.6(a), 7.8(a)
special limitation
and fifty percent limitation, § 7.9
general rules, § 7.8(a)
and general thirty percent limitation, § 7.11
Tickets, right to purchase, gift for, § 3.1(b)
Timing:
and accounting method, § 2.11(a)
and annual accounting period, § 2.1l(b)
copyright interest, gifts of, § 6.6
corporations, gifts by, § 6.13
credit card rebates, gifts of, § 6.10
of gross estate valuation, § 8.3(c)
and income taxation, § 2.11
letters of credit, gifts by, § 6.8
of money gifts
by checks, § 6.2
by credit card, § 6.3
in general, § 6.1
by telephone, § 6.4
notes, gifts by means of, § 6.7
partnerships, gifts by, § 6.14
of payment of annuity amount (from charitable remainder trust), § 12.4(g)
and percentage limitations, § 7.19(c)
property subject to option, gifts of, § 6.9
real property, gifts of, § 6.12
securities, gifts of, § 6.5
tangible personal property, gifts of, § 6.11
Total return investment principle, §§ 12.3(a)(iv), 13.8
Trade, § 3.4(b)
Trade associations, § 1.3(b)
Transactions of interest, § 10.15
Traveling expenses, limitation on deductibility of, § 9.15(a)
Treaties, international:
individuals during lifetime, giving by, § 18.6
individuals through estates, giving by, § 19.4(c)
Trust(s):
charitable lead trusts, *see* Charitable lead trusts
charitable remainder, *see* Charitable remainder annuity trusts; Charitable remainder trusts community, § 3.3(a)
contributions by
general rules for, § 9.22(a)
guaranteed annuity interests, § 9.22(b)
limitations on deductibility of, § 9.22(f)
recapture of, § 9.22(e)

unitrust interests, § 9.22(c)
valuation of, § 9.22(d)
credit maximizing, § 8.6(e)
grantor, § 3.6
income of, § 10.13
pooled income funds, § 5.5(g)
reformations of, § 8.7(c)
split-interest, § 5.3
as taxpaying entity, § 2.8(d)
wealth replacement, § 12.9
Trustees:
international transfers to, § 19.2(c)
for pooled income funds, § 5.5(f)
prohibition on, for pooled income funds, § 13.2(f)
right to change (CRTs), § 12.4(b)
Tuition, exclusion of, from gift tax, § 8.2(g)
Tuition annuity programs, § 14.3(b)
$25 Test, App. F
Twenty percent limitation:
carryover rules for, § 7.12(b)
general rules for, § 7.12(a)

Undivided portion of entire interest in property, gift of, § 15.3
Unified credit, § 8.4
Unified federal transfer tax, § 8.4
U.S. Congress, §§ 1.3, 1.3(a), 1.6, 10.6, 11.1, 17.6(b), 17.6(c), App. A
United States Olympic Team, § 3.1(b)
U.S. Supreme Court, §§ 1.3(a), 1.3(c), 2.16(a), 3.1(a), 8.3(b), 8.8
Unit plan, § 13.3(a)
Unitrust interests, §§ 5.7(a), 9.23, 12.3, 12.10(b)
Unitrusts, charitable remainder, *see* Charitable remainder unitrusts
Universal life insurance, § 17.2(b)
University endowment investment sharing, § 12.4(j)
Unreimbursed expenses, § 9.15
Unrelated business context, gift reporting in, § 24.6
Unrelated business income rules, § 3.5
charitable gift annuities, § 14.5
and definition of unrelated business, § 3.5(d)
exempted activities in, § 3.5(f)
income, exempted, § 3.5(g)
regularly carried on requirement in, § 3.5(c)
trade or business defined in, § 3.5(b)
Unrelated debt-financed income:
charitable gift annuities, § 14.6
life insurance, § 17.5
Unrelated use, gifts of property for:
definition of unrelated use, § 4.6(b)
general rule, § 4.6(a)
Use of charity, gifts for, §§ 7.13, 10.3
Use of property, contributions of, § 9.18
Used vehicles, gifts of, § 9.27

Valuation:
of art works, §§ 9.1(a), 10.1(b)
conservation purposes, gifts of real property for, § 9.7(e)
of contributions in trust, § 9.22(d)
in general, §§ 2.14, 10.1(a)
of gift transfers
basis of gifted property, § 8.2(j)
in general, § 8.2(i)
of gross estate, § 8.3(c)
of life insurance, § 17.2(c)
of partial interests
general actuarial valuations, § 11.3
nonstandard actuarial factors, § 11.4
standard actuarial factors, § 11.2
statutory law, § 11.1
of pooled income fund units, § 5.5(b)
of remainder interests, § 16.10
special valuation rules, § 8.6(b)
of vehicles, § 10.1(c)
Value, absence of, § 3.1(d)
Vehicles:
contributions of, §§ 9.27, 24.7(5)
gift reporting of, § 24.8
Voluntarism, § 1.3(a)
Volunteering/volunteers, § 1.4

Wealth replacement trusts, § 12.11
Will contests, § 8.7(b)

ISBN 978-0-470-56060-0
90000
9 780470 560600