**Charitable Contributions Deductions**

**In general.** The U.S. has allowed an income tax deduction to individual and corporate donors\(^1\) to charitable organizations since 1917,\(^2\) four years after the enactment of the federal income tax. In the typical case — a donation of cash or property to a public charity — the donor may deduct the amount of cash or the fair market value of property donated. The amount of the deduction, however, generally may not exceed (1) in the case of an individual, 50 percent of the individual’s “contribution base,”\(^3\) or (2) in the case of a corporation, 10 percent of its taxable income.\(^4\)

Even slight deviations from the plain vanilla situation, however, may call into play a variety of complex rules with the potential to change the amount of, or even wholly to deny, the charitable contributions deduction. These rules depend on the form of the gift, the type of property donated, and the nature of the donee organization. A succinct summary of some of these rules follows, below.\(^5\) Furthermore, certain sophisticated transactions — involving split-interest gifts (e.g., charitable remainder or charitable lead trusts), charitable gift annuities, pooled income funds, and the like — are subject to other detailed requirements that are generally beyond the scope of this chapter to explore.\(^6\) Because of the substantial aggregate size of charitable remainder trusts, however, a brief description of the basic fiscal rules affecting them is set out below.\(^7\)

U.S. individuals, corporations, and foundations are generous donors to charitable causes. Total charitable gifts in the U.S. were estimated to exceed $190 billion in 1999, of which nearly $144 billion came from living individuals, a further almost $16 billion repre-
sented testamentary gifts, nearly $20 billion was given by private foundations, and approximately $11 billion came from corporations.\(^8\)

**Eligible donees.** It is often said that gifts to charities, as defined in I.R.C. § 501(c)(3), are eligible for the income tax charitable contributions deduction.\(^9\) That statement, however, is both over- and under-inclusive. It is over-inclusive because gifts to organizations that test for public safety are not eligible for the deduction even though such organizations are listed in I.R.C. § 501(c)(3).\(^10\) It is under-inclusive because the Code section allowing the deduction — I.R.C. § 170(c) — mentions five types of eligible donee entities, only one of which is closely similar to those described in I.R.C. § 501(c)(3).\(^11\)

By far the most important class of eligible donees comprises entities “organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition . . . , or for the prevention of cruelty to children or animals.”\(^12\) For such entities to be eligible to receive tax-deductible gifts, three other statutory criteria must be satisfied:

- The entity must be created or organized within the United States or its possessions,\(^13\)

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\(^9\) For example, in *Bob Jones University v. United States*, Mr. Justice Powell, concurring, wrote:

> “Federal taxes are not imposed on organizations ‘operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes . . . .’ 26 U.S.C. § 501(c)(3). The Code also permits a tax deduction for contributions made to these organizations. § 170(c).” 461 U.S. 574, 605 (1983).

See also *Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 543 (1983) (“Taxpayers who contribute to § 501(c)(3) organizations are permitted by § 170(c)(2) to deduct the amount of their contributions on their federal income tax returns . . . .”).


\(^11\) The five numbered paragraphs of I.R.C. § 170(c) refer to (1) states, possessions, political subdivisions, and the District of Columbia, (2) charitable organizations (in language virtually identical to that of I.R.C. § 501(c)(3)), (3) posts or organizations of war veterans, (4) domestic fraternal societies, and (5) cemetery companies. Further conditions on eligibility are imposed under each of these paragraphs.

\(^12\) I.R.C. § 170(c)(2)(B). The quoted language is identical to that in I.R.C. § 501(c)(3) with the exception that organizations that test for public safety are included in the latter but not in the former. See text accompanying note 10, infra.

• The entity must not permit proscribed inurement of benefits to insiders,\(^\text{14}\) and
• The entity must not violate the restrictions on engaging in political campaign activity or excessive lobbying.\(^\text{15}\)

Finally, although this is not explicitly stated in the statute, the entity must not violate fundamental public policy, per the Supreme Court’s decision in \textit{Bob Jones University}.\(^\text{16}\)

Because it may be difficult for potential donors to ascertain whether a prospective charitable donee satisfies all of these conditions, the Internal Revenue Service publishes a list of eligible donees and updates it regularly.\(^\text{17}\) Donors making gifts in reliance on that published list, as modified by occasional public announcements by the Service, are generally protected even if the donee organization ceases to qualify as an eligible charity.\(^\text{18}\)

\textbf{Eligible gifts.} A “charitable contribution” is defined as “a contribution or gift to or for the use of” an eligible organization.\(^\text{19}\) There is no statutory definition of “contribution or gift.” Some early court decisions borrowed a definition from another part of the tax law,\(^\text{20}\) following a Supreme Court decision which described a “gift” for those purposes as a transfer proceeding from “detached and disinterested generosity.”\(^\text{21}\) This line of authority, however, fell into disfavor, in part because of its reliance on the subjective intent of the transferor/donor.\(^\text{22}\) More recent decisions tend to focus on objective factors. The Su-

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\(^{14}\) I.R.C. § 170(c)(2)(C).

\(^{15}\) I.R.C. § 170(c)(2)(D); Treas. Reg. § 1.170A-1(j)(5).


\(^{17}\) I.R.S. PUB. NO. 78, \textit{CUMULATIVE LIST OF ORGANIZATIONS DESCRIBED IN SECTION 170(C) OF THE INTERNAL REVENUE CODE OF 1986}, issued annually, lists all eligible charities on the IRS Master File.

\(^{18}\) See Rev. Proc. 82-39, 1982-2 C.B. 759, for a general discussion of the extent to which such reliance will be protected. The I.R.S. reserves the right to challenge deductions, even if the donee organization was listed in I.R.S. PUB. No. 78, \textit{op. cit. supra} note 17, if the donor knew of the revocation of the charity’s exempt status, was aware that it was imminent, or was in part responsible for or aware of the actions giving rise to the revocation. \textit{Id.} at § 3.01.

\(^{19}\) I.R.C. § 170(c).

\(^{20}\) I.R.C. § 102, excluding gifts from the income of the donee.


\(^{22}\) See, e.g., \textit{Singer Co. v. United States}, 449 F.2d 413 (Ct. Cl. 1971), declining to apply the \textit{Duberstein} test.
preme Court articulated the test as follows: “The sine qua non of a charitable contribution is a transfer of money or property without adequate consideration.”

Treasury regulations adopted in 1996 now state that no transfer will be treated as “a contribution or gift” unless the donor “[i]ntends to make a payment in an amount that exceeds the fair market value of the goods or services [received in exchange for the payment]” and “makes a payment in an amount that exceeds the fair market value of the goods or services.” The second leg of that test is purely objective; the first leg derives from a sentence in the American Bar Endowment decision in which the Supreme Court said “A payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return.”

Charitable gifts may be made either “to” or “for the use of” a charitable donee; this distinction affects the deduction limitation for an individual donor, and is discussed further below.

Gifts must be complete and unconditional to qualify for a deduction: retention of control by the donor, or the existence of conditions that might defeat the gift, may postpone or prevent deductibility. The Treasury Regulations state the test:


25 United States v. American Bar Endowment, 477 U.S. 105, 116 (1986) (emphasis added). Because of the substantiation requirements discussed below (see text accompanying notes 105-110, infra), the first leg of the test is not likely to have much practical significance.

26 See text accompanying notes 50-55 infra.

27 See, e.g., Rev. Rul. 73-1, 1973-1 C.B. 117 (donor’s retained option to require repayment of donated amounts fatal to deduction); Rev. Rul. 77-305, 1977-2 C.B. 72 (donor’s power to compel donee to sell donated property and accept cash instead fatal to deduction); Briggs v. Commissioner, 72 T.C. 646 (1979) (conditions on donated property not negligible; held: deduction denied), aff’d without opinion, 665 F.2d 1051 (9th Cir. 1981); 885 Inv. Co. v. Commissioner, 95 T.C. 156 (1990) (court found it “doubtful” that condition on use of donated property would be met; held: deduction denied). See also United States v. Dean, 224 F.2d 26, 29 (1st Cir. 1955). See generally Johnny Rex Buckles, The Case for the Taxpaying Good Samaritan: Deducting Earmarked Transfers to Charity Under Federal Income Tax Law, Theory and Policy, 70 Fordham L. Rev. 1243 (2002); John McGown, Jr., Major Charitable Gift — How Much Control Can Donors Keep and Chari-
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.\textsuperscript{28}

Designations of particular purposes for gifts, or imposition of conditions that are extremely unlikely to interfere with the charitable donee’s interests, are not fatal,\textsuperscript{29} but may affect valuation of the gift.\textsuperscript{30}

Gifts of less than the donor’s entire interest in the property donated do not qualify for a charitable contributions deduction.\textsuperscript{31} There are five exceptions to this rule:

\begin{itemize}
  \item Treas. Reg. § 1.170A-1(e); accord, Treas. Reg. § 1.170A-7(a)(3). The quoted language leaves room, however, for certain conditions so long as the likelihood of their occurrence is deemed “so remote as to be negligible.” The regulation goes on to confirm this:

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


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

  \item See, e.g., Rev. Rul. 85-99, 1985-2 C.B. 83, supported by G.C.M. 39,380 (July 9, 1985) (gift of land to agricultural college on condition it was to be used only for agricultural purposes; held: deduction allowed, but land valued as agricultural even though worth more if free of that restriction). Accord, Deukmejian v. Commissioner, 41 T.C.M. (CCH) 738, T.C. Memo 1981-21 (condition insisted on by donee); Fargason v. Commissioner, 21 B.T.A. 1032 (1930) (reviewed by the Board) (condition imposed by donor).
\end{itemize}
1. Gifts of remainder interests in charitable remainder trusts,\(^{32}\)
2. Gifts of lead interests in charitable lead annuity trusts or charitable lead unitrusts,\(^{33}\)
3. Gifts of an undivided interest in the entire property owned by the donor,\(^{34}\)
4. Gifts of remainder interests in a personal residence or farm,\(^{35}\) and
5. Qualified conservation donations.\(^{36}\)

Gifts of services are not eligible for a charitable contributions deduction.\(^{37}\)

**Quid pro quo.** A charitable contributions deduction is allowed for payments where goods or services are received in exchange so long as the payments to the charity exceed the value of the quid pro quo received by the donor. This long-standing position of the Service\(^{38}\) is enshrined in 1996 regulations\(^{39}\) that also provide a safe harbor for the donor to rely, in good faith, on the written statement provided by the donee setting forth the value of any goods or services received by the donor in exchange for the payment.\(^{40}\) For these purposes, the value of certain small items provided to the donor may be ignored,\(^{41}\) intangible religious benefits are not taken into account,\(^{42}\) and recognition, praise, and even naming opportunities are disregarded.\(^{43}\)


\(^{32}\) I.R.C. § 170(f)(2)(A). This includes pooled income funds as well as charitable remainder annuity trusts and charitable remainder unitrusts.


\(^{34}\) I.R.C. § 170(f)(3)(B)(i); Treas. Reg. §§ 1.170A-5(a)(2), 1.170A-7(b)(1)(i). If, however, the donor subdivides property for the purpose of avoiding this rule, no deduction is then allowed even for a donation of the entire subdivided property. Treas. Reg. § 1.170A-7(a)(2)(i).


\(^{36}\) I.R.C. § 170(f)(3)(B)(ii); 1.170A-7(b)(5) and 1.170A-14.

\(^{37}\) Treas. Reg. § 1.170A-1(g).


\(^{39}\) Treas. Reg. § 1.170A-1(h)(1).

\(^{40}\) Treas. Reg. § 1.170A-1(h)(4).


\(^{42}\) See I.R.C. § 6115(b). I.R.S. PUB. NO. 1771, CHARITABLE CONTRIBUTIONS — SUBSTANTIATION AND DISCLOSURE REQUIREMENTS 5 (2002), states:
Perhaps the most important controversy about charitable contributions and quid pro quo amounts involved the Church of Scientology. The saga began in 1978 when the I.R.S. ruled that no deduction was available to a donor who received, in exchange for the donation, “auditing,” “training,” and “processing” courses, and other services.\textsuperscript{44} The ruling explicitly referred to and was aimed at the Church of Scientology. At that time, the Service conceded that Scientology was a bona fide religion and that the Church of Scientology was entitled to tax exemption under I.R.C. § 501(c)(3). After lengthy litigation, the Service’s position denying deductions to some donors was sustained by the Supreme Court.\textsuperscript{45}

While these charitable deduction cases were wending their way to the Supreme Court, the I.R.S. changed its view about Scientology and directly attacked the tax-exempt status of Scientology organizations. It argued that they were not tax exempt because they permitted personal inurement (to the benefit of L. Ron Hubbard), conducted extensive commercial activities, and contravened fundamental public policy by violating the law. Here, again, the Service was sustained by the courts.\textsuperscript{46}

Meanwhile, many — perhaps hundreds — of donors to Scientology were contesting their own deductions. The organization itself was engaged in massive ongoing litigation with the I.R.S. L. Ron Hubbard died. Finally, on October 1, 1993, the Service and the Scientologists announced a settlement under which the Scientology organizations would be recognized, once more, as tax exempt. The details were not then revealed, but attorneys involved in the matter hinted that this resulted from the cessation of private inurement (L. Ron Hubbard was, after all, deceased) and an agreement to discontinue any further violations of law.


\textsuperscript{44} Rev. Rul. 78-189, 1978-1 C.B. 68.

\textsuperscript{45} Hernandez v. Commissioner, 490 U.S. 680 (1989), a five-to-two decision with two Justices recusing.

\textsuperscript{46} E.g., Church of Scientology of California, 83 T.C. 381 (1984), aff’d on other grounds, 823 F.2d 1310 (9th Cir. 1987), cert. denied, 486 U.S. 1015 (1988).
Then, in November of 1993, the IRS issued a ruling which “obsoleted” the 1978 ruling that had started the entire process.\(^{47}\) This flustered and confused many observers. On the one hand, there is often no substantive meaning to the IRS’s action in declaring one of its prior precedents obsolete. On the other hand, however, it appeared that the Service might be giving up a position which it had litigated to and won in the Supreme Court. And, after all, that victory in *Hernandez* was based on the stipulation that Scientology was entitled to tax-exempt status, so the restoration of such status to the organizations should not have changed the result in the ruling.

The terms of the settlement between the Scientology organizations and the Service were confidential, so no details were available which might have explained the 1993 ruling’s reversal of the 1978 ruling.\(^{48}\) Finally, on Dec. 31, 1997, the alleged text of the Oct. 1, 1993, closing agreement between the Scientology organizations and the Internal Revenue Service was made public.\(^{49}\) The lengthy (over 50-page) agreement imposes very strict restraints on the governance and operations of the Scientology organizations, using many of the standards, and often the exact words, of the statutory provisions regulating the conduct of private foundations. Nothing in the closing agreement, however, explains the Service’s change of stance vis-à-vis the deductibility of gifts to Scientology in exchange for “auditing,” “training,” and “processing” courses, and other services.

**Limitations and carryovers.** The 50 percent limitation is generally available for gifts made by individuals “to” a public charity.\(^{50}\) Gifts “for the use of” public charities are deductible only up to 30 percent of the individual donor’s contribution base.\(^{51}\) The Supreme Court has said that “a gift or contribution is ‘for the use of’ a qualified organization when it is held in a legally enforceable trust for the qualified organization or in a similar legal arrangement.”\(^{52}\) Gifts of an income interest in property, whether or not in trust, are


\(^{48}\) The 9th Circuit Court of Appeals recently analyzed the Service’s unwillingness to disclose the Scientology closing agreement, and, after lengthy discussion, rejected the government’s view “that the closing agreement made with the Church of Scientology, or at least the portion establishing rules or policies that are applicable to Scientology members generally, is not subject to public disclosure.” *Sklar v. Commissioner*, 282 F.3d 610, 618 (9th Cir. 2002), affirming *T.C. Memo. 2000-118*.

\(^{49}\) The full text of the closing agreement can be found at 19 EXEMPT ORG. TAX REV. 227 (1998). None of the parties to the closing agreement has authenticated the text, but none has denied its accuracy either.

\(^{50}\) See text accompanying note 3, supra.

\(^{51}\) I.R.C. §§ 170(b)(1)(A) & (B). The third sentence of Treas. Reg. § 1.170A-8(b) reads, “To qualify for the 50-percent limitation the contributions must be made ‘to’, and not merely ‘for the use of’, one of the specified organizations.”

treated as made “for the use of” the charitable recipient, but gifts of a remainder interest are generally treated as made “to” the charitable recipient. Unreimbursed expenses incurred in connection with rendering services to a charity are deductible and are treated as made “to” the charity, even though no deduction is permitted for a donation of services themselves.

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

An individual’s gifts to private foundations generally may only be deducted up to 30 percent of the individual’s contribution base. Furthermore, gifts of appreciated capital gain property to private foundations generally are subject to two additional adverse rules: (1) a special reduction rule discussed below and (2) a still smaller, 20 percent limitation.

There appears to be some, albeit opaque, fiscal purpose behind the creation of three separate limitations — 50 percent, 30 percent, and 20 percent — for individual charitable contributions. It may be doubted whether that purpose outweighs the resulting complexity.

54 Id.
55 Rev. Rul. 84-61, 1984-1 C.B. 39, accepting the result in Rockefeller, note 52 supra. This position is now enshrined in the regulations. Treas. Reg. § 1.170A-1(g).
60 See text accompanying note 74, infra.
Gifts by corporations are subject to a more straightforward, single 10-percent-of-taxable-income limitation.\textsuperscript{62} Corporations on the accrual basis of accounting may elect to treat certain charitable gifts made after the close of a given taxable year, but before the 15\textsuperscript{th} day of the third month thereafter, as having been made during the taxable year;\textsuperscript{63} the election is not available to S corporations.\textsuperscript{64}

Amounts disallowed by any of the limitations may be carried forward for five years and may be deducted in the future years to the extent to which the donor’s gifts made in such years are less than the relevant limitations.\textsuperscript{65} The computations may be complex, particularly if more than one of the relevant limitation percentages is involved.\textsuperscript{66}

**Special reduction rules.** Three special rules may apply to reduce the amount of a charitable contributions deduction:

- Charitable donations of property must be reduced by the amount of any ordinary income that would have been recognized if the donor had sold the property for its fair market value.\textsuperscript{67} For example, if an artist donates one of her own paintings, her deduction is limited to her basis in the painting, i.e., the cost of the canvas, frame, paints, etc.\textsuperscript{68}

- Charitable donations of tangible personal property, if the donee puts the property to an unrelated use, must be reduced by the amount of any long-term capital gain.

\textsuperscript{62}I.R.C. § 170(b)(2). Taxable income for this purpose is computed without regard to net operating loss carrybacks, deductions for dividends received, capital loss carrybacks, the charitable contributions deduction, and certain other deductions. Ibid.; Treas. Reg. § 1.170A-11(a). The limitation had been 5 percent; it was increased to 10 percent by the Economic Recovery Tax Act of 1981, § 263(a), Pub. L. No. 97-34, 95 Stat. 172, 264.

\textsuperscript{63}I.R.C. § 170(a)(2). The election is made by attaching a written declaration to the corporation’s tax return for the year. Treas. Reg. § 1.170A-11(b)(2). Prudence suggests careful compliance even though the courts and the Service have shown some flexibility in forgiving procedural foot-faults. Columbia Iron & Metal Co. v. Commissioner, 61 T.C. 5 (1973), acq. 1979-2 C.B. 1. The election may be made as to a portion as well as to all of the donations made during the 2\½ month window. Rev. Rul. 57-228, 1957-1 C.B. 506.


\textsuperscript{66}See, e.g., Treas. Reg. §§ 1.170A-10 (for individuals) and 1.170A-11(c) (for corporations).

\textsuperscript{67}I.R.C. § 170(e)(1)(A).

\textsuperscript{68}Treas. Reg. §§ 1.170A-4(a)(1) and 1.170A-4(b)(1) (which specifically states that “a work of art created by the donor” is “ordinary income property”). Accord, Maniscalco v. Commissioner, 37 T.C.M. 1174 (1978), aff’d per curiam, 632 F.2d 6 (6th Cir. 1980), denying the taxpayer a charitable contributions deduction for a gift to charity of three portraits he painted.
that would have been recognized if the donor had sold the property for its fair market value.\textsuperscript{69} It is clear that a sale by the donee is an unrelated use, thus triggering the reduction.\textsuperscript{70} When the donated property is retained by the donee, the I.R.S. has opined that:

\begin{quote}
“a direct and functional use test must be applied [for determining what is unrelated use]. Where a donee does not intend actually to use contributed appreciated personality in carrying out its specific exempt purposes, we believe the Code requires the amount of the charitable contribution otherwise allowable to be reduced.”\textsuperscript{71}
\end{quote}

Applying that standard, the Service held that display of donated art by a medical school does not constitute “related use,” and thus the donor must reduce the amount of its gift under this rule. By contrast, “if a painting contributed to an educational institution is used by that organization for educational purposes by being placed in its library for display and study by art students, the use is not an unrelated use . . . .”\textsuperscript{72} Because a donor may not always know the actual use to which donated property is put by the donee, some safe-harbor rules are provided in regulations.\textsuperscript{73}

- Charitable donations of property to a private foundation must be reduced by the amount of any long-term capital gain that would have been recognized if the donor had sold the property for its fair market value.\textsuperscript{74} An important exception permits gifts of certain “qualified appreciated stock” without any such reduction. The stock must be quoted on an established securities market, and not more than 10 percent of the corporation’s outstanding stock may be so contributed.\textsuperscript{75}

\textsuperscript{69} I.R.C. § 170(e)(1)(B)(i).

\textsuperscript{70} Treas. Reg. § 1.170A-4(b)(3)(i). I.R.C. § 6050L requires donees to report to the I.R.S., with a copy to the donor, if any donated property is sold or disposed of within two years after its receipt.

\textsuperscript{71} G.C.M. 38,804 (October 15, 1981).

\textsuperscript{72} Treas. Reg. § 1.170A-4(b)(3)(i) (emphasis added).

\textsuperscript{73} Treas. Reg. § 1.170A-4(b)(3)(ii).

\textsuperscript{74} I.R.C. § 170(e)(1)(B)(ii).

\textsuperscript{75} I.R.C. § 170(e)(5). This exception has had a stuttering history: it was enacted by the Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 301(b), 98 Stat. 494, 778; it expired at the end of 1994, but was re-enacted, effective July 1, 1996, in § 1206(a) of the Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755, 1776, with a new “sunset” date of May 31, 1997. That 1997 sunset date, in turn, passed without legislative extension, but the Taxpayer Relief Act of 1997, § 602(a), Pub. L. No. 105-34, 111 Stat. 788, 862, retroactively revived it and extended it to June 30, 1998. It again expired on June 30, 1998, but was once more retroactively resuscitated and this time made permanent by the Tax and Trade Relief Extension Act of 1998, § 1004(a), 112 Stat. 2681,
Any reduction under these three rules is forever lost, i.e., no carryover is provided in such cases.

**Split Interest Trusts.** There are two broad categories of split-interest charitable trusts: charitable *lead* trusts (in which the charitable beneficiary’s interest precedes the interest of non-charitable beneficiaries) and charitable *remainder* trusts (in which the reverse is true). Because the aggregate assets that have been donated to charitable remainder trusts (“CRTs”) are much greater than those in charitable lead trusts, this brief discussion focuses only on CRTs. Pooled income funds, a special form of CRT, are not described. As of 1998, the aggregate assets of CRTs exceeded $64 billion.

CRTs come in two flavors: charitable remainder annuity trusts (“CRATs”) and charitable remainder unitrusts (“CRUTs”). Both have a charitable beneficiary that becomes entitled to the trust assets after the termination of a predecessor non-charitable beneficiary’s interest. The lead, non-charitable interest may either be for a fixed term

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2681-888, which amended I.R.C. § 170(e)(5) by striking from it subparagraph D, that had contained the sunset provision. This last amendment was made effective for “contributions made after June 30, 1998.”

As of 1998, the total fair market value of assets in charitable lead trusts amounted to approximately 11 percent of the total fair market value of assets in all split-interest charitable trusts. Interview with Melissa J. Belvedere, Economist, Special Studies Special Projects Section, Statistics of Income Division, Internal Revenue Service (Feb. 8, 2002).


Melissa J. Belvedere, Charitable Remainder Trusts, 1998, STATISTICS OF INCOME BULLETIN, Winter 2000-01, at 58. These data were derived from more than 20,000 returns filed by charitable remainder annuity trusts and nearly 65,000 returns filed by charitable remainder unitrusts. Id. at 60, 64.

I.R.C. §§ 664(d)(1) and (2) respectively.

I.R.C. §§ 664(d)(1)(A) and (C), 664(d)(2)(A) and (C).
(not to exceed 20 years) or for the life or lives of the non-charitable beneficiary(ies).\textsuperscript{81} The value of the charitable remainder interest — determined on a present-value basis after subtracting the value of the lead, non-charitable interest — cannot be less than 10 percent of the net fair market value of the donation to the trust.\textsuperscript{82} In a CRAT, the lead interest is an annuity, i.e., a fixed annual amount specified or calculable at the inception of the trust; the annuity amount cannot be less than 5 percent nor greater than 50 percent of the initial value of the trust.\textsuperscript{83} In a CRUT, the lead interest is a fixed annual percentage (specified at the inception of the trust) of the trust assets valued at least once a year; the percentage cannot be less than 5 percent nor greater than 50 percent.\textsuperscript{84} Thus, the non-charitable beneficiary of a CRAT is entitled to receive the same amount every year regardless of the value of the trust, whereas the non-charitable beneficiary of a CRUT is entitled to receive an amount that varies from year to year depending on the value of the trust.

A donor to a CRT is entitled to a charitable contributions deduction for a portion of the fair market value of the money and property donated to the trust.\textsuperscript{85} No deduction is permitted unless the trust is either a CRAT or a CRUT;\textsuperscript{86} thus, no deduction is permitted for a donation to a trust in which the interest of the lead non-charitable beneficiary is defined solely by reference to the trust’s “income.”\textsuperscript{87} The amount of the deduction is cal-

\textsuperscript{81} I.R.C. §§ 664(d)(1)(A), 664(d)(2)(A).
\textsuperscript{82} I.R.C. §§ 664(d)(1)(D), 664(d)(2)(D).
\textsuperscript{83} I.R.C. § 664(d)(1)(A).
\textsuperscript{84} I.R.C. § 664(d)(2)(A). If the trust holds assets that do not have a readily-ascertainable fair market value, they must be appraised either by an independent trustee or a qualified appraiser. Treas. Reg. § 1.664-1(a)(7).
\textsuperscript{85} The income tax deduction is available under I.R.C. §§ 170(a)(1), 170(c), and 170(f)(2)(A). A gift tax deduction is available under I.R.C. §§ 2522(a) and 2522(c)(2)(A). An estate tax deduction is available under I.R.C. §§ 2055(a) and 2055(e)(2)(A). CRTs may be, and commonly are, created by testamentary gift as well as during a donor’s life. It is often prudent, in drafting the CRT documents, to restrict the eligible charitable beneficiaries to organizations that meet all of the relevant definitions, i.e., for income and gift and estate tax purposes; this insures eligibility for each of those tax regimes.
\textsuperscript{86} I.R.C. § 170(f)(2)(A) denies the income tax deduction; see also Treas. Reg. § 1.170A-6(b)(1). I.R.C. § 2522(c)(2)(A) denies the gift tax deduction, and I.R.C. § 2055(e)(2)(A) denies the estate tax deduction. A deduction is allowed for donations to pooled income funds, as the above subparagraphs of the Code confirm, but (as mentioned above) pooled income funds are outside the scope of the current discussion.
\textsuperscript{87} A deduction is permitted, however, for a contribution to a CRUT that either pays (a) the lesser of income or a fixed percentage of the value of its assets (I.R.C. § 664(d)(3)(A)), or (b) that lesser amount with an extra payment out of income in a later year to make up for earlier year shortfalls when trust income was less than the unitrust amount (I.R.C. § 664(d)(3)(B)). The former exception is sometimes referred to as a “net income CRUT” or “NICRUT”; the latter is sometimes referred to as “net income with make-up CRUT” or
culated by apportioning the value of the donation to the CRT between the non-charitable lead interest and the charitable remainder interest\(^{88}\) using an interest rate (or discount factor) that is fixed by the I.R.S. every month. The interest rate varies according to market interest rates on U.S. government mid-term bonds.\(^{89}\) The present value of the remainder interest is usually treated as paid “to,” rather than merely “for the use of” the charitable remainderman;\(^{90}\) therefore, it may qualify for the higher, 50 percent limitation if the remainder beneficiary is a public charity.\(^{91}\)

The CRT itself is exempt from income taxes so long as it does not generate unrelated business income.\(^{92}\) Thus, gifts to CRTs of appreciated property may be advanta-
geous, as the donor is not taxed, at the time of contribution, on the unrealized gain and the CRT is not taxed on the gain even when it is realized upon actual sale of the property by the CRT. A CRT is subject to some, but not all, of the private foundation excise tax rules (discussed elsewhere in this chapter): in all cases, the self-dealing prohibitions and the rules against expenditures for prohibited purposes apply; in certain unusual situations, the excess-business-holdings and jeopardy-investment rules may also apply.

A lead, non-charitable beneficiary is taxable on annuity or unitrust amounts paid by the CRT under a four-tier system of tracing income from the CRT to the beneficiary. The details are beyond the scope of this chapter. CRTs are subject to other highly complex and technical rules that the Service tends to enforce with rigorous and remorseless rigidity.

**Deduction floor.** An individual’s itemized income tax deductions, including those for charitable donations, must be reduced by the lesser of (i) three percent of the excess of adjusted gross income over the “applicable amount” or (ii) 80 percent of itemized deductions. The “applicable amount” was $100,000 when the statutory provision was

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94 These latter rules apply if there is a charitable lead beneficiary in addition to one or more lead, non-charitable beneficiaries. I.R.C. §§ 4947(a)(2), 4947(b)(3)(B).

95 I.R.C. § 664(b). Thus, gain realized by the trust upon sale of donated appreciated property may, under some circumstances, be taxed in whole or part to the lead, non-charitable beneficiary.


98 I.R.C. § 68(a). Not all itemized deductions are included for this purpose: medical expenses, investment interest, and casualty or theft losses are excluded. I.R.C. § 68(c).
adopted in 1990, but it is subject to inflation adjustments and is $137,300 for calendar year 2002. Legislation adopted in 2001 schedules the phase-out of this floor beginning in 2006, with total repeal slated for 2010; the repeal itself, however, is scheduled to be repealed (thus fully restoring the floor) in 2011.

This provision is not even handed: taxpayers in different states or with different housing arrangements may be affected differently. That is because the affected itemized deductions are, in addition to the charitable contributions deduction, those for mortgage interest and for state and local taxes. Homeowners making payments on mortgages and persons living in states with income taxes often will incur such expenses in excess of the deduction floor. Because such payments are not discretionary, the deduction floor, from one point of view, will not adversely affect their charitable donations deduction. In contrast, people living in rented housing or in states with low or no income taxes may experience this deduction floor primarily against their charitable gifts.

**Substantiation and Valuation.** Under long-standing regulations, a charitable contributions deduction is only available if proper substantiation is maintained by the donor. In some cases, this includes obtaining a “qualified appraisal” of the value of property donated. In 1993, Congress added two further requirements. The first mandates do-

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99 I.R.C. § 68(b)(1).
100 I.R.C. § 68(b)(2).
104 For an insightful discussion of the floor, see Reed Shuldiner & David Shakow, Lessons from the Limitation on Itemized Deductions, 93 Tax Notes 673 (2001).
105 Treas. Reg. § 1.170A-13 is captioned “Recordkeeping and return requirements for deductions for charitable contributions.” It is about 16 pages long and was adopted in substantially its current form on Dec. 26, 1984, by T.D. 8002, 49 Fed. Reg. 50,663 (Dec. 31, 1984). The second sentence of I.R.C. § 170(a)(1) cautions that “[a] charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.”
106 Treas. Reg. § 1.170A-13(c), dealing with deductions in excess of $5,000 for certain charitable contributions of property.
nors to obtain a “contemporaneous written acknowledgment”\textsuperscript{108} from the charitable donee for gifts of $250 or more.\textsuperscript{109} The second imposes burdens on donees, not donors, to provide written notice of the existence and amount of any quid pro quo provided to a donor of more than $75.\textsuperscript{110}

Because a charitable contributions deduction is often allowed for the fair market value of donated property, disputes arise about how to fix that value. The standard definition for this purpose reads:

“The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.”\textsuperscript{111}

The determination of fair market value is very fact specific. Thus, despite a large number of litigated cases, controversies continue to emerge regularly. The Internal Revenue Service publishes a helpful valuation guide for its appeals officers.\textsuperscript{112}

Special procedures provide guidance on these provisions for donors and for donee charities. See also Robert A. Boisture, IRS Issues Final Regulations Clarifying Rules on Valuing and Substantiating Charitable Contributions, \textit{16 Exempt Org. Tax Rev.} 457 (1997).

\textsuperscript{108} To be “contemporaneous” the acknowledgment be received by the date the donor’s tax return is filed or due to be filed. I.R.C. § 170(f)(8)(C); Treas. Reg. § 1.170A-13(f)(3). In the wake of the September 11, 2001, terrorist attacks, the Service extended the deadline to October 15, 2002, for donors who made gifts after that date. Notice 2002-25, 2002-15 I.R.B. ___.


\textsuperscript{110} I.R.C. §§ 6115 and 6714. The $75 is a gross figure, i.e., the new requirements apply whenever the gross amount transferred exceeds $75, even though — after deducting the value of the quid-pro-quo amount — the charitable contributions deduction is less than $75.

\textsuperscript{111} Treas. Reg. § 1.170A-1(c)(2). Similar, if not identical, language appears in several other places in the regulations, e.g., Treas. Reg. §§ 1.412(c)(2)-1(c)(1), 1.611-1(d)(2), 1.631-1(d)(2), 1.897-1(o)(2)(ii), 1.1445-1(g)(7), 20.2031-1(b), 20.2031-6(a), 25.2702-2(c)(1).

dures apply to gifts of art, and an I.R.S. Art Advisory Panel meets in closed session, several times each year, in order to determine the authenticity and fair market value of works of art. The meetings are closed in order to protect the confidentiality of taxpayer information presented to the Panel.

**Non-Itemizers.** Taxpayers may elect either to itemize their deductions or to take a "standard deduction" instead. Most — more than 70 percent — choose the standard deduction. As a result (1) they cannot claim an itemized charitable contributions deduction and (2) they are entitled instead to the simpler, and at least sometimes more generous, standard deduction. Because the amount of the standard deduction does not vary with actual charitable donations, and is in lieu of certain other deductions as well, it provides no incentive to make charitable gifts, and it treats equally those nonitemizers who donate to charity and those who do not. There is an unavoidable policy tension here: between simplification of taxpayer compliance burdens, on the one hand, and a desire for improved incentives and horizontal equity among taxpayers, on the other.

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

115 I.R.C. § 63(e).

116 "For 2001, an estimated 110.3 million returns, or 72.1 percent of all filers, will utilize the standard deduction, while an estimated 42.7 million returns, or 27.9 percent of all filers, will itemize." II STAFF OF JOINT COMM. ON TAX’N, STUDY OF THE OVERALL STATE OF THE FEDERAL TAX SYSTEM AND RECOMMENDATIONS FOR SIMPLIFICATION, PURSUANT TO SECTION 9022(3)(B) OF THE INTERNAL REVENUE CODE OF 1986 (JCS-3-01) 34 (Comm. Print 2001).

117 For taxable years beginning in 2001, the standard deduction is $4,550 ($7,600 for a joint return of married individuals) for individuals who are less than 65 years old and are not blind. I.R.C. § 63(c). Individuals or couples whose charitable contributions exceed those limits are likely to elect to itemize their deductions to claim those higher deductions. However, because the standard deduction is in lieu of certain other deductions as well as the charitable contributions deduction, and because there is some cost in preparing the more-detailed tax return required to be filed by itemizers, there is not a one-to-one correspondence between the amounts given to charity and the decision whether to itemize.

From 1982 to 1986, a nonitemizer charitable contributions deduction was allowed, phasing in during the earlier years until fully effective in 1986. It terminated after 1986 and later was completely repealed. Restoration of the nonitemizer charitable contributions deduction has since been a favorite goal of charitable organizations. The design of any such deduction should respond to the various policy considerations and tensions among them; some of these will be discussed below.

**Cross-border issues.** No income tax charitable contributions deduction is allowed unless the charitable donee is organized within the United States. This limitation is subject to two important qualifications. First, eligible U.S. charitable donees may use their funds abroad for charitable purposes. Second, a donor may donate to a U.S. charity

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119 The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 121(a), 95 Stat. 172, 196, added section 170(i) to the Internal Revenue Code and made conforming changes to other relevant Code sections. Section 170(i) provided for a nonitemizer charitable contributions deduction subject to phase-in and limitation, as follows: for taxable years beginning in 1982 or 1983, the deduction was 25 percent of the donation not to exceed $100; for taxable years beginning in 1984, the deduction was 25 percent of the donation not to exceed $300; for taxable years beginning in 1985, the deduction was 50 percent of the donation with no limitation; and for taxable years beginning in 1986 and thereafter, the deduction was 100 percent of the donation with no limitation.

120 The original enactment, by its own terms, did not apply “to contributions made after December 31, 1986.”


122 See text accompanying notes 195-199, infra.

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

124 The legislative history to the 1938 legislation (see note 123, supra) explicitly confirmed this. H.R. REP. NO. 1860, 75th Cong., 3d Sess. 19-20 (1938). Treasury Regulations state that “all, or some portion, of the funds of the [donee] organization may be used in foreign countries for charitable or educational purposes.” Treas. Reg. § 1.170A-8(a)(1). For inexplicable reasons, however, U.S. corporate donors are only allowed a deduction for donations to a U.S. corporate charity (as opposed to a non-corporate trust, community chest, or fund) if that domestic charity in turns uses its funds abroad. I.R.C. § 170(c)(2); Rev. Rul. 69-80, 1969-1 C.B. 65.
that, in turn, donates to a foreign charity. However, the Service has denied deductions, in such a case, if the intermediate U.S. charity is a mere conduit, i.e., if “the domestic organization is only nominally the donee” but “the real donee is the ultimate foreign recipient.” The deduction nevertheless may be allowed even if the intermediate U.S. donee gives funds only to a particular named foreign entity; such U.S. intermediate entities are sometimes called “friends of” organizations because they are frequently so named. The intermediate donee must not be bound, by any charter or by-law provision, to deliver the funds to the foreign charity; gifts by the intermediate donee to the foreign charity must be within the charitable mission and purpose of the U.S. intermediate entity; and the U.S. intermediate entity must exercise some appropriate level of scrutiny over the foreign donee to make sure that it qualifies as an eligible charity.

The above place-of-organization limitation does not apply for purposes of the gift tax or estate tax. The Internal Revenue Code, however, generally requires charities (other than certain religious groups or very small organizations) to notify the Service, and to apply for a determination letter confirming their charitable status, within 27 months of their organization. This requirement applies to foreign charities unless they derive less...

131 I.R.C. § 508(a) mandates the notice requirement. Treas. Reg. § 1.508-1(a)(2)(i) prescribes the use of a Form 1023 and states that it must be filed within 15 months from the end of the month of organization. Section 4.01 of Rev. Proc. 92-85, 1992-2 C.B. 490, grants an automatic 12-month extension of this 15-month time period.
than 15 percent of their “support”\textsuperscript{132} from U.S. sources.\textsuperscript{133} A foreign charity that is not excused from this requirement but that fails to comply with it is not “treated as an organization described in section 501(c)(3)”\textsuperscript{134} and donors to it may be denied gift tax and estate tax charitable contributions deductions for their gifts.\textsuperscript{135}

Because they are generally exempt from taxation, neither U.S. private foundations nor U.S. public charities need a charitable contributions deduction. They are, therefore, untouched by the place-of-formation rule\textsuperscript{136} that affects individual and corporate donors. They do, however, have other concerns when making grants to foreign charities. Domestic private foundations making grants to foreign organizations may deal with those concerns either by making a so-called “foreign equivalency” determination or by exercising expenditure responsibility. Either course of action can address the three particular issues such private foundations confront:

1. Grants to non-operating private foundations generally are not “qualifying distributions,”\textsuperscript{137}

2. A grant to a private foundation (unlike one to a public charity) may be a taxable expenditure;\textsuperscript{138} and

3. A grant may be a taxable expenditure if it is used by the donee for non-charitable purposes.\textsuperscript{139}

If a U.S. private foundation so chooses, it may cope with each of these by analyzing whether its foreign donee is a properly qualified organization. This path requires testing

\textsuperscript{132} For this purpose, “support” includes gifts, grants, contributions, membership fees, gross receipts from admissions or sales or furnishing facilities, and net income from unrelated business activities, but does not include “gross investment income.” I.R.C. §§ 4948(b), 509(d) and (e). Gifts, grants, contributions, and membership fees paid by U.S. persons are treated as from U.S. sources. Treas. Reg. § 53.4948-1(b).

\textsuperscript{133} I.R.C. § 4948(b) and Treas. Reg. § 53.4948-1(b). Under certain circumstances, even such excepted foreign charities may cease to be eligible to receive donations that are deductible for gift and estate tax purposes if they engage in a “prohibited transaction” and the Commissioner so notifies them. I.R.C. § 4948(c); Treas. Reg. § 53.4948-1(c) and (d).

\textsuperscript{134} I.R.C. § 508(a).

\textsuperscript{135} I.R.C. §§ 508(d)(2)(B), 2055(e)(1), 2522(c)(1).

\textsuperscript{136} See text accompanying notes 123-129, supra.

\textsuperscript{137} I.R.C. § 4942(g)(1)(A)(ii). There is an exception for certain donee pass-through private foundations, per I.R.C. § 4942(g)(3).

\textsuperscript{138} I.R.C. § 4945(d)(4). There is an exception for grants to exempt operating foundations. I.R.C. § 4945(d)(4)(A).

\textsuperscript{139} I.R.C. § 4945(d)(5), requiring that such grants be used only for purposes described in I.R.C. § 170(c)(2)(B).
how the foreign recipient is categorized under U.S. standards. To avoid the first two problems, the U.S. private foundation must conclude that its foreign donee is a public charity rather than a private foundation. If the foreign donee has not received an I.R.S. determination of its public-charity status, the regulations permit the U.S. foundation to make a good-faith judgment based either on an affidavit of the foreign donee or an opinion of counsel. To avoid the third problem, the U.S. private foundation must determine that the foreign donee is described in I.R.C. § 501(c)(3).

The Service issued procedural guidance in 1992 that substantially reduced the compliance burdens of U.S. private foundations electing to follow the foreign-equivalency route. The revenue procedure in question applies when the foreign donee does not have a determination letter from the I.R.S.; it provides a simplified method for obtaining a “currently qualified” affidavit from the foreign donee. The exact language of an acceptable form for that affidavit is set forth in the revenue procedure. A proper affidavit generally will protect all U.S. private foundations relying on it so long as it remains “currently qualified”; it will remain so unless the underlying facts change or, if financial data are important, so long as they reflect the grantee’s “latest complete accounting year.”

Because foreign equivalency determinations are often problematical, many U.S. private foundations instead elect to address the three issues, above, by exercising expenditure responsibility. Five steps are usually required: (1) a pre-grant inquiry to determine

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140 Exceptions are mentioned in notes 137 and 138, supra, but each requires its own even-more-precise foreign equivalency determination.
142 Id.
143 Treas. Reg. § 43.4945-6(c)(2)(i) protects the U.S. donor private foundation if the foreign donee is within the § 501(c)(3) definition (whether that donee is a public charity or a private foundation). The donor may make a “reasonable judgment” for this purpose. Treas. Reg. § 43.4945-6(c)(2)(ii).
145 Id., § 3.
146 Id., § 5.04. Variations are permitted. Id., § 5.01.
147 Id., § 4.01.
148 Id., §§ 4.02-4.05.
149 For example, relevant aspects of the foreign legal system may need to be researched; the organizational documents of the foreign donee often must be translated into English; those documents may have to be amended to insert proper provisions dealing with dissolution, lobbying, electioneering, and inurement; and in many cases, several years of financial data must be gathered. See generally JOHN A. EDIE & JANE C. NOBER, BEYOND OUR BORDERS: A GUIDE TO MAKING GRANTS OUTSIDE THE U.S. (2d ed. 1999). A third edition is expected to be forthcoming in 2002.
that the foreign grantee is able to fulfill the charitable purposes of the grant; (2) a written
grant agreement; (3) annual reports from the foreign grantee; (4) notifications to the
I.R.S.; and (5) ensuring that the granted funds are maintained in a segregated account. If the U.S. donor follows this path, it is no longer necessary to determine how its foreign donee would be characterized under U.S. law.\textsuperscript{151}

A U.S. public charity, although free from the three burdens discussed above,\textsuperscript{152} may also elect to determine whether its foreign donees are charitable organizations. If they are, the U.S. donor public charity is protected in making those grants; if not, it must, at the risk of losing its tax-exempt status, verify that the foreign donees used the funds for charitable purposes.\textsuperscript{153} This verification often entails taking steps similar to those taken by a private foundation exercising formal expenditure responsibility. Thus, if the public charity exercises expenditure responsibility with respect to a grant to a foreign donee, it does not have to make a foreign equivalency determination.

\textbf{Transfer taxes.} Charitable contributions are deductible for purposes of both the estate tax and the gift tax.\textsuperscript{154} Although there are minor linguistic differences within and

\begin{itemize}
\item \textsuperscript{150} For more details, see generally \textit{John A. Edie, Expenditure Responsibility Step by Step} (2001).
\item \textsuperscript{152} See text accompanying notes 137-139, supra.
\item \textsuperscript{153} Rev. Rul. 67-149, 1967-2 C.B. 133.
\item \textsuperscript{155} I.R.C. §§ 2055(a ), 2522(a). In addition, although there is no explicit charitable deduction provision in the Generation Skipping Transfer rules, charities are generally “assigned to the transferor’s generation.” I.R.C. §§ 2651(e)(3)(A) and (B). The statutory chain is a bit tedious, but the result is fairly clear: transfers to charities do not trigger the tax. See I.R.C. §§ 2601, 2611(a), 2612, 2613(a), and 2651(e)(3).
\end{itemize}
between the relevant sections, those do not portend significant legal differences for most purposes. Under both the estate and the gift tax regimes:

- The deductions are unlimited, so there is no need for any carryover provisions;
- The special reduction rules that apply for income tax purposes do not apply;
- The deduction floor that applies for income tax purposes does not apply;
- The special donation-substantiation rules that apply for income tax purposes do not apply (although general substantiation-of-deduction requirements are applicable); and
- As in the case of the income tax, no deduction is permitted for charitable gifts of partial interests, except for: (i) donations in the form of charitable lead annuity trusts or unitrusts, charitable remainder annuity trusts or unitrusts, or pooled income funds; (ii) gifts of a undivided interest in the donor’s entire property; (iii) remainder interests in personal residences and farms, and (iv) certain qualified conservation interests.

A Venn diagram of the income tax, gift tax, and estate tax charitable deduction provisions would show a considerable overlap, but also areas of each that differ from the others. It is often desirable to draft documents to focus on the intersection to ensure that the charitable donations qualify under each and all of the regimes. In almost all cases, in-

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156 They are beyond the scope of this chapter to explore. Some are cataloged at Harvey P. Dale, Foreign Charities, 48 TAX LAW. 655, 670 n. 75 (1995).

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

158 See text accompanying notes 67-75, supra.

159 See text accompanying notes 98-103, supra.

160 These special rules, under I.R.C. §§ 170(t)(8), 6115, and 6714, are discussed in the text accompanying notes 108-110, supra.

161 Treas. Reg. §§ 20.2055-1(c), 25.2522(a)-1(c).

162 I.R.C. §§ 2055(e)(2), 2522(c)(2).

163 I.R.C. §§ 2055(e)(2), 2522(c)(2).


ter vivos transfers should attempt to qualify for both income and gift tax purposes, lest an income tax deduction be allowed but a gift tax be imposed or vice-versa.

Recent legislation provides for the phase-down of both estate and gift tax rates and the eventual repeal of the estate (but not the gift) tax. The repeal, scheduled to be effective on January 1, 2010, is itself scheduled to lapse on January 1, 2011, thus fully restoring the estate tax to the Code. Because this risible state of affairs makes it very difficult to do sensible estate planning, it is very likely that Congress will revisit this and will revise either the estate tax repeal or its scheduled restoration.

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

Even if the base-defining rationale is accepted, allowing a deduction for the appreciation in value of property donated to charity, without including that increase in the in-

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170 Id., § 501(d).


173 HENRY SIMONS, PERSONAL INCOME TAXATION 50 (1938).

come of the donor, cannot be so justified.\textsuperscript{175} To that extent, it must be supported, if at all, on the grounds that it is an incentive or subsidy for giving. If it were thought desirable to preserve the deduction generally, but eliminate the harder-to-justify deduction for appreciation in value of property donated, three routes to achieve that could be followed:

1. The deduction could be limited to the adjusted basis of the property donated, i.e., the deduction for the unrealized appreciation in value could be denied, or

2. The deduction could be allowed for the full fair market value of the property donated, but the gain inherent in the property could be included in the donor’s income at the time of the gift, or

3. A deduction could be permitted for the full fair market value of the property donated, but the charitable donee could be required to pay tax on the unrealized appreciation in value at any later time when it sells or disposes of the property.\textsuperscript{176}

The first route is similar to some already in the Code for charitable gifts;\textsuperscript{177} the second and third would be novel in that context.\textsuperscript{178} The second approach requires donors to pay tax even though they do not receive any cash or property in exchange for the donated property; this is sometimes deemed undesirable as a matter of tax policy. The third route not only defers, perhaps indefinitely, the imposition of any tax on the unrealized appreciation in value, but would subject it to tax, upon later disposition of the property, at the tax rates of the donee rather than those of the donor. Consideration might be given to making the first route the default rule, but allowing donors to elect to apply the second or (with the consent of the donee) the third route in lieu of the first.

The deduction for charitable gifts can be viewed as a government matching program.\textsuperscript{179} For example, if a donor who itemizes deductions and whose top marginal tax

\textsuperscript{175} As Professor Andrews puts it, “Whatever its origin, the fair market value rule must now be viewed as a subsidy or artificial inducement, above and beyond mere tax exemption, for philanthropic giving. The magnitude of the subsidy is a function of the amount of unrealized appreciation in relation to the basis of the property and the taxpayer’s rates of tax, being greatest for taxpayers in highest brackets and with most appreciation.” William D. Andrews, \textit{Personal Deductions in an Ideal Income Tax}, 86 HARV. L. REV. 309, 372 (1972).

\textsuperscript{176} This might be accomplished, for example, by treating any such later gain as unrelated business taxable income.

\textsuperscript{177} For example, the special reduction rules discussed in the text accompanying notes 67-75, supra, tend to limit the deduction to the adjusted basis of the donated property.


bracket is 35 percent makes a $100 gift to charity, and deducts that amount from his in-
come, the net cost or “price” of the gift is $65. The government, from this viewpoint, is 
making a $35 matching grant to the charity chosen by the donor. The size of the match-
ing grant varies directly with the top tax bracket of the donor. Thus, the government of-
ers a higher match to wealthier, higher-income taxpayers than to less-wealthy, lower-
income taxpayers. This regressivity is objectionable to some on tax policy grounds; de-
defenders support it as merely an appropriate base-defining rule.

If it were thought desirable to eliminate this regressivity, a credit could be provided 
in lieu of the deduction. The amount of the credit could be calculated, at least approx-
imately, so as to involve any chosen amount of revenue loss and to simulate an equivalent 
deduction at any selected target tax rate. While this would eliminate the regressivity (be-
cause the government’s “matching grant” would then be the same at all income levels), it 
would not be possible to justify a credit of this sort under a base-defining rationale.

There is uncertainty about how much the income tax deduction for charitable giv-
ing affects amounts given to charity. Economists analyze this in terms of “price elastic-
ity”: the extent (expressed as a decimal ratio) by which a reduction in the “price” of giving

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

181 For example, the same regressivity occurs when a sole proprietor deducts expenses, 
e.g., for salaries and rent, incurred in business: a higher-income proprietor gets a greater 
benefit from those deductions than a lower-income proprietor.

182 The credit would probably have to be refundable if all taxpayers, even those with very 
low incomes, were to be treated equally.

183 For further discussions of a credit rather than a deduction for charitable giving, see 
CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING 44, 103-04 
(1985); Mark P. Gergen, The Case for a Charitable Contributions Deduction, 74 VA. L. 
REV. 1393, 1400-06 (1988); Peter J. Wiedenbeck, Charitable Contributions: A Policy Per-
spective, 50 MO. L. REV. 85, 100-02 (1988); John K. McNulty, Public Policy and Private 

184 The estate tax, of course, exerts a price effect on bequests, even though it only reaches 
fairly large estates. Some simulations have suggested that repeal of the estate tax would 
reduce testamentary charitable gifts by between 24 percent and 44 percent. Charles T. 
Clotfelter & Richard L. Schmalbeck, The Impact of Fundamental Tax Reform on Non-
profit Organizations, in ECONOMIC EFFECTS OF FUNDAMENTAL TAX REFORM 211-43 
(Henry J. Aaron & William G. Gale eds. 1996). Others disagree, believing that the wealth 
effect would overwhelm the price effect. For a more recent analysis, see JON BAKIJA, WILL-
LIAM GALE & JOEL SLEMROD, CHARITABLE BEQUESTS AND TAXES ON INHERITANCE AND ES-
w9661, May, 2003).
increases such giving. The price of a $1 donation for itemizers is one minus the donor’s top marginal tax rate. If the price declines by 10 percent (e.g., because of an increase in the donor’s top marginal tax rate), and if donations, as a result, increase by the same 10 percent, the price elasticity would be -1.0. If, however, a 10 percent reduction in price produces only an 8 percent increase in donations, the price elasticity would be -0.8. There is general agreement that the lower the price of giving, the more is given to charity, but quantifying the effect has proved to be extremely difficult. The more recent economic literature has produced estimates of price elasticity ranging from -0.5 to -1.75; the former number suggests that a 10 percent decline in the price of giving would increase long-run charitable giving by only 5 percent; the latter suggests that a price decline of 10 percent would increase long-run charitable giving by 17.5 percent. Analyzing prior writings, and taking into account other effects — particularly the so-called “crowding out” effect of tax-financed contributions — beyond price elasticities, one economist has concluded that tax incentives are treasury efficient if they exceed -0.99 (using low estimates for the amount of crowding out) or -0.56 (using high estimates).

Using newly-available panel data, several leading scholars have found differing price elasticities for “transitory,” as opposed to “permanent,” tax rate changes, concluding that the former are significantly smaller in absolute terms than the latter, which fall in the range of -0.79 to -1.26. The authors concede that their research is only a “first

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186 See the example in the text accompanying note 180, supra.

187 An April 1999 conference at the Urban Institute convened economics experts who explored this issue. A consensus emerged that there was “much uncertainty” about price elasticity, and that the issue “is far from settled.” Joseph Cordes, The Cost of Giving: How do Changes in Tax Deductions Affect Charitable Contributions?, EMERGING ISSUES IN PHILANTHROPY (Urban Institute 1999).


189 Donors of money or property are also more likely to volunteer their time. Some empirical work suggests, therefore, that beyond the price elasticity (which only measures price impact on gifts of money or property), a reduced price for donations also tends to encourage more volunteering. Eleanor Brown & Hamilton Lankford, Gifts of Money and Gifts of Time, 47 J. PUBLIC ECON. 321 (1992). See also Ellen P. Aprill, op. cit. supra note 118, at 862-64.

190 Steinberg, ___, in __ (Ben-Ner & Anheier, eds., forthcoming).

191 Panel data are longitudinal, as opposed to cross-sectional data which are static.


193 Id. at 379.
step,” and that much further work has to be done with panel data “to address how changes in expectations of future tax policies . . . affect current individual [charitable] behavior.”

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

Designing a sound nonitemizer deduction requires confronting and balancing conflicting policies:

- The standard deduction is intended to provide nonitemizers an implicit deduction in an amount sufficient to substitute for itemized deductions, including the charita-

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194 Id. at 381.
196 Independent Sector argues that “the nonitemizer deduction included in the Charity Aid, Recovery, and Empowerment Act of 2002 would likely stimulate at least $1.15 of charitable giving for every $1.00 it costs.” FACT SHEET, GIVING IN AMERICA 4 (2002), http://www.independentsector.org/PDFs/issue_brief.pdf. For a useful analysis of these issues, see Ellen R. Aprill, op. cit. supra note 118, at 857-59.
ble contributions deduction. Permitting nonitemizers to deduct charitable contributions thus raises two concerns: (1) would this erode the simplification of compliance burden fostered by the standard deduction, and (2) if a nonitemizer charitable deduction is permitted, should the amount of the standard deduction be reduced to take that into account and prevent “double dipping”?  

- Because the amounts covered by a nonitemizer deduction are relatively modest but the number of people claiming it would likely be large, the already-lean I.R.S. resources might not be able to audit those returns effectively, thus giving rise to the perception, if not the reality, of more tax fraud.  

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

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198 See the discussion of these administrative concerns in Ellen P. Aprill, op cit. supra note 118, at 859-62.

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