Tax Policy and Charities
URBAN INSTITUTE CENTER ON NONPROFITS AND PHILANTHROPY
URBAN INSTITUTE–BROOKINGS TAX POLICY CENTER

The Charitable Contribution Deduction

Section 170 Reorganized

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October 2012

URBAN INSTITUTE

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This project attempts first to clarify the current statute by reorganizing section 170 and simplifying the language, where possible, so that the operative rules will be clearer. Whether or not the Code is actually revised in accordance with the attached draft, having this tool available will help analyze the statute. Second, some (mostly modest) changes are reflected in the proposed draft. Third, the possibility of further substantial simplification is explored in the section by section analysis which follows the proposed code revision. Finally, a revision of the estate and gift tax provisions, intended to increase uniformity, is proposed. Errors are unavoidable, and the author urges readers to bring any you discover to his attention.

This paper was prepared for a conference on the charitable deduction under the auspices of the National Center on Philanthropy and the Law at NYU on October 25, 2012. As such, it has only limited discussion of issues dealt with in other conference papers, particularly substantiation rules, property donations, and the policy behind the charitable deduction.

In the draft, I have expanded **section 170(a)** in an effort to include all provisions that provide special valuation rules for the charitable deduction, including the limits on deduction of capital gain property now under subsection **(e)** and the election under **(b)** to limit deduction to basis. Subsection **(e)** in this draft is limited to treatment of donations of ordinary income property. While the line is not absolute, the restrictions on the deduction that do not seem valuation related are in subsection **(f). [**The special treatment of clothing and household goods, which remains in (f), could perhaps have been moved to (a).] New s**ection 170A** collects all the rules on partial interest gifts. New section **170B** includes the substantiation rules. A revision of the **estate and gift** tax provisions follows at the end.

Some preliminary matters first.

Credit or Deduction. I am not suggesting that the charitable deduction be replaced by either a credit or a matching grant. As I have previously discussed,[1] I do not believe the case for a deduction, either as appropriate income measurement or as more efficient than a credit in encouraging contributions, is strong. Nevertheless, the deduction has led to a particular pattern of support for charitable organizations that would be disrupted by a credit. Unless there is overriding concern with the direction of giving, a shift to a credit seems unwise even if one believes that a credit is more equitable. To support a credit, I believe one must make the argument that the current pattern of giving is inappropriate rather than focusing on equitable treatment of donors.

Non-Itemizers. I do think it would be useful to reconsider the relationship between the standard deduction and itemized expenses. The only way to reconcile the dual role of the standard deduction (as both a zero bracket amount and a simplification device) is to consider the standard deduction as a floor under the itemized deductions. However, there is no reason to believe that the floor should be equal to the appropriate zero bracket as determined by distributional concerns.[2] I think separate floors for each deduction (as we now have for casualty and medical) would be more sensible. **This would allow all taxpayers to deduct charitable contributions that exceed a specified percentage of adjusted gross income.**

Year of Allowance. We have occasionally allowed charitable deductions for contributions made after the close of the year. For example, cash contributions for relief of Indian Ocean tsunami victims made in January 2005 were deductible in 2004, and contributions to help victims of the Haitian earthquake made between January 11 and February 11, 2010, were deductible in 2009.

Gene Steuerle has suggested that the incentive for giving would increase if we generally allowed contributions on or before April 15 to be deducted in the prior year.[3] **This is worth considering if it can be reconciled with required verification by donees.**

Proposed Restructuring of Section 170[4]

Sec. 170. Charitable, etc., contributions and gifts

a) Allowance of deduction

(1) General Rule…..

(2) Corporations on Accrual Basis…

(3) *Moved to 170A(a)*

Add:

Special Measurement Rules

(3) *from 170*(*i*) Standard mileage rate for use of passenger automobile –

Limit Deduction to Basis

(4) *from 170(e)(1)(B)(ii)* Contributions to Private Foundations –

(A) In general. – Deduction for contributions of other than qualified appreciated stock as defined in subparagraph (B) to or for the use of a private foundation (as defined in section 509(a)) other than a private foundation described in subsection(b)(1)(C) **shall not exceed the basis of the property**.

(B) *from 170(e)(5)(B)* Qualified appreciated stock

(5) *from 170(e)(1)(B)(iv)* Contributions of Taxidermy Property –

(A) In general. – Deduction for contributions of any taxidermy property which 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 **shall not exceed the basis of the property**. *From 170(f)(15)(B)* For purposes of this section the term "taxidermy property" means any work of art which –

(i) is the reproduction or preservation of an animal, in whole or in part,

(ii) is prepared, stuffed, or mounted for purposes of recreating one or more characteristics of such animal, and

(iii) contains a part of the body of the dead animal

(B) *from 170(f)(15)(A)* Special basis rule for taxidermy property. – For purposes of this section and notwithstanding section 1012, in the case of a charitable contribution of taxidermy property described in this paragraph, only the costs of preparing, stuffing, or mounting shall be included in the basis of such property.

(6) *from 170(b)(1)(C)(iii)* Election of Taxpayer – At the election of the taxpayer (made at such time and in such manner as the Secretary prescribes by regulations), the deduction for contributions of all property made by the taxpayer during the taxable year **shall not exceed the basis of the property**. If such an election is made, in applying subsection (d)(1) for such taxable year with respect to contributions made in any prior contribution year for which an election was not made under this paragraph, such contributions shall be reduced to the basis of the property as if an election had been made in the year in which made.

(7) *from 170(e)(1)(B)(i)* Tangible Personal Property –

(A) In general. – Contributions of tangible personal property shall not exceed the basis of the property –

(i) if the use by the donee is unrelated to the purpose or function constituting the basis of its exemption under section 501 (or, in the case of a governmental unit, to any purpose or function described in subsection (c)), or

(ii) it is property (described in subparagraph (B)(i)) which is sold, exchanged, or otherwise disposed of by the donee before the last day of the taxable year in which the contribution was

made and with respect to which the donee has not made a certification in accordance with subparagraph (C).

(B) *from 170(e)(7)* Recapture of deduction on certain dispositions of exempt use property. –

(i) In general. – In the case of an applicable disposition of tangible personal property which is charitable deduction property (as defined in section 6050L(a)(2)(A)), there shall be included in the income of the donor of such property for the taxable year of such donor in which the applicable disposition occurs an amount equal to the excess (if any) of –

(I) the amount of the deduction allowed to the donor under this section with respect to such property, over

(II) the donor's basis in such property at the time such property was contributed.

(ii) Applicable disposition. – For purposes of this paragraph, the term "applicable disposition" means any sale, exchange, or other disposition by the donee –

(I) after the last day of the taxable year of the donor in which such property was contributed and

(II) before the last day of the 3-year period beginning on the date of the contribution of such property, unless the donee makes a certification in accordance with subparagraph (C).

(C) *from 170(e)(7)(D)* Certification. – A certification meets the requirements of this subparagraph if it is a written statement which is signed under penalty of perjury by an officer of the donee organization and –

(i) which –

(I) certifies that the use of the property by the donee was substantial and related to the purpose or function constituting the basis for the donee's exemption under section 501, and

(II) describes how the property was used and how such use furthered such purpose or function, or

(ii) which –

(I) states the intended use of the property by the donee at the time of the contribution and

(II) certifies that such intended use has become impossible or infeasible to implement.

Limit Deduction to Proceeds to Charity

(8) *from 170(f)(12)* Contributions of used motor vehicles, boats, and airplanes – In the case of a contribution of a qualified vehicle if the claimed value of the property exceeds $500, *from (F)* unless by regulations or other guidance the Secretary exempts sales by the donee organization which are in direct furtherance of such organization's charitable purpose –

(A) If the organization sells the vehicle without any significant intervening use or material improvement of such vehicle by the organization, the amount of the deduction allowed shall not exceed the gross proceeds received from such sale.

(B) In the case of a qualified vehicle to which subparagraph (A) does not apply, no deduction shall be allowed unless donee organization within 30 days of the contribution provides –

(i) a certification of the intended use or material improvement of the vehicle and the intended duration of such use, and

(ii) a certification that the vehicle would not be transferred in exchange for money, other property, or services before completion of such use or improvement.

(C) *from (f)(12)(E)* Qualified vehicle. – For purposes of this paragraph, the term "qualified vehicle" means any –

(i) motor vehicle manufactured primarily for use on public streets, roads, and highways,

(ii) boat, or

(iii) airplane.

Such term shall not include any property which is described in section 1221(a)(1).

(D) For the required acknowledgement from the donee see section 170B(d).

(9) Intellectual Property –

(A) *from 170(e)(1)(b)(iii)* In the case of a contribution of any patent, copyright, etc., the amount of the deduction allowed under this subsection shall not exceed the greater of the basis of the property or the amount determined under subparagraph (B)

(B) *Adopt from section 170(m)*

(C) *repeal or codify* ANTI-ABUSE RULES PL 108-357, Sec. 882(e).

(10) *from 170(e)(2)* Allocation of Basis – For purposes of this subsection, in the case of a charitable contribution of less than the taxpayer's entire interest in the property contributed, the taxpayer's adjusted

basis in such property shall be allocated between the interest contributed and any interest not contributed in accordance with regulations prescribed by the Secretary.

(b) Percentage limitations

(1) Individuals – In the case of an individual, the deduction provided in subsection (a) shall be limited as provided in the succeeding subparagraphs.

(A) General rule. – Any charitable contribution, other than a contribution of **any** property for which the allowable deduction **can exceed** the basis of the property, to –

(i) a church, etc.,

(ii) an educational organization, etc.,

(iii) can this be limited to hospitals,

(iv) support of state universities DELETE

(v) a governmental unit referred to in subsection (c)(1),

(vi) an organization referred to in subsection (c)(2) which normally receives a substantial part of its support, etc.,

(vii) a private foundation described in subparagraph (C), or

(viii) an organization described in section 509(a)(2) or (3),

shall be allowed to the extent that the aggregate of such contributions does not exceed 50 percent of the taxpayer's contribution base for the taxable year. For the election to limit the deduction for property contributions to basis, see (a)(6).

(B) Other contributions. – Any charitable contribution other than a charitable contribution to which subparagraph (A) applies shall be allowed to the extent that the aggregate of such contributions does not exceed the lesser of –

(i) 30 percent of the taxpayer's contribution base for the taxable year, or

(ii) the excess of 50 percent of the taxpayer's contribution base for the taxable year over the amount of charitable contributions allowable under subparagraph (A). If the aggregate of such contributions exceeds the limitation of the preceding sentence, such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution (to which subparagraph (A) does not apply) in each of the 5 succeeding taxable years in order of time.

(C) *from 170(b)(1)(F)* Certain private foundations

(D) *from 170(b)(1)(G)* Contribution base defined

(2) Corporations – In the case of a corporation –

(A) In general. – The total deductions under subsection (a) for any taxable year shall not exceed 10 percent of the taxpayer's taxable income.

(B) *from 170(b)(2)(C)* Taxable income. – For purposes of this paragraph, taxable income shall be computed without regard to...

(c) Charitable contribution defined. – For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of –

(1) A State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

(2) A corporation, trust, or community chest, fund, or foundation –

(A) 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;

(B) which is qualified for tax exemption under section 501(c)(3), including sections 501(j) and (k).

(3) *from 170(c)(3)* A post or organization of war veterans, or an auxiliary unit or society of or trust or foundation for any such post or organizations organized in the United States or any of its possessions, and no part of their net earnings of which insures to the benefit of any private shareholder or individual.

OR

(3) *from 2055(a)(4)* any veterans' organization incorporated by Act of Congress, or of its departments or local chapters or posts, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(4) **Delete or Modify as Follows** In the case of a contribution or gift by an individual, a domestic fraternal society, order, or association, operating under the lodge system, but only if such contribution or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals (*source 2055(a)(3))* if such organization would not be disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and 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;

(5) A cemetery company **DELETE**

For purposes of this section, the term "charitable contribution" also means an amount treated under subsection (g) as paid for the use of an organization described in paragraph (2), (3), or (4). See *section 170(n) (Expenses Paid by Certain Whaling Captains in Support of Native Alaskan Subsistence Whaling*.)

(d) Carryovers of excess contributions

Delete special rules for conservation easements

(e) Certain contributions of ordinary income property

(1) Limit of Deduction

(A) In general. – Except as provided in subparagraph (B) the amount of any charitable contribution of property otherwise taken into account under this section shall be reduced by the amount of gain which would not have been long-term capital gain (determined without regard to section 1221(b)(3)) if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution).

(B) *from 170(e)(3)(B)* The reduction under paragraph (1)(A) for any qualified contribution (as defined in paragraph (2)) shall be one-half of the amount computed under paragraph (1)(A)(computed without regard to this paragraph), except that the charitable contribution deduction under this section for any qualified contribution shall not exceed twice the basis of such property.

(C) (flush language (e)(1) Character of gain. –

(i) For purposes of applying this paragraph (other than in the case of gain to which section 617(d)(1), 1245(a), 1250(a), 1252(a), or 1254(a) applies), property which is property used in the trade or business (as defined in section 1231(b)) shall be treated as a capital asset.

(ii) For purposes of applying this paragraph in the case of a charitable contribution of stock in an S corporation, rules similar to the rules of section 751 shall apply in determining whether gain on such stock would have been long-term capital gain if such stock were sold by the taxpayer.

(D) *from 170(e)(3)(E)* Subparagraph (B) shall not apply to so much of the amount of the gain described in paragraph (1)(A) which would be long-term capital gain but for the application of sections 617, 1245, 1250, or 1252.

(2) For purposes of this paragraph a qualified contribution shall mean

(A) *from 170(e)(3)(B)* Care of ill, needy and infants. – A charitable contribution of property described in paragraph (1) or (2) of section 1221(a), by a corporation (other than a corporation which is an S corporation) to an organization which is described in section 501(c)(3) and is exempt under section

501(a) (other than a private foundation, as defined in section 509(a), which is not an operating foundation, as defined in section 4942(j)(3)), but only if the use of the property by the donee is related to the purpose or function constituting the basis for its exemption under section 501 and the property is to be used by the donee solely for the care of the ill, the needy, or infants *and the conditions of paragraph (3) are satisfied*;

(B) *from 170(e)(3)(C)* Food inventory. – A charitable contribution of *apparently wholesome food as defined in paragraph (3)(B)* from any trade or business of the taxpayer, in accordance with subparagraph (A), applied without regard to whether the contribution is made by a C corporation, provided that in the case of a taxpayer other than a C corporation, the aggregate amount of such contributions for any taxable year which may be taken into account under this section shall not exceed 10 percent of the taxpayer's aggregate net income for such taxable year from all trades or businesses from which such contributions were made for such year, computed without regard to this section.

(C) *from 170(e)(3)(D)* Book inventory. – A charitable contribution of books to a public school which is an educational organization described in subsection (b)(1)(A)(ii) and which provides elementary education or secondary education (kindergarten through grade 12), without regard to whether the donee is an organization described in subparagraph (A), provided the conditions of paragraph (4) are satisfied.

(D) *from 170(e)(4)* Research contributions. – A charitable contribution by a corporation other than –

(i) an S corporation,

(ii) a personal holding company (as defined in section 542), and

(iii) a service organization (as defined in section 414(m)(3))

of tangible personal property described in paragraph (1) of section 1221(a), which is scientific equipment or apparatus substantially all of the use of which by the donee is for research or experimentation (within the meaning of section 174), or for research training, in the United States in physical or biological sciences, but only if the contribution is to an organization described in subparagraph (A) or subparagraph (B) of section 41(e)(6) *and the conditions of paragraph (5) are satisfied.*

(E) *from 170(e)(6)* Qualified computer contribution. – A charitable contribution by a corporation (as limited by subparagraph (D)) of any computer technology or equipment, but only if *the conditions of paragraph (6) are satisfied* and the contribution is to

(i) an educational organization described in subsection (b)(1)(A)(ii),

(ii) an entity described in section 501(c)(3) and exempt from tax under section 501(a) (other than an entity described in clause (i)) that is organized primarily for purposes of supporting elementary and secondary education,

or

(iii) a public library (within the meaning of section 213(2)(A) of the Library Services and Technology Act (20 U.S.C. 9122(2)(A)), as in effect on the date of the

enactment of the Community Renewal Tax Relief Act of 2000), established or maintained by an organization described in subsection (c)(1).

(F) Paragraphs (B), (C), and (E) shall not apply to contributions made after December 31, 2011.

(3) Conditions for Compliance with Paragraphs (2)(A) and (B)

(A) In general. –

(i) the property is not transferred by the donee in exchange for money, other property, or services;

(ii) the taxpayer receives from the donee a written statement representing that its use and disposition of the property will be in accordance with the provisions of clause (i) and paragraph (2)(A); and

(iii) in the case where the property is subject to regulation under the Federal Food, Drug, and Cosmetic Act, as amended, such property must fully satisfy the applicable requirements of such Act and regulations promulgated thereunder on the date of transfer and for one hundred and eighty days prior thereto.

(B) *from 170(e)(3)(C)(iii)* Apparently wholesome food. – For purposes of paragraph (2)(B), the term "apparently wholesome food" has the meaning given to such term by section 22(b)(2) of the Bill Emerson Good Samaritan Food Donation Act (42 U.S.C. 1791(b)(2)), as in effect on the date of the enactment of this subparagraph.

(4) *from 170(e)(3)(D)(iii)* Conditions for Compliance with Paragraph (2)(C). – Paragraph (2)(C) shall not apply to any contribution unless in addition to the certifications required by paragraph (3)(A)**(as modified by this paragraph),**[5] the donee certifies in writing that the books are suitable, in terms of currency, content, and quantity, for use in the donee's educational programs, and the donee will use the books in its educational programs.

(5) *from 170(e)(4)(B)* Conditions for Compliance with Paragraph (2)(D)

(A) In general.

(i) the property is constructed or assembled by the taxpayer,

(ii) the contribution is made not later than 2 years after the date the construction or assembly of the property is substantially completed,

(iii) the original use of the property is by the donee,

(iv) the property is not transferred by the donee in exchange for money, other property, or services, and

(v) the taxpayer receives from the donee a written statement representing that its use and disposition of the property will be in accordance with the provisions of clauses (iv) and paragraph (2)(D).

(B) *from 170(e)(4)(C)* Construction of property by taxpayer. – For purposes of this paragraph, property shall be treated as constructed by the taxpayer only if the cost of the parts used in the construction of such property (other than parts manufactured by the taxpayer or a related person) do not exceed 50 percent of the taxpayer's basis in such property.

(6) Conditions for Compliance with Paragraph (2)(E)

(A) In general. –

(i) the contribution is made not later than 3 years after the date the taxpayer acquired the property (or in the case of property constructed or assembled by the taxpayer, the date the construction or assembling of the property is substantially completed),

(ii) the original use of the property is by the donor or the donee,

(iii) substantially all of the use of the property by the donee is for use within the United States for educational purposes that are related to the purpose or function of the donee,

(iv) the property is not transferred by the donee in exchange for money, other property, or services, except for shipping, installation and transfer costs,

(v) the property will fit productively into the donee's education plan,

(vi) the donee's use and disposition of the property will be in accordance with the provisions of clauses (iii) and (iv),

and

(vii) the property meets such standards, if any, as the Secretary may prescribe by regulation to assure that the property meets minimum functionality and suitability standards for educational purposes.

(B) Contribution to private foundation

A contribution by a corporation of any computer technology or equipment to a private foundation (as defined in section 509) shall be treated as a qualified computer contribution for purposes of this paragraph if –

(i) the contribution to the private foundation satisfies the requirements of clauses (i) and (iii) of subparagraph (A), and

(ii) within 30 days after such contribution, the private foundation –

(I) contributes the property to a donee described in paragraph (2)(E) that satisfies the requirements of clauses (iii) through (vi) of subparagraph (A), and

(II) notifies the donor of such contribution.

(C) Donations of property reacquired by manufacturer

In the case of property which is reacquired by the person who constructed or assembled the property–

(i) subparagraph (A)(i) shall be applied to a contribution of such property by such person by taking into account the date that the original construction or assembly of the property was substantially completed, and

(ii) subparagraph (A)(ii) shall not apply to such contribution.

(D) Special rule relating to construction of property. – For the purposes of this paragraph, the rules of paragraph (5)(B) shall apply.

(E) Computer technology or equipment. – The term "computer technology or equipment" means computer software (as defined by section 197(e)(3)(B)), computer or peripheral equipment (as defined by section 168(i)(2)(B)), and fiber optic cable related to computer use.

(f) Disallowance of deduction in certain cases and special rules

(1) Certain Organizations

(A) *from 170(f)(1)* – No deduction shall be allowed under this section for a contribution to or for the use of an organization or trust described in section 508(d) or 4948(c)(4) subject to the conditions specified in such sections.

(B) *from 170(k)* Communist controlled organizations. – For disallowance of deductions for contributions to or for the use of communist controlled organizations, see section 11(a) of the Internal Security Act of 1950 (50 U.S.C. 790)

(C) *from 170(f)(18)* A deduction, otherwise allowed under subsection (a) for any contribution to a donor advised fund (as defined in section 4966(d)(2)), shall not be allowed if the sponsoring organization (as defined in section 4966(d)(1)) with respect to such donor advised fund is –

(i) described in paragraph (3) (4) or (5) of subsection (c),

(ii) a type III supporting organization (as defined in section 4943(f)(5)(A)) which is not a functionally integrated type III supporting organization (as defined in section 4943(f)(5)(B)), or

(iii) not described in clause (i) or (ii) and the taxpayer fails to obtain a contemporaneous written acknowledgment as described in section 170B(e).

(2) Lobbying

(A) *from 170(f)(6)* Deductions for out-of-pocket expenditures. – No deduction shall be allowed … if the expenditure is made for the purpose of influencing legislation (within the meaning of section 501(c)(3)).

(B) *from* 170*(f)(9)* Denial of deduction where contribution for lobbying activities. – No deduction shall be allowed …… if a principal purpose of the contribution was to avoid Federal income tax by securing a deduction for such activities under this section which would be disallowed by reason of section 162(e)….

Abuse

(3) *from 170(f)*(*16*) Contributions of Clothing and Household Items –

(A) In general. – In the case of an individual, partnership, or corporation, no deduction shall be allowed under section 170(a) for any contribution of clothing or a household item unless such clothing or household item is in good used condition or better.

(B) Items of minimal value. – Notwithstanding subparagraph (A), the Secretary may by regulation deny a deduction under subsection (a) for any contribution of clothing or a household item which has minimal monetary value.

(C) Exceptions for certain property. – Subparagraphs (A) and (B)shall not apply to a single item of clothing or a household item for which a deduction of more than $500 is claimed if the taxpayer includes with the taxpayer's return a qualified appraisal with respect to the property

(D) Household items. – For purposes of this paragraph –

(i) In general. – The term 'household items' includes furniture, furnishings, electronics, appliances, linens, and other similar items.

(ii) Excluded items. – Such term does not include food, paintings, antiques, and other objects of art, jewelry and gems, and collections.

(E) Special rule for pass-through entities, etc.

Personal benefit

(4) *from 170(j)* Denial of Deduction for Certain Travel Expenses – No deduction shall be allowed under this section for traveling expenses … unless there is no significant element of personal pleasure, recreation, or vacation in such travel.

(5) *from 170(l)* Treatment of Certain Amounts Paid to or for the Benefit of Institutions of Higher Education –

(6) *from 170(f)(5)* Reduction for Certain Interest –

(7) *from 170(f)*(*10*) Split-Dollar Life Insurance, Annuity, and Endowment Contracts –

(g) Amounts paid to maintain certain students as members of taxpayer's household. –

(h) *moved to 170A(e)*

(i) *moved to 170(a)(3)*

(j) *moved to 170(f)(4)*

(k) *moved to 170(f)(1)(B)*

(l) *moved to 170(f)(5)*

(m) *moved to 170(a)(9)(B)*

(n) Expenses Paid by Certain Whaling Captains in Support of Native Alaskan Subsistence Whaling.–

(o) *moved to 170A(d)*

(p) Other cross references. –

170A Partial Interests in Property

(a) *from 170(a)*(3) Future interests in tangible personal property. – For purposes of section 170, payment of a charitable contribution which consists of a future interest in tangible personal property shall be 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 taxpayer or those standing in a relationship to the taxpayer described in section 267(b) or 707(b), etc.

(b) *from 170(f)(2)* Contributions of property placed in trust. –

(1) *from 170(f)(2)(A)* Remainder Interest, etc.

(2) *from 170(f)(2)(B)* Income Interests, etc.

(3) *from 170(f)(2)(C)* Denial of Deduction in Case of Payments by Certain Trusts, etc.

(4) *from 170(f)(2)(D)* Exception

This paragraph shall not apply in a case in which the value of all interests in property transferred in trust are deductible under subsection (a).

(5) *from 170(f)(7)* Reformations to Comply with This Subsection

(A) In general. – A deduction shall be allowed under section 170(a) in respect of any qualified reformation (within the meaning of section 2055(e)(3)(B)).

(B) Rules similar to section 2055(e)(3) to apply. – For purposes of this paragraph, rules similar to the rules of section 2055(e)(3) shall apply.

(c) *from 170(f)(3)* Denial of deduction in case of certain contributions of partial interests in property.–

(1) In General. –

In the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall be allowed under this section only to the extent that the value of the interest contributed would be allowable as a deduction under this section if such interest had been transferred in trust. For purposes of this subparagraph, a contribution by

a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in such property.

(2) Exceptions. – Paragraph (1) shall not apply to –

(A) a contribution of a remainder interest in a personal residence or farm,

(B) a contribution of an undivided portion of the taxpayer's entire interest in property **in accordance with subsection (d),** and

(C) a qualified conservation contribution **as provided in subsection (e)**

(3) *from 170(f)(4)* Valuation of remainder interest in real property, etc.

(d) ***from 170(o)*** **Special rules for fractional gifts. –**

(e) ***from 170(h)*** **Qualified conservation contribution**

(1) In General. – For purposes of subsection (c)(2)(C), the term "qualified conservation contribution" means ...

(2) Qualified Real Property Interest

(3) Qualified Organization

(4) Conservation Purpose Defined

(5) Exclusively for Conservation Purposes

(6) Qualified Mineral Interest

(7) *from 170(f)(13)* Contributions of Certain Interests in Buildings Located in Registered Historic Districts–

(A) In general. – No deduction shall be allowed with respect to any contribution described in subparagraph (B) unless the taxpayer includes with the return for the taxable year of the contribution a $500 filing fee.

(B) Contribution described. – A contribution is described in this subparagraph if such contribution is a qualified conservation contribution (as defined in subsection (e)) which is a restriction with respect to the exterior of a building described in subsection (e)(4)(C)(ii) and for which a deduction is claimed in excess of $10,000.

(C) Dedication of fee. – Any fee collected under this paragraph shall be used for the enforcement of the provisions of subsection (e).

(8) *from 170(f)*(14) Reduction for Amounts Attributable to Rehabilitation Credit – In the case of any qualified conservation contribution (as defined in subsection (e)), the amount of the deduction allowed under section 170 shall be reduced by an amount which bears the same ratio to the fair market value of the contribution as –

(A) the sum of the credits allowed to the taxpayer under section 47 for the 5 preceding taxable years and not recaptured under section 50(a) as a result of this disposition of the property with respect to any building which is a part of such contribution, bears to

(B) the fair market value of the building on the date of the contribution.

170B Substantiation of Deduction

(a) *from 170(f)*(17) Recordkeeping. – No deduction shall be allowed under section 170(a) for any contribution of cash, check, or other monetary gift unless the donor maintains as a record of such contribution a bank record or a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution.

(b) *from (f)*(8) Substantiation requirement for certain contributions

(1) General Rule. – No deduction shall be allowed under section 170(a) for any contribution of $**250** or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization that meets the requirements of paragraph (2).

(2) Content of Acknowledgment

(3) Contemporaneous

(4) Substantiation Not Required for Contributions Reported by the Donee Organization, etc.

(5) Regulations

(c) *from 170(f)*(11) Qualified appraisal and other documentation for contributions of property of more than $500. –

(1) In General. –

(A) Denial of deduction. – In the case of an individual, partnership, or corporation, no deduction shall be allowed under section 170(a) for any contribution of property for which a deduction of more

than $500 is claimed unless such person meets the requirements of paragraphs (2), (3), and (4), as the case may be, with respect to such contribution.

(B) Exceptions. –

(i) Readily valued property. – Paragraphs (3) and (4) shall not apply to cash, property described in 170(a)(9) (relating to copyrights, etc.) or section 1221(a)(1), publicly traded securities (as defined in section 6050L(a)(2)(B)), and any qualified vehicle described in section 170(a)(8)(C) for which an acknowledgement under subsection (d) is provided.

(ii) Reasonable cause. – Subparagraph (A) shall not apply if it is shown that the failure to meet such requirements is due to reasonable cause and not to willful neglect.

(iii) *from Section 6281 of Pub. L. 100-647* The Secretary of the Treasury or his delegate may waive the requirement of a qualified appraisal in the case of a qualified contribution (within the meaning of section 170(e)(2)(A) of the 1986 Code) of property described in section 1221(1) with a claimed value in excess of $5,000.

[Is this needed? should it be codified?]

(2) Property Description for Contributions of More Than $**500** – In the case of contributions of property for which a deduction of more than $**500** is claimed, the requirements of this paragraph are met if the individual, partnership, or corporation includes with the return for the taxable year in which the contribution is made a description of such property and such other information as the Secretary may require. The requirements of this subparagraph shall not apply to a C corporation which is not a personal service corporation or a closely held C corporation.

(3) Qualified Appraisal for Contributions of More Than $**5,000** – In the case of contributions of property for which a deduction of more than $5,000 is claimed, the requirements of this paragraph are met if the individual, partnership, or corporation obtains a qualified appraisal of such property and attaches to the return for the taxable year in which such contribution is made such information regarding such property and such appraisal as the Secretary may require.

(4) Substantiation for Contributions of More Than $**500,000** – In the case of contributions of property for which a deduction of more than $500,000 is claimed, the requirements of this paragraph are met if the individual, partnership, or corporation attaches to the return for the taxable year a qualified appraisal of such property.

(5) Qualified Appraisal and Appraiser –

(6) Aggregation of Similar Items of Property –

(7) Special Rule for Pass-Through Entities – In the case of a partnership or S corporation, this paragraph shall be applied at the entity level, except that the deduction shall be denied at the partner or shareholder level.

(8) Regulations –

(d) ***from 170(f)*****(12) Contributions of used motor vehicles, boats, and airplanes. –**

(1) In General – In the case of a contribution of a qualified vehicle the claimed value of which exceeds $500 subsection (b) shall not apply and no deduction shall be allowed under section 170(a)(8) for such contribution unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization that meets the requirements of paragraph (2) and includes the acknowledgment with the taxpayer's return of tax which includes the deduction.

(2) Content of Acknowledgment – An acknowledgment meets the requirements of this paragraph if it includes the following information:

(A) The name and taxpayer identification number of the donor.

(B) The vehicle identification number or similar number.

(C) In the case of a qualified vehicle to which section 170(a)(8)(A) applies –

(i) a certification that the vehicle was sold in an arm's length transaction between unrelated parties,

(ii) the gross proceeds from the sale, and

(iii) a statement that the deductible amount may not exceed the amount of such gross proceeds.

(D) Whether the donee organization provided any goods or services in consideration, in whole or in part, for the qualified vehicle.

(E) A description and good faith estimate of the value of any goods or services referred to subparagraph (D) or, if such goods or services consist solely of intangible religious benefits (as defined in subsection (b)(2)(C)), a statement to that effect.

(3) Contemporaneous – For purposes of paragraph (2)(C), an acknowledgment shall be considered to be contemporaneous if the donee organization provides it within 30 days of the sale of the qualified vehicle,

(4) Information to Secretary – A donee organization required to provide an acknowledgment under this paragraph shall provide to the Secretary the information contained in the acknowledgment. Such information shall be provided at such time and in such manner as the Secretary may prescribe.

(5) Regulations or Other Guidance – The Secretary shall prescribe such regulations or other guidance as may be necessary to carry out the purposes of this subsection.

(e) ***from 170(f)*****(18) Contributions to donor advised funds.** – A deduction otherwise allowed under section 170 (determined with regard to subparagraph (f)(1)(C) thereof) for any contribution to a donor advised fund (as defined in section 4966(d)(2)) shall only be allowed if the taxpayer obtains a contemporaneous written acknowledgment (determined under rules similar to the rules of paragraph (b)(3)) from the sponsoring organization (as defined in section 4966(d)(1)) of such donor advised fund that such organization has exclusive legal control over the assets contributed.

(f) Notices by charity. –

(1) For required notice from donee in case of quid pro quo contribution in excess of $75, see Section 6115.

(2) For return required if charity sells property within 3 years, see 6050L(a).

(3) For return required by donee of intellectual property contribution, see 6050L(b).

Estate and Gift Tax Provisions

2055 (a) In general. –

(1) For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers *which would be charitable contributions under section 170(c) determined without regard to subparagraph (c)(2)(A) thereof.*

(2) For purpose of paragraph (1) the restrictions of section (f)(1), (5), (6), and (7) and 170A (except (d)(2)[currently 170(o)(2)] and (e)(8) [currently 170(f)(14)] thereof) shall be taken into account and the exception in 170A(c)(2)(B)(relating to undivided interests) shall not apply.

Add to 2055

(a) flush language re. disclaimers

(b) power of appointment

(c) debt payable out of bequests

(d) deduction cannot exceed value of included property

(e) (3) reformation

Nonresidents

Section 2106(a) For purposes of the tax imposed by section 2101, the value of the taxable estate of every decedent nonresident not a citizen of the United States shall be determined by deducting from the value of the gross estate which at the time of his death is situated in the United States –

(2) Transfers for Public Charitable and Religious Uses –

(A) In general. – The amount of all bequests, legacies, devises, or transfers (including etc. as to disclaimers) which would be charitable contributions under section 170(c)(1), (2)(except for organizations to foster national or international sports competition) and (4) (if in the latter case such contributions or gifts are used within the United States) determined with regard to section 2055(a)(2).

(B) (C)(D) included

Gifts

Sec. 2522. Charitable and similar gifts

(a) Citizens or residents. – In computing taxable gifts for the calendar year, there shall be allowed as a deduction in the case of a citizen or resident the amount of all gifts made during such *year which would be charitable contributions under section 170(c) determined without regard to subparagraph(c)(2)(A) thereof and with regard to section 2055(a)(2)* except that section 170A(c)(2)(B)(relating to undivided interests) and the recapture rules of section 170A(d)(3) [currently 170(o)(3)] shall apply.

(b) Nonresidents

In the case of a nonresident not a citizen of the United States, there shall be allowed as a deduction the amount of all gifts made during such year *which would be deductible under subsection (a) except that subparagraph(c)(2)(A) of section 170 shall be disregarded* only in the case of gifts to be used within the United States.

Section-by-Section Analysis

New Section 170

(a) Allowance of Deduction (source: 170(a) and other provisions as indicated)

Retain paragraphs (1) and (2)

Move 170(a)(3)(Future Interests in Tangible Personal Property) to a separate section (170A) in which all the rules relating to transfers of partial interests are collected.

Add a number of new paragraphs collecting various valuation rules derived primarily from (e)(1)(B) (transfers of capital gain property) and (f)(12) (transfers of automobiles, boats, etc.).

(3) *from (i)* providing the standard mileage rate for passenger automobiles

The idea is to allow a deduction for marginal operating expenses (gas) and deny any allowance for depreciation, repairs, insurance, registration fees, etc. Perhaps, this makes sense if one views the charitable use as incremental (and relatively limited?) which does not appreciably affect the overall cost of automobile ownership. Prior to 1984, the standard rate was set by the IRS in regulations (as it continues to do for other standard mileage rates-business, medical). Congress wanted to increase the rate (from 9 to 12 cents) so it made it statutory.

Note this rule was modified for Hurricane Katrina, during the period beginning on August 25, 2005, and ending on December 31, 2006, to increase the rate to 70 percent of the business mileage rate. **Revisiting the question of what costs should be counted for charitable deduction purposes might be useful.** It **clearly** would be sensible to restore IRS authority to periodically adjust the rate, which today would likely lead to an increase in the rate.

Deduction limited to basis

The current Code, in a number of instances, reduces the amount of the deduction by the potential capital gain. I believe the impact is to reduce the deduction to basis and the draft describes it in this way.

While the rules in current subsection (e) for capital gain property would appear designed to limit the advantage of gifts of appreciated property, in fact, these rules, except for the special treatment of gifts to private foundations, all arose out of valuation concerns. For example, the provision limiting the deduction to basis for gifts of "unrelated" tangible personal property[6] was motivated by stories of excessive valuation. Since the charity would not be using the property for its exempt purpose, it was difficult to argue that a fair-

market value deduction was an essential incentive. Given the valuation issue, Congress was willing to, in effect, require indirect gain recognition for these gifts even though it was unwilling to do so generally. The treatment of taxidermy and intellectual property is unquestionably focused on preventing excessive valuation. The recent exception to section 170(e) for gifts of qualified stock to private foundations[7] also suggests the issue is valuation.

Thus, collecting these rules in a section relating to special valuation makes sense. I have left the limitations on gifts of ordinary income property (which are not primarily related to valuation issues) in (e) which would then deal only with ordinary income property.

(4) Private foundations. – The exception later added for gifts of so-called qualified (traded) stock suggests a valuation concern but the original rule arose from the effort in 1969 to create a second disfavored class for private foundations. **This approach could be reconsidered here and for the limits in (b) as well**. However, there may be a concern that private foundations are more likely to tolerate gifts of untraded property and perhaps more likely to manage such property in the interests of the donor. If so, retention of the special rule seems justified.

(5) Taxidermy property. – The taxidermy rule clearly responds to abuse by limiting gifts to basis and narrowing sharply what can be included in basis. **More sensibly a deduction should be completely denied** (which would move the rule to subsection (f)).

(6) Taxpayer's election. –Under (b)(1)(C)(iii) a taxpayer can avoid the 30 percent limitation for gifts of appreciated property by electing to limit gifts of capital gain property made during the taxable year (or carried forward to such year) (effectively) to basis. This rule is now hidden in the limitations rule and **would be more transparent if included here**. I have described the election as applying to all gifts of property during the year which, if an election were made, would limit the deduction of ordinary income property to basis, as well. As drafted, in the event of an election, there would not be an additional deduction for intellectual property in future years.

(7) Tangible personal property. – 170(e)(1)(B)(i) is in substance unchanged but it is hopefully significantly simplified. The recapture rules are included in the same paragraph.

This provision limits the deduction to basis if (a) use is unrelated to exempt purpose even if property is not sold or (b) deduction is in excess of $5000, the property is sold within 3 years of gift (*if the sale takes place after the end of the taxable year of the gift, the fair market value deduction may be allowed but recapture would apply*) and donee does not certify as to related use or reason why intended use was infeasible.

If the property is not sold within that period or if the value is below $5000, the donee is not required to furnish a certification. It seems likely that enforcement would be difficult in the absence of donee

reporting. I would suggest that donee certification be required without regard to sale preferably **at some** lower value than $5,000.

Limiting Deduction to Amount of Charity's Benefit

Applying this approach more generally in particular to conservation easements would seem an idea well worth consideration. See initial discussion under Section 170A.

(**8**) Automobiles, etc. – The current rules (limiting deduction to selling price, if sold without significant intervening use or **material improvement,** and claimed deduction exceeds $500) are retained but the provision is significantly revised in an effort to make the substantive rules clearly stand out. The substantiation requirements have mostly moved to section 170B(d).

If not sold (or there is intervening use or material improvement) no deduction is allowed unless donee certifies within 30 days of contribution, as to intended use and duration thereof or intended material improvement. Presumably the deduction would be fair market value. **In the event of sale following material improvement, it seems better to limit deduction to selling price less cost of improvement.**

Note as to Tangible Personal Property

The concern over excess valuation of gifts of tangible property is also manifested in the rule for tangible property. (a)(7), and current (f) (16) (household items). These provisions all relate to transfers of tangible property which *roughly speaking* will (in most cases at least) be sold by the charity. This suggests the possibility of a more general approach limiting a deduction to the **lesser of basis or selling price** for contributions of tangible personal property where the charity does not certify its intention to use the property for a related purpose. Enforcement of such a rule would require the charity to report selling price and deferring the deduction until the property is sold in order to preclude avoidance by deferring sale even if the charity does not intend to use the property for a related purpose**. Since this would be an undue burden for small items total disallowance for items below a certain value would seem appropriate.**

Thus, the restriction on deductions for vehicles now does not apply if the claimed deduction does not exceed $500, which presumably permits a deduction for fair market value. Currently household goods valued at $500 or less are nondeductible only as to items **not** in good condition or better (or of minimal value under regs). (Household items valued over $500 require a qualified appraisal unless in good condition or better.) Possibly, a deduction should be completely denied, for clothing or household goods below $500 (or some lower amount) regardless of condition, for automobiles worth less than $500 and for taxidermy property.

(**9**) Copyrights etc. – The rules for copyrights and other intellectual property are a close cousin to the rules for gifts of automobiles; the intent being to limit the donor's deduction to the (present value of the)

amount actually received by the charity. As such the operative rule is actually 170(m), which bases the deduction on the donee's income. The initial allowance of a deduction for basis is not consistent with this approach. It may be that if a disposition would be a deductible ordinary loss, basis would be recovered on sale which might suggest a charitable deduction for basis is not an advantage even if the charity eventually gets nothing. **However, allowing a deduction solely under the rules of subsection (m) would be preferable.**

PL 108-357 sec. 882(e) authorized the Treasury to promulgate rules to prevent taxpayers from avoiding the purposes of this rule including the circumvention of the reduction of the charitable deduction by embedding the patent or similar property as part of a charitable contribution of property that includes the patent or similar property. Presumably, the anti-abuse provision was intended to enhance the authority of the IRS to prevent firms from engaging in such abusive behavior. It is not clear this authority was needed and **it has not been used. The draft suggests codification or repeal.**

(b) Limits on Deduction

The temporary special limit for contributions of conservation easements should be allowed to die for both individuals and corporations. It is absurd to elevate this charitable purpose above all others let alone to favor a deduction that seems highly abusive. Daniel Halperin, *Incentives for Conservation Easements: The Charitable Deduction or a Better Way* 74 Law and Contemp Probs. 29 (2011.) Daniel Halperin, Shelf Project:*Replace The Charitable Deduction for Conservation Easements with Limited Refundable Tax Credits* Tax Notes (July 16, 2012).

Still the number of different limits could seem complex. Accordingly, the draft shows what section 170(b) could look like with two limits: namely **50%** but no more than **30%** for contributions other than cash contributions (or property contributions limited to basis) **to** "public" charities. The election to limit the deduction to basis has been moved to (a)(6). Alternatively, two limits can be achieved by allowing all cash gifts up to 50% regardless of the donee.

As to organizations qualifying for the 50% limit

> (iii) Can it be limited to hospitals deleting the inclusion of medical education or medical research?
>
> (iv) Public Universities—should be unnecessary in light of vi

The complexity of the multiple limits arises from two policy decisions:

1. Favor contributions for gifts to (and not for the use of) certain so-called public charities.

2. Provide lower limits for gifts of appreciated property.

A single limit requires that both these goals be abandoned. Since I believe the ability to take a fair market deduction without recognizing unrealized gains is abusive, I would oppose not continuing to favor cash gifts. Thus, at least two separate limits are required.

Two ways to provide only two limits may be suggested:

Allow the 50% limit for all cash gifts regardless of donee and apply the same 30% limit on all appreciated property transfers whether or not to "public" charities.

Eliminate the special 20% limit for gifts of appreciated property to other than "public" charities and combine the two current 30% limits (for gifts of appreciated property to public charities and for cash gifts to other institutions) into one combined 30% limit.

The draft reflects the latter approach which retains both policy goals. Significant simplification of the deduction limits (including that suggested in the draft) raises the following questions.

1. Unlimited deduction—I am on record as favoring an unlimited deduction if it would enable a rule requiring gain recognition (or equivalent reduction in the charitable deduction) Daniel Halperin, *A Charitable Contribution of Appreciated Property* 56 Tax L. Rev. 1, 23-5 (2002). I found the arguments for a limit not wholly persuasive. If the idea is to limit the ability of any person to in effect allocate matching tax dollars, a dollar limit seems more sensible. If the idea is a minimum tax, an overall limit on itemized deductions would be more effective. Further, the repeal of the previous unlimited deduction was largely motivated by its use by those who contributed appreciated property and retained all presumably taxable income for personal use without paying tax. Repeal of the unlimited deduction was accompanied by enactment of 170(e) and a lower limit on appreciated property gifts, in that the limit was increased to 50% for cash gifts only. **An unlimited deduction (accompanied by recognition of unrealized gains) would reduce the complexity of both section 170(b) and (e) but seems unlikely to be enacted.**
   Section 1400S(a) had an unlimited deduction for a brief period to deal with Katrina. The ability to direct payment from an IRA to a charity without income recognition, section 408(d)(8), is a small step towards an unlimited deduction.

2. Universal 50% limit—While this would provide significant simplification, I would be opposed to increasing the limit on gifts of appreciated property as long as unrealized gains are not taxed.

3. **Widen the 50% limit to all cash gifts**—This alternative would also reduce the number of percentage limits to **two and retain the distinction between gifts of cash and gifts of appreciated property.** It would no longer privilege gifts **to** public charities. Equal treatment

would be given to gifts for the use of public charities, private foundations, war veterans etc. **It is not suggested in the draft.**

4. One 30% limit—Under current law, as I understand it, it is possible to take a charitable deduction for up to 50% of AGI even if all contributions are either in (i) appreciated property to "public" charities or (ii) to private foundations etc. since there are separate 30% limits for each. Apparently, this reflects a feeling that **each type should be disfavored** by not allowing the full 50% but **if neither type exceeds 30% it is not a problem** even if the combined amount reaches 50%. However, I think it is also possible to believe that a combined contribution of over 30% is problematic. In the interest of simplification **the draft makes this choice.**

5. 20% limit on appreciated property gifts—Since gifts to private foundations other than traded securities are limited to basis, this limit would apply to contributions **for the use of** rather than **to** public charities, gifts of traded shares to private foundations and contributions to war veterans posts, fraternal societies and cemetery companies. Cash contributions in these circumstances are disfavored by reducing the limit to 30%. **A further 10% reduction, if the gift is in appreciated property, sends a message about the problematic treatment of such gifts.** On balance it may make sense to opt for simplicity and **eliminate the special 20% limit,** even though it treats cash and property gifts alike in these cases. The draft reflects this choice.

(c) Charitable Contribution Defined

This part attempts to move towards uniform rules as to the organizations eligible to receive deductible charitable contributions for income, gift and estate taxes (as well as eligibility for exemption under section 501(c)(3)). A proposed revision of the estate and gift tax provisions at the end of the draft (and this memo) begins by allowing deductions for contributions to organizations described in section 170(c). As described next, some of the differences in eligible donees, which do not seem essential, are eliminated in this draft. The estate and gift tax discussion, below, notes the differences that remain. **Conceivably the estate tax deduction for ESOPs, section 2055(a)(5), could be retained. The draft deletes it.**

(c)(1) Estate and gift tax does not include United States possessions as potential donees. I see no reason to retain this distinction.

(c)(2) To achieve direct uniformity with 501(c)(3), this provision refers to a corporation etc. created or organized in the United States (or any possession thereof) which is qualified under section 501(c)(3), determined **with regard to 501(j) and (k).**

This would require eliminating **testing for public safety** from 501(c)(3).

The special rule allowing a deduction for corporate gifts used outside the US only if the donee is a corporation (and not a trust etc.) should be deleted.

Sections 2055 and 2522(a) include the words " **including the encouragement of art."** I assume deleting these words has no impact.

Section 2055 is limited to "corporate" donees (does not refer to trusts etc). If this **does have an impact, it would not seem to make sense.**

(c)(3) **War veterans –** I have included the Estate tax provision as an alternative (it seems more compact than the section 170 language). The gift tax provision essentially tracks section 170 except for lack of reference to trust or foundation.

(c)(4) Fraternal society – Why is this essential? Can't these organizations form a separate (c)(3). If retained adding the estate tax language which precludes lobbying etc. seems essential. Gift tax tracks 170 except for special reference to encouragement of art which seems unnecessary.

(c)(5) **Cemetery companies** – This seems like an anachronism. It does not exist for gift and estate. I would **get rid of it.**

Cross reference to 170(g) (maintaining students in taxpayer's household) is retained and cross reference to 170(n) (expenditures by whaling captains) is added.

I note a special provision outside the Code for housing Hurricane Katrina displaced individuals which allows a $500 deduction for each Hurricane Katrina displaced individual provided housing free of charge by the taxpayer in the principal residence of the taxpayer for a period of 60 consecutive days. **In general, in order to limit potential abuse, the requirement that contributions be made to or for the use of a qualified organization should be retained.**

(d) Carryover of Excess Contributions

Except for deleting the special rules for conservation easements, no change is suggested.

The rules do seem unnecessarily detailed. In particular, as I understand it, the special rule, reducing the amount of net operating loss carryovers, is necessary because while the charitable deduction may not be allowed in certain circumstances (so more of the NOL is used to reduce taxable income), the amount of the loss carryover to future years is determined as if the charitable deduction (and not the loss carryover) is used to reduce taxable income. It would seem more sensible to coordinate these rules so if the NOL is used to

determine taxable income, the carryover should be computed on this basis and the charitable contribution carryover would also reflect actual use.

(e) Gifts of Ordinary Income Property (*Source (e)(1)(A), (3)(4)(6)).*

(e)(1)(A) General Rule – reduces deduction by an amount of gain which would not have been long-term capital gain.

(B) Special rule for qualified contributions is restated as limiting the amount of the reduction to one-half of ordinary income provided that the deduction does not exceed twice basis. I believe this is a clearer way to describe current law.

(C) *From flush language of (e)(1)* – 1231 property considered to produce capital gain and treatment of pass throughs

(D) *From (e)(3)(E)*- The special rule for qualified contributions is not applicable to recapture amounts. Should section 1254 be added here as it is in (C)(i)?

(e)(2) *From (e)(3 (4)(6)* **Describes five categories of qualified contributions as succinctly as possible *in one place* deferring the bells and whistles to (3) through (6). I have insufficient knowledge of the reasons behind the conditions to suggest simplicity but the roadmap should be more visible if one wants to try.**

These rules are enormously complex and the several special rules for contributions of inventory are difficult if not impossible to distill into one overall rule. **I favor repeal** of all of the special rules and restoring the original rule which would reduce the deduction by the full amount of ordinary income in all cases.

Thus, I think 170(e) is the right approach, which should apply to all gifts of appreciated property, and I hate to give up the foot in the door. **I would also be concerned that there may be valuation abuse with some gifts of inventory.** Nevertheless, one must recognize that the foot has been in the door for over 40 years and probably on balance the door is closer to closing than it was in 1969. Thus, alternatively, although I do not recommend it, we could consider increasing the deduction, for **al**l gifts of ordinary income property, to achieve parity (that is the same net after-tax cost) with gifts of capital gain property.

As we know, by giving appreciated property, a taxpayer can reduce the out-of pocket cost of a gift. For simplicity assume zero basis. For a taxpayer at the top marginal rate, a cash gift of $100,000 costs **$65,000**. On the other hand, since a sale of capital gain property for $100,000 would only net $85,000, with a tax savings of $35,000,a contribution would cost only **$50,000** – the difference being the avoidance of the $15,000 tax on the capital gain.

If this were ordinary income property, however, a sale would net only **$65,000** so a contribution (which reduces taxes by **$35,000)** would only cost **$30,000 or some $20,000 less (because** here a tax of

$35,000 is avoided). Congress accepted the special rule for ordinary income property because, given the top rate of 70%, it was possible to get a better cash flow from a charitable gifts than a sale. For example, the rare highly successful artist, subject to a 70% marginal tax rate, would retain $30,000 if she sold a painting for $100,000. Donating the painting to the museum would net $70,000. Since the top rate is below 50%, this ploy is not possible today. A sale is always better. (Since there **is no special capital gain rate for corporations, there would be no distinction between gifts of ordinary income and capital gain property in this regard).**

One possibility is to make the net cost the same ($50,000 at the 35% marginal rate) which would require reducing the contribution for this taxpayer by 57.15% of the ordinary gain. The tax saving from deducting 42.85% of the appreciation is about $15,000 which makes the net cost of the gift as opposed to sale about $50,000 ($65,000 net proceeds from sale vs. $15,000 tax savings) as it would be in the case of capital gain property.

Unfortunately, the appropriate percentage, which is the ratio of the capital gain rate to the ordinary income rate (15 divided by 35 = 42.85) would vary by taxpayer's marginal rate unless the pre-1986 approach to capital gain taxation, a uniform deduction under section 1202, was restored. If we allowed a 50% deduction for qualified capital gain under section 1202, the appropriate reduction in the charitable deduction would be 50% of the ordinary income. A reduction of 50% of ordinary income is the operative rule in the special cases of gifts of qualified property except for the maximum deduction of 2 times basis.

(f) Disallowance of Deductions Special Rules

Some of the rules currently in (f) are moved elsewhere in the draft including 170A (relating to gifts of future interests) and 170B (substantiation and valuation rules). As previously noted, some provisions have been moved to (a)(relating to measuring the deduction). The remaining rules in (f) and additional provisions moved from (j), (k) and (l) have been reorganized according to the purpose of the rule.

(1) Disallowance of gifts to certain organization

(A) From (f)(1) Termination of private foundation status under 507

(B) From (k) Communist controlled organizations (**This seems an anachronism)**

(C) *From (f)(18) Donor Advised Funds*-This provisions disallows deductions for contributions to certain donor advised funds and requires an acknowledgment from the donee in cases where a deduction could be allowed. The revised language is intended to only clarify not to change substance. The reference to (c)(5) (cemetery companies) would be removed if the recommendation in the draft that this section be deleted is followed. The required acknowledgment is described in 170B(e).

(2) Lobbying

(A) From (f)(6) Out-of pocket lobbying expenditures on behalf of charity

(B) *From (f)(9)* Contributions if a principal purpose is to avoid section 162 limits on deduction of lobbying expenditures

(3) *From (f)(16*) Household items-. No change is proposed in the draft. However, the amount claimed in this category is extremely large and abuse is likely to be rampant. For possible options see discussion under vehicle donations, (a)(8), of this draft.

Personal Benefit to Donor

(4) *From (j)* Denial of deduction for travel expenses if significant element of personal pleasure

(5) *From (l)* Limit deduction to 80% of amount paid if obtain right to purchase "football" tickets

(6) *From (f)(5) reduction for certain interest*

(7) *From (f)(10) split dollar life insurance*

Other former subsections

170 (i) and (m) moved to 170(a)
170 (j) (k) (l) moved to 170(f)
170 (h) and (o) moved to 170A (relating to partial interests)

<u>New Section 170A (Partial Interests)</u>

This paper does not generally propose new initiatives which are not related to simplifying or "reconciling" existing rules but I wish to note my proposals for modifying the deduction for conservation easements. (Shelf Project Tax Notes July 16, 2012). The proposal suggests replacing the deduction with a limited dollar tax credit. If this is rejected, it suggests limiting qualified donees to organizations which hold a substantial number of easements and have sufficient staff and resources to monitor and enforce compliance, limiting the deduction to a conservation value certified by a qualified organization and imposing an excise tax on those that do not monitor compliance

Section 170A brings together **without significant change** the rules relating to partial interest gifts.

(a) From 170 (a)(3) **Future interests in tangible personal property** Given the subsequent enactment of 170(f) (denying a deduction for gifts of a partial interest), this provision may seem unnecessary. However, it applies to certain interests where it may be that section 170(f) is not applicable. For example, the regulations state that it applies to purported current gifts where there is an oral or written understanding retaining possession by the donor.

On the other hand, since under this provision, the contribution is not treated as made until the intervening interests expire, it can prevent section 170(f) from denying the deduction for a gift of remainder interest. A deduction could conceivably be allowed when the intervening interest expires.

(b) **Trust contributions including the reformation rule from (f)(7).**

The specific rules for reformation of partial interest gifts are found in the estate tax provisions (2055(e)(3)) and cross referenced to income and gift sections. I have left it as is.

(c) *from 170(f)(3)* Partial interest not in trust.

(d) *from 170(o)* Special rule for undivided interests

(e) *from 170(h)* Special rule for conservation easements in addition to:

The rule now in (f)(13) requiring filing fee

The rule now in (f)(14) relating to reduction of charitable deduction by the **ratio** of rehabilitation credits (under section 47) allowed for the last 5 years to fair market value. The rationale appears to be that to the extent of the rehabilitation credits, the government has effectively financed the property and it would be inappropriate to allow a charitable deduction for value paid for by the government.

However, under section 50(a) if property is disposed of within 5 full years of being placed in service between 100% (within 1 year) and 20% (between 4 and 5 years) of the credit will be recaptured. The IRS has taken the position that a charitable contribution is a disposition. (Rev. Rul. 89-90). Apparently despite recapture, for purposes of 170(f)(14), the credit would still be treated as "allowed" during the preceding 5 years. This seems inappropriate.

New Section 170B (Substantiation)

Section 170B brings together **without significant change** the rules relating to substantiation of contributions

(a) *From 170(f)(17)* Substantiation of cash gifts

(b) *From 170(f)(8)* Gifts of $250 or more

(c) *From 170(f)(11)* Documentation for property gifts over $500

Appraisals for gifts over $5000 (attach to return if over $500,000)

(d) *From 170(f)(12)* Special rules for motor vehicles

(e) *From 170(f)(18)* Donor Advised funds

(f) Notices by Charity

— **These cross references are not now in section 170. Did I miss any?**

The following substantiation rules which are now in Section 170 could conceivably be moved to this point

(a)(7) Certification as to use of tangible property

(a)(8)(B) Certification as to use or material improvement of vehicles

(e)(3),(4) and (6) Relating to contributions of ordinary income property

Estate and Gift (2055, 2106, 2522)

I have provided a suggested revision of sections 2055(a) (estate tax residents), 2106 (estate tax nonresidents) and 2522 (gift tax) to allow deduction for contributions to organizations described in section 170(c) except when deviation is required. The estate and gift tax provisions do not allow contributions to cemetery companies which should be considered if that opportunity is retained for income tax purposes.

A domestic organization is required for income tax purposes and bequests and gifts by nonresidents (except for gifts used in the U.S.). It is not required for bequests or gifts by residents. No change is proposed. The draft provides an exception for the domestic organization requirement (section 170((c)(2)(A)) where applicable.

Section 2106 as proposed follows the current limits on bequests by nonresidents—not allowed for organizations to foster sports competitions, to war veteran organizations and, if used outside US, to fraternal societies. The reason for these differences is unclear to me.

Since the draft refers to contributions to organizations defined in section 170(c), rather than referring to deductions allowable under section 170, section 2055(a)(2) (which is then made applicable to the other estate and gift sections) is needed to incorporate the relevant restrictions on the income tax deduction. This approach is taken because, as explained below, incorporating all the restrictions of the income tax provisions would be inappropriate.

The gift and estate provisions do **now** contain some of the restrictions on donations found in 170 – for example 2055(e)(1)denying the deduction for gifts to organizations subject to 508(d)[170f)(1)(A)],[8] (e)(2)

limiting the deduction for gifts of a partial interest[170A] (except for the special rule (section 170(f)(4), discounting the value of a remainder interest in real estate), (e)(5) (relating to donor advised funds)[170(f)(1)(C) and 170 (f)(10) relating to split dollar policies[170(f)(7)] (which seems to be the only current income tax restriction which refers to the estate and gift tax).

The rules of 170(o)[170A(d)] including recapture in the case of gifts of undivided interest, for among other things failing to complete the gift within 10 years, or death if earlier, is now applicable for gift (2522(e)) but not estate tax. Since 170(o) requires gifts of undivided interests to become a complete gift by death, it would seem an estate tax deduction for an undivided interest would be inappropriate (as opposed to current law which allows an estate tax deduction even if the charity does not ever get 100% ownership). **The draft so provides** in 2055(a)(2) which requires an exception in 2522 to allow for partial interest gifts subject to potential recapture as under current law.

Additional restrictions including 170(k) relating to communist controlled organizations [170(f)(1)(B)] seem appropriate. I also see no reason why current (f)(13) [170A(e)(7)] (fees on donations of property in historic district) should not apply for estate tax purposes.

Other rules limiting the deduction because of a private benefit received by the donor (or a transferee) such as **170(l)** (relating to opportunity to buy certain tickets)[170(f)(5)] and (f)(5) certain interest [170(f)(6)] would seem as essential for transfer tax as for income tax. The draft **includes all these restrictions by cross reference to what in the proposed draft is (f)(1),(5),(6)(7) and 170A. See proposed 2055(a)(2).**

However, since the gift and estate deduction merely **prevent** a tax on the amount of the transfer, rules which do not allow a fair market value deduction because of concerns over valuation or as an indirect tax on appreciation, would be inappropriate if the transfer were unequivocal. Thus, the special rules of 170(a), (e) and (f)(3)(relating to household goods), current section (f)(14) (relating to rehabilitation credit) and current 170(o)(2) (subsequent transfers following a gift of an undivided interest) are not applied to the estate and gift tax. Other income tax limitations, such as (f)(6) out of pocket lobbying expenditures, (f)(9) indirect lobbying and (j) travel expenses, would seem to have no relevance to the estate and gift tax.

Current sections 2055(e)(4) and 2522(c)(3) allow work of art and copyright to be split without triggering a partial interest gift. According to JCT Explanation of the Economic Recovery Act of 1981 (24-6), it has become common to split the tangible property and the intangible copyright and since there will be sales of these separate interests, valuation will not be difficult. Despite this, the rule was not extended to the income tax which the JCT described as an **"unnecessary tax incentive." I have no information on the importance of this rule or the difficulty of an accurate valuation. However, if it is unwise for section 170, I see no reason why it is acceptable for estate and gift. The draft deletes this exception.**

Current sections 2522(d) and 2055(f) seem to negate the requirement of section 170(h)(4) that an allowable partial interest gift be for conservation purposes. This apparently means a deduction is allowed if there is a gift of a perpetual restriction to a qualified organization. According to the JCT General Explanation of the Tax Reform Act of 1986(1257-58), the prior law caused **"undesirable"** results, if the deduction was disallowed, apparently because the charitable organization owned the property interest and the donor might not have funds to pay the tax. Presumably, the argument is that the donor has reduced the value of his assets in favor of a charitable organization so why should we care whether there is a conservation purpose or not. **However, we generally disallow deductions for transfers of partial interests because of the risk that the benefit to charity is overstated. This risk exists for transfer tax as well. We make an exception for conservation easements because we apparently believe the benefits outweigh the potential tax avoidance. Given this, it would make *absolutely no sense* to allow a deduction if there is no conservation purpose. The draft deletes this exception.**

Notes

[1] Daniel Halperin, "A Charitable Contribution of Appreciated Property and the Realization of Built-in Gains," *Tax L. Rev.* 56, no. 1 (2002): 4–10.
[2] John Brooks, Doing Too Much: The Standard Deduction and the Conflict Between Progressivity and Simplification 2 Colum. J. Tax L. 203 (2011).
[3] C. Eugene Steuerle, "A New April 15th: Make It a Day of Giving (Efficiently)," *Government We Deserve* column, www.urban.org/url.cfm?ID=901325.
[4] The draft cross-references the proposed draft, not current law.
[5] The words in bold seem superfluous to me but who knows?
[6] 26 U.S.C. § 170(e)(1)(B)(i)(I)
[7] 26 U.S.C. § 170(e)(5)
[8] Section in brackets is the proposed Code provision.