ARTICLE

CHARITABLE CONTRIBUTIONS OF PROPERTY: A BROKEN SYSTEM REIMAGINED

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On average, nearly $46 billion of property is given to charitable organizations each year, about twenty-five percent of the total charitable deduction. This makes the charitable contribution deduction for property a tax expenditure within a tax expenditure, yet it is rarely analyzed as such. It emerged as part of a noble effort to encourage contributions to worthy organizations. But the deduction for property has never worked well. The general rule allowing a deduction based on the fair market value of the property may have some intuitive appeal, but its implementation has yielded numerous exceptions and immense complexity. The Article argues that the extensive historical effort to allow a deduction for property contributions is a failure. Given the substantial direct and indirect costs involved, the uncertain benefit to the donee from property contributions, and the absence of any affirmative policy to favor property contributions as such, it is time to reverse the general rule and not allow a charitable deduction for property contributions. Reversing the general rule would provide many benefits—increased revenue, improved tax administration, fewer abusive transactions, a simpler and more equitable tax code, and a preference for cash. Exceptions to the general rule of disallowance may be warranted, but any exception should be analyzed and fashioned according to whether it provides a measurable benefit to the donee. By following a measurable benefit to the donee standard, emphasis will be placed on providing a tax benefit that is administrable and that is based on the goal—donee benefit. Any resulting complexity should be viewed as a cost of the incentive, and weighed accordingly in deciding whether it should be provided.

I. INTRODUCTION

The charitable deduction of the federal income tax lets donors deduct their charitable contributions.[1] This makes for one of the largest tax expendi-

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[1] I.R.C. § 170(a) (2006).

tures, estimated to cost over $238 billion in the next five years.[2] There have been many proposals to change the charitable deduction—to expand it to more taxpayers, to convert it to a credit, or to limit it in various ways.[3] Largely missing from debates about the deduction, however, is acknowledgment that in substance "the" charitable deduction is, broadly speaking, not one deduction but two: one for cash, and another for property.[4]

The tendency to think of the charitable deduction monolithically is understandable. The idea of "one" deduction flows directly from the general rule of the Internal Revenue Code ("Code") allowing a deduction for "charitable contributions" with no initial distinction between cash and property.[5] But ignoring the reality of two distinct deductions also ignores the fact that different policy concerns and goals undergird each. Cash contributions are fairly straightforward. Cash is easy to measure and easy to spend, and it is easy to fathom the benefit that flows to the donee. Property, by contrast, is hard to measure (and so administer), can be hard to spend, and makes for a difficult assessment of the benefit to the donee. In addition, as a matter of tax policy, it is easy to defend a deduction for cash contributions, even if there is no consensus as to any one rationale. Property contributions, however, are much harder to defend under any of the prevailing rationales.

This Article argues that given the dire straights of the federal tax law of property contributions, a new understanding of the tax policy is needed—not just for property, but for all charitable contributions. Thus, although the Article is focused on property contributions, this focus brings certain truths about what the broader policy for all charitable contributions should be: namely, to encourage (or at least not tax) gifts of measurable benefit to charitable organizations.[6] This principle—of promoting gifts of measureable benefit—emerges as a sensible policy guide because only gifts of measurable benefit serve the indisputable policy goal of getting items of value to charitable organizations, is administrable, and is virtually certain to be efficient in the sense that the benefits will exceed the costs. Adopting the principle of promoting gifts of measurable benefit secures the deduction for cash

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[2] STAFF OF JOINT COMM. ON TAXATION, 113TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012–2017, 37–39 (Comm. Print 2013) (estimate covering fiscal years 2013–2017 combining $31.9 billion for educational institutions, $23.9 billion for health organizations, and $183 billion for other charitable contributions).

[3] *See generally* ROGER COLINVAUX, BRIAN GALLE, & EUGENE STEUERLE, URBAN INST. & TAX POL'Y CENTER, EVALUATING THE CHARITABLE DEDUCTION AND PROPOSED REFORMS (2012).

[4] "Property," as used in this Article, includes everything but cash, including, e.g., investments, land and real estate, intellectual property, vehicles, artwork, clothing, easements, and inventory property.

[5] I.R.C. § 170(a) (2006).

[6] The term "charitable" is a misnomer and underinclusive, as many non-charitable organizations are eligible to receive deductible contributions. *See* I.R.C. § 170(c) (2006). This Article generally uses the less emotive but more accurate "donee" instead of "charity" to describe the recipient, but also uses "charitable sector" when referring generally to organizations that are eligible for the deduction.

gifts.[7] But, as argued here, this principle suggests reversal of present law for gifts of property so that, as a general rule, no deduction for property contributions is allowed.

The Article proceeds in five additional parts. Part II provides background and discussion of the present law and policy of the charitable deduction for property contributions. This Part argues that the general rule of the charitable deduction is to treat cash and property as equivalents, but that implementing the policy of equivalence has led not only to considerable complexity but is also flawed under either of the principal rationales supporting the charitable deduction. Part III provides a legislative history of the rules governing property contributions and shows that the history has largely been one of trying to maintain the equivalence between cash and property in the face of policy and administrative challenges. Part IV examines the many costs of the deduction for property contributions, including revenue loss, administrative cost, damage to the reputation of the charitable sector, and harm to the tax system generally. Part V highlights the difficulties of assessing the benefits from the deduction for property contributions in general and based on property type, concluding that donee benefit is hard to assess due in large part to the fact that the fair market value measure for the deduction is not closely aligned to the actual benefit to donee organizations. Part VI notes the significant costs, uncertain benefits, and weak policy support for the current general rule from either of the principal rationales for the charitable deduction, and then outlines a new approach. In general, under the new approach, there should be no deduction allowed for contributions of property. To the extent exceptions are warranted, any incentive for property contributions should, in the first instance, be based on a measurable benefit to the donee standard. If the tax benefit is desired but cannot feasibly be based on such a standard, additional steps should be taken to ensure that the benefit to the donee (and so to the public) is ensured.

II: Present Law and Policy for Charitable Contributions of Property

The Internal Revenue Code provides, in language worthy of a commandment: "There shall be allowed as a deduction any charitable contribution . . . ."[8] This language is the starting point for the law and policy of the charitable deduction. Because lawmakers declined to give any definitive

[7] It is beyond the scope of this Article to discuss whether and how the charitable deduction should be changed for cash gifts. For additional discussion, see generally Colinvaux, Galle, & Steuerle, *supra* note 3; Joseph J. Cordes, *Re-Thinking the Deduction for Charitable Contributions: Evaluating the Effects of Deficit-Reduction Proposals*, 64 Nat'l Tax J. 1001 (2011).

[8] I.R.C. § 170(a) (2006).

content to the term "charitable contribution,"[9] the result, whether intended or not, was that *any* gift to an eligible organization, of any kind, was deductible. In other words, from the general rule came an implied policy favoring deductibility generally, whatever form the gift may take, as cash or property.[10]

Consistent with this general policy, at the outset, cash and property were treated as equivalents—with the amount allowed as a deduction equal to the amount of cash contributed or, in the case of property, its fair market value.[11] As discussed in Part III, however, maintaining this equivalence has proved exceptionally difficult. Thus, although a fair market value deduction currently is available for many contributions of appreciated property,[12] and for contributions of depreciated property,[13] the general rule has become riddled with property-related exceptions. The result is that there are at least ten approaches for gifts of property, involving different property types and multiple ways to measure the amount of the deduction.

The list is long. For contributions of vehicles, a deduction is allowed based on the sales price of the vehicle after the donation.[14] For intellectual property, a deduction is allowed equal to the donor's cost basis,[15] but with a promise of additional deductions in future if the property earns income for the donee.[16] For inventory, a deduction is allowed equal to the donor's cost,[17] but if the inventory is food or scientific property,[18] then a deduction of cost plus one-half of the appreciation not to exceed twice basis may be allowed.[19] For clothing and household items, a deduction at fair market value is allowed if the property is in good used condition or better.[20] For art, a deduction is allowed at fair market value[21] unless the art was created by the donor or the art is not for use by the donee as part of its mission, in which case the

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[9] The content of the term "charitable contribution" is not substantive. It "means a contribution or gift to or for the use of [a qualified donee]." I.R.C. § 170(c) (2006). The Treasury Department initially was uncertain as to whether the amount allowed as a deduction was fair market value or the donor's cost. *See infra* notes 40–42. This uncertainty could, and perhaps should, have extended to whether the allowance extended to property in the first place.

[10] Or, to frame the policy from a more cynical standpoint, as achieved by one tax software program, "It's deductible," which asks "How much are your donated items *really* worth?" *How Much Are Your Donated Items Really Worth?* TurboTax, http://turbotax.intuit.com/personal-taxes/itsdeductible (last visited Mar. 7, 2013).

[11] Treas. Reg. § 1.170A-1(c)(1) (2012). The history of the rule is described *infra* Part III.

[12] If property is appreciated, the value has gone up since acquired by the donor.

[13] If property is depreciated, the value has gone down since acquired by the donor.

[14] I.R.C. § 170(f)(12) (2006).

[15] I.R.C. § 170(e)(1) (2006). "Basis" is a tax term that generally refers in this context to the cost of the property. For example, if stock is purchased for $1,000, the purchaser's basis in the stock is $1,000. *See* I.R.C. §§ 1011, 1012 (2006).

[16] I.R.C. §§ 170(e)(1)(B)(iii), 170(m) (2006).

[17] I.R.C. § 170(e)(1)(A) (2006).

[18] Special rules for books and computers expired for taxable years beginning after December 31, 2011. I.R.C. §§ 170(e)(3)(D)(iv), 170(e)(6)(G) (2006).

[19] I.R.C. §§ 170(e)(3), (4), (6) (2006).

[20] I.R.C. § 170(f)(16) (2006).

[21] I.R.C. § 170(e)(1)(B)(i)(I) (2006).

deduction is the donor's cost.[22] For conservation easements, taxidermy, and fractional gifts, there are other special rules.[23]

Added to all of this is an extensive set of rules directed toward substantiating and reporting property contributions, including rules requiring appraisals by qualified appraisers and valuation-related penalties.[24] The net effect is an incredibly complex regime, for taxpayers and administrators alike.[25]

The complexity, though maddening, is not surprising. Almost without exception, the complex legal regime for property contributions is a direct result of basing the tax benefit on fair market value. The fair market value-based deduction has proved to be overly generous, resulting in many of the changes.[26] In addition, fair market value, as calculated in the absence of a sale, is a malleable and imprecise concept that ultimately leaves the determination of a lucrative tax benefit in the hands of the taxpayer, not the Internal Revenue Service ("IRS"). This is a clear invitation for abuse, and thus for the many detailed anti-abuse special rules.

The technical source of the complexity is thus known—it is the fair market value measure for the deduction. But the fair market value measure is merely an outgrowth of the original, if implied, policy of equivalence—treating cash and property alike. The initial question, therefore, is whether equivalence makes sense as a policy. One way to assess this is by examining the rationales of the charitable deduction more broadly to see whether the reasons for the charitable deduction support treating cash and property as equally worthy of support.

Broadly, there are two rationales. First, the charitable deduction is viewed simply as a necessary adjustment to properly measure income (the "base-defining" approach).[27] Under this approach, the tax base is defined to exclude charitable giving expenses, which are seen as unlike other forms of

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[22] I.R.C. §§ 170(e)(1)(A), 1221(a)(3) (2006).

[23] I.R.C. §§ 170(h), 170(f)(13), 170(f)(14), 170(f)(15), 170(o) (2006). Additional rules include that no deduction is allowed for contributions of services, Treas. Reg. § 1.170A-1(g) (2008), or for partial interests in property. I.R.C. § 170(f)(3) (2006).

[24] *See* Ellen P. Aprill, *Reforming the Charitable Contribution Substantiation Rules*, 14 FLA. TAX REV. (forthcoming 2013). These rules are discussed in Parts III and IV *infra*.

[25] In 1969, after Congress reduced the tax benefits for charitable contributions of property, one commentator noted that, as a result of the changes, "It is no longer possible to derive from the tax statutes a basic rule for the deductible amount in the case of gifts of appreciated property to charity." Harry K. Mansfield & Ronald L. Groves, *Legal Aspects of Charitable Contributions of Appreciated Property to Public Charities*, *in* 4 RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS 2251, 2252 (1977). Now, over four decades later, fashioning a "basic rule" is still impossible—only worse.

[26] *See* discussion *infra* Part III.

[27] *See, e.g.*, William Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 313 (1972). The base-defining rationale has been widely questioned. *See* Miranda Perry Fleischer, *Theorizing the Charitable Tax Subsidies: The Role of Distributive Justice*, 87 WASH. U. L. REV. 505, 517 (2010) (noting that the subsidy theory is the more "common" view); Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an 'Ideal' Income Tax and Why They Fit Worse in a Far From Ideal World*, 31 STAN. L. REV. 831 (1979).

private consumption.[28] Second, the charitable deduction is viewed as a form of government subsidy or tax expenditure (the "subsidy" approach).[29] Different strands of the subsidy approach emphasize different reasons for the subsidy, but the main reasons are that the deduction helps organizations that provide under-produced public goods, fosters altruism by encouraging giving as a social value, and provides a way for individuals to choose which organizations receive (albeit indirect) government assistance.[30] The question is the extent to which either rationale supports a deduction for cash, a deduction for property, or both.

Under the base-defining approach, a charitable deduction for the amount of contributed cash makes sense because the cash represents the amount of income that otherwise would have been available for consumption by the donor and subject to tax. The deduction merely removes the amount from the tax base.

The analysis for property under the base-defining approach depends on whether the property is appreciated or depreciated. For appreciated property, a deduction of fair market value means that a deduction is allowed with respect to the appreciation. This plainly is the wrong result under the base-defining approach because the appreciation has never been included in the donor's income,[31] yet the donor is allowed to deduct it, offsetting other, ordinary income. In other words, the donor of appreciated property not only escapes tax on the built-in gain, but gets to deduct it to boot. This represents a windfall (or loophole) for donors, and has led to widespread condemnation (on both base-defining and subsidy grounds) of the fair market value deduction as "inefficient and unfair,"[32] a "clear error,"[33] "inequitable,"[34] and a "mistake."[35]

In addition, the value-based deduction for depreciated property finds weak support under the base-defining rationale. When property has depreciated, it means that it is less valuable than when purchased by the donor—i.e., the donor has consumed or benefitted from the diminished value. Although a fair market value deduction may make sense as representing the remaining (and already taxed) value of contributed property, at the same

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[28] Andrews, *supra* note 27, at 313. *See also* Richard Schmalbeck, *Reforming Uneven Subsidies in the Charitable Sector*, 66 EXEMPT ORG. TAX REV. 237 (2010).

[29] For a discussion of the subsidy theory, see Fleischer, *supra* note 27, at 517–28.

[30] *See generally* COLINVAUX, GALLE, & STEUERLE, *supra* note 3.

[31] This is because the gain has not been realized. Andrews, *supra* note 27, at 372.

[32] Evelyn Brody, *Charities in Tax Reform: Threats to Subsidies Overt and Covert*, 66 TENN. L. REV. 687, 720 (1999) (citing long criticism of the rule by commentators and the U.S. Treasury Department).

[33] Richard Schmalbeck, *Gifts and the Income Tax – An Enduring Puzzle*, 73 LAW & CONTEMP. PROBS. 63, 89 (2010).

[34] Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-In Gains*, 56 TAX L. REV. 1, 4 (2002); Wendy C. Gerzog, *From the Greedy to the Needy*, 87 OR. L. REV. 1133, 1158 (2008).

[35] Calvin H. Johnson, *Ain't Charity: Disallowing Deduction for Kept Resources*, 128 TAX NOTES 545, 549 (2010).

time, oft-contributed items of depreciated property such as clothing and vehicles arguably are contributed at the point where the remaining value to the donor is low or close to zero. This subjective value may be more representative of the actual amount given away, leaving a fair market value deduction again, in many cases, as a windfall to donors.

In sum, under the base-defining approach, a deduction for cash makes sense, but there is no support for a value-based deduction for appreciated property and weak support for such a deduction in the case of depreciated property.

Next, applying the subsidy approach, an incentive for gifts of cash helps to accomplish all the theory's main goals. Cash gifts support the provision of undersupplied goods, and promote altruism and individual choice. Similarly, encouraging gifts of property with a value-based deduction also appears to support each goal—after all, as an incentive to give, it should not make a difference whether the gift is of cash or of property—the altruism, choice, and provision of goods are all supported.

However, this depends in large part on whether cash and property actually are equivalents. If so, then it makes sense to view the charitable deduction as "one" deduction and one subsidy—with the goals of subsidy served by either equivalent. But self-evidently, cash and property are not equivalents. Cash is the medium of exchange and can be used in limitless ways by a donee organization to advance its mission. Property, though valuable, is far less versatile than cash. Given a choice, in most cases donee organizations would prefer cash to property.[36]

The nonequivalence of cash and property thus affects analysis of the deduction under the subsidy approach. This is because a subsidy for property contributions, viewed as an additional subsidy to the subsidy for cash contributions, does not appear independently to advance the subsidy goals of promoting altruism and choice. These goals arguably are, or should be, accomplished by the cash subsidy. That is, the incentive to give cash is, or should be, sufficient to generate altruism and allow individual funding choices (unless the only item available to a donor for giving is property). In other words, given the nonequivalence of cash and property, having an additional subsidy for property contributions does not materially advance two of the main goals of the subsidy approach.

Further, ironically, the policy of equivalence through a value-based deduction for property comes at the expense of cash contributions. First, all things equal, a donor with depreciated property and cash likely will prefer to give the depreciated property rather than the cash. As indicated above, depreciated property is, in part if not entirely, already-consumed property. For a donor to part with such property may be to part with what is in effect waste

[36] The main exception to this is in some cases of "related-use" property, or property for direct use in the donee's mission. Related use property is discussed *infra* Parts V and VI. *See also infra* note 312 and accompanying text.

or surplus to the donor. Parting with cash, however, is always to part with future consumption (or savings). Giving depreciated property thus may come at the expense of cash. It can satisfy a donor's sense of obligation to give, and depending on the amount and valuation uncertainties, still provide a similar tax benefit to a cash gift.

Second, from a tax perspective, a donor with similar amounts of appreciated property and cash should always choose to give the property. The benefit of a cash gift is simply that the donor is not taxed on the cash. The benefit of a gift of appreciated property, by contrast, is that the donor is able to deduct unrealized appreciation to offset other realized income. In addition, if the donor was otherwise going to sell the property, the gift avoids imposition of capital gains tax on that same appreciation.[37] Thus, donors with property to give are more likely to part with property than cash. In short, efforts to treat functional nonequivalents as legal equivalents results in nonneutral treatment, to the detriment of the cash subsidy.

This then leads to the principal remaining theoretical support for a subsidy for property contributions—namely that it is a subsidy for property qua property. In other words, property is not subsidized primarily to foster altruism or promote choice (cash accomplishes these goals). Rather, property contributions are encouraged, notwithstanding the negative effect on cash gifts, because it is specifically desirable that donee organizations receive property. This represents an important shift in focus—away from the behavior of the donor, and toward the need of the donee. Although normally, i.e., for cash, the perspective of the donee does not trump other concerns because of the many goals for promoting cash gifts, in the case of property, the benefit to the donee from property contributions (and so to society) becomes paramount.

By focusing on the benefit to the donee, evaluating the charitable deduction for property contributions as a subsidy becomes in large part an exercise in weighing the costs and assessing the benefits. This task occupies Parts IV and V of the Article. As discussed there, the costs of maintaining the value-based deduction are considerable and the benefit to the donee from property contributions (both appreciated and depreciated) is difficult to assess and not well defined by the fair market value measure for the deduction. Before assessing costs and benefits, however, the next Part of this Article examines the legislative history of the deduction for property contributions.

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[37] This has led some commentators to suggest making the gift of appreciated property a realization event. *See, e.g.*, Halperin *supra* note 34 (noting that keeping the cash and using it to purchase alternative investments helps donors diversify their holdings).

III. Legislative History of the Fair Market Value Measure for Property Contributions

The legislative history of the rules of charitable contributions of property is in many respects a history of futility—of trying to make the general policy of equivalence work—and stems largely from an initial failure to differentiate between cash and property. As discussed below, the history reveals an equivocal, initial administrative decision to base the deduction for property contributions on fair market value. Subsequently, abuses associated with this initial rule led to dramatic changes by Congress—first to ensure that donors would not be better off from donation of property instead of sale, and then to police ongoing valuation abuses. Viewed over decades, the history shows that Congress has long been concerned about the policy of property contributions, aware of many of the problems, but hopeful—in the face of evidence to the contrary—that a solution short of reversal is possible.

A. *Construction of Original Statute*

As noted in Part II, the general rule of charitable contributions of property is to allow the donor a deduction equal to the fair market value of the property. It is perhaps astonishing that this starting point for the deduction—fair market value—and this result—a deduction for unrealized appreciation—did not originate from the Internal Revenue Code ("Code"). The Code merely "allows" a deduction for charitable contributions,[38] but does not specify the amount allowed as fair market value or something else.[39]

Treasury Regulations at first construed the amount allowed under the original 1917 statute as the fair market value of the property.[40] Then, after the statute was reenacted in 1918, the Regulations instead determined that the amount allowed was the donor's cost basis.[41] Three years later, however, the Treasury switched back to fair market value "without any change in the underlying statute."[42] Thereafter, the fair market value of property was established as the amount allowed, and subsequent changes to the Code were made with this fundamental accounting error[43] and "mistake"[44] as the baseline rule.

There was some early resistance to this interpretation. In 1938, the House of Representatives voted to change the amount allowed to the donor's

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[38] I.R.C. § 170(a) (2006).

[39] The Code also did not specifically provide that property was included.

[40] Mansfield & Groves, *supra* note 25, at 2251.

[41] Johnson, *supra* note 35, at 549; O. 979, 2 C.B. 148 (1920) (providing that "the amount of the gift is cost").

[42] Johnson, *supra* note 35, at 549; L.O. 1118, II-2 C.B. 148 (1923) (revoking the prior regulation).

[43] Johnson, *supra* note 35, at 549.

[44] *Id.*

cost basis, but the Senate struck the provision on the ground that doing so would discourage charitable giving.[45]

B. Changes in the Tax Reform Act of 1969

Although modest cutbacks to the fair market value measure for the deduction were enacted in 1962[46] and 1964,[47] it was not until 1969 that the measure began to be swallowed by a tide of exceptions.

1. Ordinary Income Property

The critical issue in 1969 was that a fair market value deduction often resulted in taxpayers being better off donating property rather than selling it. This was largely a function of the prevailing high tax rates—namely a seventy percent top marginal rate on ordinary income.[48] Thus, as the Senate Finance Committee explained,[49] if a taxpayer in the seventy–percent bracket donated an (ordinary income) asset worth $100 with a $50 cost basis, the benefit to the taxpayer was a $100 deduction (worth $70 to the taxpayer) plus an exclusion of $50 of gain (worth $35).[50] The combined tax benefit of $105 from the deduction and the exclusion exceeds by $5 the amount the taxpayer could receive upon sale.[51]

Such a tax-induced distortion thus led Congress to modify the fair market value measure to require a reduction from fair market value of the amount of gain that would have been ordinary income if the property had been sold instead of donated.[52] Such "ordinary income property" included inventory, artwork and other documents in the hands of the artist or creator,[53]

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[45] S. Rep. No. 1567, at 14 (1938).

[46] Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 1034 (reducing the deduction to recapture ordinary income on the sale of personal property).

[47] Revenue Act of 1964, Pub. L. No. 88-272, 78 Stat. 105 (reducing the deduction to recapture ordinary income on the sale of real property); *see also* Pub. L. No. 89-570, 80 Stat. 759 (1966) (recapture on the sale of mining property).

[48] In general, income can be ordinary or capital gain income. Capital gain income is income from the sale or exchange of property (with exceptions, including for inventory). Long-term capital gain income is subject to tax at preferential rates. *See* I.R.C. § 1221 (2006).

[49] S. Rep. No. 1567, at 14 (1938).

[50] Note the assumption here is that the taxpayer would otherwise have sold the property. The benefit of the exclusion would not occur if instead the taxpayer holds the property to death, and then donates it, because of the other "egregious error" in the tax code—namely that the built-in gain is wiped out upon death because the taxpayer's basis is stepped up to equal the fair market value. Schmalbeck, *supra* note 33, at 93; I.R.C. § 1014 (2006).

[51] As Boris Bittker pointed out, if instead the basis was very low or zero, the profit from donating becomes startling—a deduction worth $70 plus an exclusion worth $70—for an overall gain to the taxpayer of $40 from donating rather than selling the property. *See* Boris Bittker & Lawrence Stone, Federal Income Taxation 235–36 (5th ed. 1979).

[52] Tax Reform Act of 1969, Pub. L. No. 91-172, § 201(a), 83 Stat. 487, 549.

[53] *Id.* Such property is considered ordinary income property because the gain represents income from the personal efforts of the taxpayer, like wage income, and not gain from an investment.

and certain types of stock.[54] Thus, the measure for the deduction became either fair market value or the donor's basis, depending upon the type of property contributed.

2. *Capital Gain Property*

Property that would produce long-term capital gain if sold ("capital gain property") did not present quite the same issue as ordinary income property because the lesser rate on capital gains decreased the value of the exclusion, meaning that in general a taxpayer was still better off selling the property rather than donating it.[55] Nevertheless, even for capital gain property, Congress continued to have concerns stemming from the fair market value measure. The benefit seemed plainly excessive, and, further, this opulence was somewhat inconsistent with a charitable intent. As explained by the Senate Finance Committee: the charitable deduction was not "intended to provide greater—or even nearly as great—tax benefit in the case of property than would be realized if the property were sold and the proceeds retained by the taxpayer. In cases where the tax savings is so large, it is not clear how much charitable motivation remains. It appears that the Government, in fact, is almost the sole contributor to the charity."[56]

Accordingly, Congress provided for a reduction from fair market value to basis[57] for contributions of capital gain property and for donations of tangible personal property, if the property was not for use by the donee in programs that further the donee's mission.[58] Put another way, the fair market

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[54] S. Rep. No. 91-552, at 81 (1969).

[55] Prior to 1969, the capital gains rate was twenty-five percent. William M. Speiller, *The Favored Tax Treatment of Purchasers of Art*, 80 Colum. L. Rev. 214, 217 n.14 (1980). Ironically, in 1969 Congress also increased the capital gains rate (after application of the new alternative minimum tax) to thirty-five percent (once fully phased in), thus making a fair market value deduction more attractive for capital gain property than previously—indeed attractive enough that profit from donating capital gain property was possible. *Id.* at 219 & n.22. As noted *infra* note 57, at the time, the tax rate for capital gains was achieved through a separate deduction of a percentage of capital gains. The remaining, nondeductible, capital gains were then subject to tax at the applicable, ordinary income, rate.

[56] S. Rep. No. 91-552, 80–81 (1969).

[57] The reduction from fair market value was of fifty percent (62.5% for corporate donors) of the appreciation in the property. The law at the time allowed a deduction for fifty percent of capital gains. Thus, the effect of the fifty percent reduction was to take away the charitable deduction with respect to the nondeductible portion of the capital gain that would have been recognized upon sale. The percentage was changed to forty percent in 1978 (to "28/46" for corporations) to correspond with a change to the capital gains deduction, and then eliminated altogether in 1986 to correspond with elimination of the capital gains deduction.

[58] S. Rep. No. 91-552, 81–82 (1969). A reduction from fair market value to basis was also provided for donations to private nonoperating foundations. S. Rep. No. 91-552, at 80–81 (1969). This reduction is consistent with the 1969 Act's punitive purpose regarding private foundations. *See* Thomas A. Troyer, *The 1969 Private Foundations Law: Historical Perspectives on Its Origins and Underpinnings*, 27 Exempt Org. Tax Rev. 52, 56 (2000). In 1984, Congress relaxed this rule by going back—temporarily—to a fair market value measure for gifts of stock to nonoperating private foundations. *See* The Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 301(b), 98 Stat. 494. Such contributions, "should be permitted" because

value measure was retained for related use capital gain tangible personal property (the "related use rule"). Presumably, the related use rule was justified because the donor showed some actual charitable intent by selecting property that the donee would actually use to advance its mission. Also, the fact that the property is for a related use perhaps suggests that regardless of a donor's motive, an extra incentive is appropriate to encourage related-use donations.[59]

Other approaches were considered. The House would have reduced the deduction to the donor's basis, both for ordinary income property and *all* tangible personal property (regardless of use).[60] This more penurious approach appears to have been driven less by concern about the excessive generosity of the benefit or by the absence of a charitable intent, than by misgivings about valuation, especially of art. "Works of art," the Ways and Means Committee wrote, "are very difficult to value and it appears likely that in some cases they may have been overvalued for purposes of determining the charitable contribution deduction."[61] Nevertheless, the related use rule prevailed, not because valuation abuse was immaterial, but rather because "a more desirable method of controlling overvaluation is for the Internal Revenue Service to strengthen its audit procedures for reviewing the value claimed on such gifts."[62]

C. Weakening of the 1969 Reforms: Inventory and Other Ordinary Income Property

Soon after the 1969 changes[63] there was resistance, especially with respect to inventory. In the lead-up to what became the Tax Reform Act of

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"the potential for abuse, including overvaluations" was not seen as a concern due to the ability to value stock accurately. STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, at 667 (Comm. Print 1984). To ensure the minimization of abuse, the provision was limited to stock traded on an established securities market, with market quotations for price readily available. *Id.* at 668. This provision was extended multiple times, and eventually became permanent, in order "to encourage donations to charitable private foundations." STAFF OF JOINT COMM. ON TAXATION, 105TH CONG., GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN 1998 240 (1998); I.R.C. § 170(e)(5) (2006).

[59] This rationale also helps explain the rise of the enhanced deduction.

[60] H.R. REP. NO. 91-413, at 55 (1969).

[61] *Id.*

[62] S. REP. NO. 91-552, 81–82 (1969). The Committee also noted that "special consideration" should be made to small contributions. *Id.*

[63] Another important change affecting property contributions in the 1969 Act involved the percentage limitation rules. Prior to 1969, there were two caps on the charitable deduction: a thirty-percent-of-adjusted-gross-income ("AGI") limit for most gifts, and a twenty-percent-of-AGI limit for gifts to private foundations. STAFF OF JOINT COMM. ON TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969 75 (Comm. Print 1970). There was no distinction between cash and property under either limit. *Id.* The 1969 Act created a new fifty-percent-of-AGI limit, kept the other two percentages, and then reordered the contents of the resulting three percentage limitations. *Id.* The net effect was to keep the public charity-private foundation distinction and to layer on top a cash capital gain property distinction, with capital gain property receiving the less favorable limitations (thirty percent if to a public char-

1976,[64] charitable organizations such as the Red Cross and CARE testified before the House Ways and Means Committee that inventory contributions of items such as food, medicine, and clothing had declined dramatically, and urged changes to the basis limitation.[65] In response, Congress adopted a special rule for certain inventory contributions—today's section 170(e)(3)(A)—allowing a deduction of basis plus one-half of the appreciation, not to exceed twice basis.[66] Explaining the provision, Congress cited the concern of "those charitable organizations that provide food, clothing, medical equipment, and supplies, etc. to the needy and disaster victims."[67] A greater incentive was "desirable," but still not one "such that the donor could be in a better after-tax situation" from a donation as compared to a sale.[68]

Thus, in creating another measure for the deduction (the "enhanced deduction"), Congress adopted a compromise. Critical items of inventory that were for a related use deserved more than a mere basis deduction, but because the property was ordinary income property (and not capital gain property), it should not benefit from the fair market value measure because of the risk of making the donation too attractive. And so a limited enhancement for inventory was adopted.[69]

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ity instead of fifty percent for cash; twenty percent if to a private foundation). At the time, all contributions to private nonoperating foundations were subject to the twenty percent limitation, whether for cash or property. *Id.* Although the purpose of the separate limitation for capital gain property may be murky, *see generally* Miranda Perry Fleischer, *Generous to a Fault? Fair Shares and Charitable Giving*, 93 MINN. L. REV. 165 (2008), one explanation is that Congress, concerned at the time about the excessive nature of the fair market value measure, decided that to the extent it was being retained, there should at least be a separate overall limitation on its use. Congress was in a sense keeping the fair market value measure for some appreciated property, but pinching its nose at the same time.

In 1984, Congress increased the percentage limitation for cash and ordinary income property from twenty percent to thirty percent. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 301(a)(1), 98 Stat. 494. Notwithstanding this raise, capital gain property remained a per se disfavored category for percentage limitation purposes relative to other gifts, now for both public charities and private foundations. Congress also allowed a carryforward of contributions in excess of the private foundation percentage limitation, whether the gift was for cash or property.

[64] Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520.

[65] Mansfield & Groves, *supra* note 25, at 2254.

[66] Tax Reform Act of 1976, Pub. L. No. 94-455, § 2135(a), 90 Stat. 1520, 1928 (codified at I.R.C. § 170) (2006)). Additional limitations applied, including that the donor must be a C corporation and the inventory must: be for a related use of the donee and used solely for the care of the ill, the needy, or infants; not be transferred by the donee for money, property, or services, be substantiated by the donee, and be in compliance with requirements of the Federal Food, Drug, and Cosmetic Act. Subsequently, Congress has expanded the provision. *See infra* text accompanying notes 69–72.

[67] STAFF OF JOINT COMM. ON TAXATION, 94TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, at 672 (Comm. Print 1976).

[68] *Id.* at 673.

[69] This new measure stuck. Five years later, in 1981, contributions of scientific property used for research became eligible for the enhanced deduction. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 222(a), 95 Stat. 172, 248. As in 1976, Congress cited "reduced contributions" resulting from the basis deduction, and the need for educational institutions to have new scientific equipment for research and training purposes. STAFF OF JOINT COMM. ON TAXATION, 97TH CONG., GENERAL EXPLANATION OF THE ECONOMIC RECOVERY TAX ACT OF

D. Attempts to Address the Problem of Valuation

1. Deficit Reduction Act of 1984

Until the Deficit Reduction Act of 1984[70] (the "1984 Act"), the system for valuing property was based largely on trust. Taxpayers did not have to get an appraisal, and appraisers, if used, did not have to meet any particular standards. This meant that for all intents and purposes, the value placed on contributed property was unregulated, and donors had considerable leeway to determine the value of their own tax benefits.

The consequences to the tax system from overvaluation could be severe. An example from the legislative history to the 1984 Act is illustrative. In the example, a donor in the fifty percent rate bracket gives a painting to a museum, claiming a $500,000 value.[71] At the fifty percent rate, this is worth $250,000 of tax savings to the donor. The painting's actual value, however, is $100,000, which should result in a tax benefit of $50,000. Thus, the donor (if not corrected) saves $200,000 on taxes because of an overvaluation that will be hard to prove. This is a monumental insult to the tax system—the government pays $200,000 for a museum to have a painting worth $100,000. Additionally, such an overvalued property donation is a far better deal for the donor than a sale of the property.

Of course, there is a risk to the donor of being caught. But it was a risk many donors took. As explained by the legislative history, under the "typical tax shelter promotion[ ],"[72] donors would acquire artwork, hold it for the requisite period (to make it capital gain property), then donate it at the "appreciated" fair market value.[73] "The shelter package may include an 'inde-

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1981, at 139 (Comm. Print 1981). Concluding in effect that the enhanced deduction did not violate the overriding purpose of the basis limitation (to keep the tax benefits from favoring donation over sale), Congress decided that the enhanced deduction was appropriate. As with the special rule for inventory, a list of restrictions applied—including on permissible donees, the age and construction of the property, permissible use, and substantiation. *Id.* at 140. Much later, in 1997, the model again was used to allow an enhanced deduction for contributions of computer technology and equipment—with another detailed list of requirements. "The Congress believed that providing an incentive for businesses to invest their computer equipment and software for the benefit of primary and secondary school students will help to provide America's schools with the technological resources necessary to prepare both teachers and students for a technologically advanced present and future." STAFF OF JOINT COMM. ON TAXATION, 105TH CONG., GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN 1997, at 37 (Comm. Print 1997). During the following decade, the enhanced deduction was expanded to include special rules for food and books. Katrina Emergency Tax Relief Act of 2005, Pub. L. No. 109-73, §§ 305, 306, 119 Stat. 2016, 2025 (codified as amended at I.R.C. § 170(e)(3)(C), (D) (2006)). The special rules for computer equipment and books were allowed to expire for taxable years beginning after December 31, 2011. *See supra* note 18.

[70] Pub. L. No. 98-369, 98 Stat. 494.

[71] STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, at 502 n.18 (Comm. Print 1984).

[72] *Id.* at 503.

[73] *Id.*

pendent' appraisal, and the potential donor may be assured that his or her subsequent gift will be accepted by a charitable organization."[74] Further, Congress was concerned not just with shelter promoters but with ordinary donations by individuals, citing problems with gems donated to museums, interests in real estate, and, as a category, contributions to educational organizations.[75]

Thus, the administrative solution hoped for in 1969 was not working. Noting that although the IRS "had succeeded in challenging overvaluations claimed by donors, and had initiated a special audit program to combat charitable contribution tax shelters," it "is not possible to detect all or even most instances of excessive deductions by relying solely on the audit process," a process that had many "uncertainties."[76]

In addition, Congress expressed a new concern stemming from overvaluation of charitable contributions: a "disrespect for the tax law."[77] Such disrespect could occur because, as overvaluations were publicized, law-abiding taxpayers (and those without property to contribute) generally would resent the law's tolerance of overvaluation and the inappropriate benefits inuring to those fortunate enough to have surplus property to donate.

Congress's prescribed solution was to require the Treasury to write substantiation regulations with certain minimum requirements.[78] The parameters were that donors of property with a claimed value of $5,000 or more must obtain a written "qualified" appraisal from an independent appraiser and provide a summary of the appraisal to the IRS with the tax return (the Form 8283).[79] In addition, donee organizations were required to acknowledge the appraisal summary by signature, though doing so "in no way is to be construed as indicating the donee's agreement with or acceptance of the valuation or amount claimed by the donor for the donated property."[80] Donee organizations were also required to file their own return with the IRS if the donee disposed of donated property within two years. The form must describe the contributed property and the amount received upon disposition.[81]

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[74] *Id.*

[75] *Id.*

[76] *Id.* at 504.

[77] *Id.*

[78] Although not made explicit in the statute, the legislative history was clear: "no deduction (either for appreciation or basis) is allowed for any contribution of property for which an appraisal is required under the Act unless the appraisal requirements are satisfied." *Id.* at 505. This result followed from the language in I.R.C. § 170(a)(1): "A charitable contribution deduction shall be allowable as a deduction only if verified under regulations prescribed by the Secretary."

[79] The resulting regulations were lengthy, and set forth detailed definitions of a qualified appraisal, a qualified appraiser, timing rules, among other requirements. Treas. Reg. § 1.170A-13 (1985).

[80] STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, at 510 (Comm. Print 1984).

[81] I.R.C. § 6050L (2006 & Supp. IV 2011). Publicly traded stock was, and is, exempt from the reporting requirement. The two-year period was changed to a three-year period in 2006. Pub. L. No. 109-280, § 1215(b)(1), 120 Stat. 780, 1077 (2006).

The 1984 Act also made modest changes to the valuation penalty provisions.[82]

Even with the new rules, "the Treasury Department remain[ed] concerned whether the substantiation and penalty provisions of the Act will prove sufficient."[83] Thus, Congress urged the Treasury and the IRS to use their authority to its fullest extent, and to report to the tax-writing committees if additional legislative solutions were needed.[84]

2. *Overvaluation Redux—2004 and 2006 Changes*

Treasury's concerns proved prescient. Twenty years after the 1984 Act,[85] Congress returned to the valuation problem. First, Congress attempted to strengthen the 1984 Act's substantiation regime by enacting section 170(f)(11) of the Code.[86] However, this new provision mostly just codified the post-1984 Act regulatory requirements of a qualified appraisal and a qualified appraiser, although there were modest new restrictions.[87] The provision also gave explicit statutory authority for the proposition that no deduction is allowed unless the appraisal requirements are met.[88]

Perhaps due to the weakness of the 2004 effort, Congress revisited the issue two years later,[89] resulting in a more rigorous definition of a qualified appraiser. Appraisers must now earn "an appraisal designation from a recognized professional appraiser organization"[90] or meet other educational requirements; regularly perform appraisals for pay; and have relevant experience in valuing the type of contributed property.[91] Additionally, the thresholds for penalties on overvaluations were widened to cover more cases,[92] and the reasonable cause exception to the overvaluation penalty was

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[82] *See* Pub. L. No. 98-369, § 155(c), 98 Stat. 494, 651 (1984) (deleting an exception to the penalty for long-held property, increasing penalty amounts, and limiting the IRS's discretion to waive the penalty).

[83] STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, at 504 (Comm. Print 1984).

[84] *Id.* at 505.

[85] In 1993, Congress conditioned the deduction on a contemporaneous receipt from the donee for all charitable contributions (cash or property) of $250 or more. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13172(a), 107 Stat. 312, 455–56. On the receipt, donees had to describe (but not value) any property contributed. I.R.C. § 170(f)(8) (1994).

[86] American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 883(a), 118 Stat. 1418, 1631–32.

[87] I.R.C. § 170(f)(11) (2006). For instance, corporations were subject to the appraisal requirement for the first time, and all donors were required actually to attach the appraisal to the return for property with a claimed value of $500,000 or more.

[88] § 170(f)(11)(A) (2006).

[89] Pension Protection Act of 2006, Pub. L. No. 109-280, § 1219(c)(1), 120 Stat. 780, 1083–84.

[90] I.R.C. § 170(f)(11)(E) (2006).

[91] *Id.* The appraiser must also not have been barred from practicing before the IRS for the three years prior to the appraisal.

[92] STAFF OF JOINT COMM. ON TAXATION, 110TH CONG., GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 109TH CONGRESS 605–06 (Comm. Print 2007).

eliminated for gross overvaluations.[93] Perhaps most importantly, a new penalty was imposed directly on appraisers for preparing an appraisal that resulted in a taxpayer's substantial understatement of taxes due.[94]

Apart from regulating the valuation process, Congress also opened another, more direct attack on valuation abuse. As abuses became associated with particular property types, Congress responded by changing the measure of the deduction away from taxpayer-determined fair market value.[95] Thus, different measures for the deduction were enacted for contributions of vehicles,[96] intellectual property,[97] and taxidermy.[98] In addition, also in response to valuation abuses, Congress enacted new restrictions for donations of easements,[99] clothing and household items,[100] and fractional gifts.[101] Further, in order to better enforce the related use rule, Congress provided that if ostensibly "related use" property is sold within three years, in general, any deduction of gain will be recaptured, leaving a deduction of basis.[102]

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[93] *Id.*

[94] *Id.* at 606; I.R.C. § 6695A (2006).

[95] Notable also during the 2004–2006 time period, Congress twice signaled, in temporary provisions, that as a policy matter, cash should be preferred to property, at least in some situations. In response to devastating hurricanes in the autumn of 2005, Congress temporarily waived the percentage limitations so that donors could claim deductions up to 100% of AGI. Katrina Emergency Tax Relief Act of 2005, Pub. L. No. 109-73, § 301, 119 Stat. 2016, 2022–23. However, the waiver applied only with respect to cash gifts. I.R.C. § 1400S(a)(4)(A)(i) (2006). Similarly, after the Indian Ocean tsunami in late 2004 and the outpouring of support, Congress allowed cash and not property donations made in January 2005 to be deducted for the 2004 year. Act of Jan. 7, 2005, Pub. L. No. 109-1, § 1, 119 Stat. 3, 3–4. A similar rule was enacted after the January 2010 Haitian earthquake. Pub. L. No. 111-126, 124 Stat. 3 (2010).

Yet even as Congress reformed and disfavored property contributions, it also expanded the rules in some areas. Contributions of ordinary income property such as food and books were provided the benefit of the enhanced deduction. I.R.C. § 170(e)(3) (2006). Contributions of conservation easements, notwithstanding numerous restrictions, as a general matter were treated better than any other charitable contribution. The percentage limitations for such gifts were increased to, in some cases, 100% of AGI, and were allowed a fifteen-year carryforward (as compared to the usual ten). I.R.C. §§ 170(b)(1)(E), (2)(B) (2006).

[96] The general rule for vehicles is to base the deduction on the sales price of the vehicle, not the pre-contribution appraised value. I.R.C. § 170(f)(12) (2006).

[97] For intellectual property, the deduction is reduced to the donor's basis, but if the intellectual property generates income in the hands of the donee, additional charitable deductions are available in future years based on the amount of such income. I.R.C. § 170(e)(1)(B)(iii), (m) (2006).

[98] Taxidermy is treated like ordinary income property (i.e., a basis deduction), and a special basis rule applies. I.R.C. § 170(e)(1)(B)(iv), (f)(15)(A) (2006).

[99] A contribution of an easement protecting the façade of a historic structure is subject to special rules and fees. I.R.C. § 170(f)(13), (f)(14), (h)(4)(B) (2006).

[100] Clothing and household items must be in good used condition or better. I.R.C. § 170(f)(16) (2006).

[101] Fractional gifts, (i.e., an entire portion of the donor's interest, usually of art) come with obligations to give the entire property eventually, a requirement that the donee substantially physically possess the property, and a special valuation rule constraining the value of gifts after the initial fractional contribution. I.R.C. § 170(o) (2006).

[102] I.R.C. § 170(e)(7) (2006). There is no recapture if the donee certifies that the property actually was used for a related use and describes such use, or the donee states the intended use and certifies that such use became impossible or infeasible to implement. Relatedly, the do-

E. Summary

In brief, this history describes a process of moving from one faulty measure for the deduction for property contributions (fair market value), to two, to now at least six, combined with extensive anti-abuse rules. It shows how complex the law has become, complexity that is largely in service of keeping the value-based deduction. Amid the changes, Congress has cited concerns about the generosity of a fair market value deduction, its undermining of charitable intent, and problems of overvaluation. Yet the fair market value measure persists.

IV. Costs of the Deduction for Property Contributions

As the legislative history shows, Congress has gone to great effort to retain the value-based deduction for property contributions, but at significant cost. As discussed below, the costs are of various types, and include revenue loss, administrative cost, cost to the reputation of the charitable sector, and cost to the tax system generally.

A. Cost Measured by Revenue Loss

Deductions for property contributions vary considerably from year-to-year. Unfortunately, publicly available data on property contributions is for individuals only, and does not include corporate giving. In 2010 (the most recent year for which data is available), individual taxpayers claimed $44.3 billion of noncash contributions. Of this amount, $9.4 billion was for contributions under $500 and so was not separately reported on the Form 8283. As shown in Table 1,[103] the 2010 numbers are up significantly from 2009, which at $31.8 billion was the lowest number over several years (likely reflecting the decline in giving generally during a recession, and the decline in stock prices).

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nee's obligation to report information upon the disposition of contributed property (Form 8282) was extended from two years to three, and the donee was required to describe the donee's use of the property, whether the use was a related use, and to certify such use.

[103] The numbers in the first two columns of Table 1 are derived from the following publications: for 2010, Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2010*, Stat. Income Bull., Winter 2013, at 64 [hereinafter Liddell & Wilson, *2010*]; for 2009, Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2009*, Stat. Income Bull., Spring 2012, at 62 [hereinafter Liddell & Wilson, *2009*]; for 2008, Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2008*, Stat. Income Bull., Winter 2011, at 76 [hereinafter Liddell & Wilson, *2008*]; for 2007, Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2007*, Stat. Income Bull., Spring 2010, at 52 [hereinafter Liddell & Wilson, *2007*]; for 2006, Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2006*, Stat. Income Bull., Summer 2009, at 67 [hereinafter Liddell & Wilson, *2006*]; for 2005, Janette Wilson, *Individual Noncash Contributions, 2005*, Stat. Income Bull., Spring 2008, at 68 [hereinafter Wilson, *2005*].

Table 1. Deductions for Property Contributions

Year	Total Deductions	Deductions Reported on Form 8283	Property as a Percentage of All Charitable Deductions[104]
2010	$44.3 billion	$34.9 billion	25%
2009	$31.8 billion	$28 billion	20%
2008	$40.4 billion	$34.6 billion	23%
2007	$58.7 billion	$52.8 billion	29%
2006	$52.6 billion	$46.8 billion	27%
2005	$48.1 billion	$41.1 billion	26%

The revenue cost of these deductions for property contributions depends upon the top marginal rate of the donor. For example, in general, the revenue cost of a $1,000 contribution by a donor in the 35% tax bracket would be $350. If the donor is in the 25% bracket, the cost is $250, etc. Existing data allows a rough determination of revenue cost.[105] Assuming an average tax rate of 28%, then of 33%, the revenue cost for six years from 2010 is shown in Table 2[106] below.[107]

In short, at over $10 billion a year, and millions of contributions among many property types, the deduction for property contributions is a significant tax expenditure.[108] In addition to revenue cost, however, other costs should be taken into account, including the cost of administering the deduction.

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[104] The numbers in this column are taken from *SOI Tax Stats—Individual Statistical Tables by Size of Adjusted Gross Income, Returns with Itemized Deductions: Itemized Deductions by Type and by Size of Adjusted Gross Income, Tax Years 2010, 2009, 2008, 2007, 2006, 2005*, INTERNAL REVENUE SERV., http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96981,00.html (last modified Feb. 26, 2013) (calculations derived by adding total cash and noncash contributions, and dividing noncash contributions by total contributions; numbers rounded to the nearest percent).

[105] An additional revenue cost, not included in this rough calculation, is the amount of any unrealized gain that would have been taxed if the property was sold and not donated.

[106] The numbers in Table 2 are 28% and 33% of the amount claimed as deductions shown in Table 1.

[107] Revenue cost here is calculated based on the amount claimed as a deduction before application of the percentage limitations. *See* Liddell & Wilson *2010*, *supra* note 103, at 73. Note that although revenue loss from charitable deductions of property is helpful to understand the magnitude of the deduction, it is not necessarily a useful estimate of overall revenue loss attributable to the deduction for property contributions. For example, if the deduction for noncash property were eliminated, there would not be an offsetting revenue gain because many donors would give cash instead. Nevertheless, the aggregate numbers demonstrate that considerable amounts are at stake annually because of the deduction.

[108] *See* Deena Ackerman & Gerald Auten, *Tax Expenditures for Noncash Charitable Contributions*, 64 NAT'L TAX J. 651, 652 (2011) (noting that "the deduction for noncash charitable contributions is one of the larger tax expenditures"). The Joint Committee on Taxation publishes an annual list of tax expenditures. *See, e.g.*, STAFF OF JOINT COMM. ON TAXATION, 113TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012-2017 (Comm. Print 2013).

Table 2. Revenue Loss from Property Contributions, Assuming Average Tax Rates

Year	Revenue Loss at Average Tax Rate of 28%	Revenue Loss at Average Tax Rate of 33%
2010	$12.4 billion	$15.5 billion
2009	$8.91 billion	$10.5 billion
2008	$11.32 billion	$13.34 billion
2007	$16.45 billion	$19.39 billion
2006	$14.74 billion	$17.37 billion
2005	$13.46 billion	$15.89 billion

B. Administrative Cost

1. The Challenge of Administering Value

The tax system is not free. There are costs associated with collecting the correct amount of revenue. Some rules will be easier (and so less costly) to administer than others. In general, tax administration is most effective when the task for administrators is verification of an item of income or expense. Although taxpayers can and sometimes do go to great lengths to disguise or defer income, or exaggerate expenses, the essential task for the IRS is forensic and objective.

When the question is the value of an item of income or expense, however, the IRS is at a disadvantage, especially in the absence of a market transaction. In such a case, the right answer depends upon a variable, value, largely within the control of the taxpayer. Donations of property, which typically require valuation and do not occur at arm's length, thus present challenges for tax administration.

Substantiation rules are one possible response. First and foremost, they are verification tools. In the charitable contribution context, taxpayers have thus long been required to keep records of property contributions to show both the fact and amount of a donation.[109] Further, because taxpayer records alone leave too much to taxpayer discretion (for gifts of both cash and property), donee organizations also are required to confirm a donation[110]—making cheating more difficult. In addition, for charitable contributions, the IRS needs proof not only that a transaction occurred, but also whether goods or

[109] Treas. Reg. § 1.170A-13(a)(1) (2006).
[110] *Id.* § (1)(ii).

services were received in exchange.[111] And so donees are asked to verify whether there was a quid pro quo (and to estimate the amount).[112]

Such substantiation measures are all targeted at verifying something objective and inherently factual in nature. They impose reasonable burdens on taxpayers and donees, and if followed, provide taxpayers with certainty that the fact and nominal amount of a contribution will not be challenged.

But substantiation rules cannot establish the value of a contribution. Unless property value is tied to some objective measure, there is uncertainty at the outset as to value and thus as to the amount of the deduction. "Trust but verify," which works well to check whether a contribution was made and for what stated amount, is inadequate on the question of value. This is because, at bottom, for many types of property contributions, there is nothing objective to verify, no ready touchstone.[113] With a value-based deduction, the best the tax system can hope for is to establish a process that will provide assurances that values determined by the taxpayer are reasonably accurate.

This explains the rules requiring qualified appraisals by qualified appraisers and extra information reporting by donors and donees.[114] Yet because value turns on judgment, this legal process has its limitations. Taxpayers that adhere to the process have no assurance that the claimed amount will escape challenge. And they should have no such assurance. The IRS should not concede the question of value just because the process is used. At most, the process is a prophylactic, best understood as an anti-abuse regime that may say little to nothing about the actual value of a contribution. Even with the best appraiser and in the absence of abuse, the amount of a tax benefit—an amount with a definite value in terms of a donor's tax savings—is based on something that cannot be verified.

2. *Enforcement Approaches to Valuation Problems and Their Cost*

As an initial matter, enforcing the anti-abuse process for noncash contributions generally does not appear to be a priority of the IRS. A report by the Treasury Inspector General for Tax Administration ("TIGTA") found that approximately sixty percent of returns sampled did not comply with reporting requirements, affecting about $201.6 million in claimed contribu-

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[111] To the extent there is such a quid pro quo, the amount of the deduction is reduced. *See, e.g.*, Ottawa Silica Co. v. United States, 699 F.2d 1124, 1131–32 (Fed. Cir. 1983); Rev. Proc. 92-49, 1992-26 I.R.B. 18; Rev. Rul. 67-246, 1967-2 C.B. 104.

[112] I.R.C. § 6115 (2006).

[113] The main exception, discussed *supra*, is publicly traded securities. The value of such securities is tied to an objective measure—the price actually paid for identical securities. Unique property, property that is not widely traded, property where value is dependent on condition, and low value items all present verification difficulties.

[114] *See* discussion *supra* text accompanying notes 88–91.

tions.[115] Of this sixty percent, eighteen percent of errors resulted from missing documents (such as a Form 8283 or an appraisal).[116] The result, under the law, should be disallowance of the deduction.[117] But none of the returns sampled by TIGTA had been examined.[118] TIGTA estimated that "more than 273,000 taxpayers claimed approximately $3.8 billion in potentially unsubstantiated noncash contributions in Tax Year 2010, which resulted in an estimated $1.1 billion reduction in tax."[119]

These numbers give a sense of the scope of the problem—but may also provide a false impression that the IRS does not attempt to enforce the law. The TIGTA report also comments, however, on eight compliance initiatives undertaken by the IRS regarding noncash contributions.[120] As to why so many unsubstantiated contributions are allowed, one reason might be that denying a deduction for nonsubstantiation is a harsh outcome not to be undertaken lightly. Further, because of the inherent uncertainty of value, administering valuation, if undertaken, is resource intensive.[121] It involves experts, is specific to property type,[122] and is not within the normal expertise of an auditor.[123] Thus, to assist in valuation, the IRS resorts to expert panels

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[115] TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, MANY TAXPAYERS ARE STILL NOT COMPLYING WITH NONCASH CHARITABLE CONTRIBUTION REPORTING REQUIREMENTS 5 (2012).

[116] *Id.* at 7.

[117] I.R.C. § 170(f)(11)(A)(i) (2006).

[118] TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, *supra* note 115, at 8.

[119] *Id.* at 6.

[120] *Id.* at 8. TIGTA notes that :

> [the] IRS is in the process of or has completed at least eight compliance initiatives on noncash charitable contributions. As of April 2012, the IRS reported that it has closed 834 audits as part of these projects with total assessments of approximately $671 million. One project involving the examination of 219 tax returns over a four-year period resulted in 28 percent of the examinations closed with no change proposed to the tax returns. Seventy-two percent (158 of 219) of the cases were closed with assessments, which totaled in all more than $5 million.

Id.

[121] STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES 296 (Comm. Print 2005) ("[V]aluation is a difficult and resource intensive issue for the IRS to identify, audit, and litigate."); *Enforcement Problems, Accomplishments, and Future Direction: Hearing Before the S. Comm. on Finance*, 109th Cong. 166 (2005) (statement of Mark W. Everson, Comm'r of IRS), *available at* http://finance.senate.gov/imo/media/doc/metest040505.pdf ("Overvaluations are difficult to identify, substantiate and litigate. Further, donors and the recipient charities do not have adverse interests that would help establish a correct valuation."); Richard Kovach, *New Rulemaking Approaches to Improve Federal Tax Administration Through Use of Precisional Substituions that Avoid Valuation Uncertainties*, 6 HOUS. BUS. & TAX L. J. 79, 79–80 ("Valuation problems . . . generate enormous tax planning and compliance costs for businesses and individuals.").

[122] For example, valuation of easements is an entirely different undertaking from valuation of a partnership interest or artwork.

[123] As noted by the United States Government Accountability Office ("GAO"), the "IRS does not staff examinations based on appraisals. The examiners who lead these teams are generalists and do not necessarily have specific expertise related to appraisal techniques." U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-608, REP. TO CONGRESSIONAL REQUESTERS, APPRAISED VALUES ON TAX RETURNS: BURDENS ON TAXPAYERS COULD BE REDUCED AND SELECTED PRACTICES IMPROVED 11 (2012).

and outside contractors.[124] For example, over fiscal years 2005–2011 the IRS entered into twenty-three outside contracts for help in reviewing noncash contributions and estate and gift tax valuation questions.[125] Some property types, such as easements[126] and artwork,[127] are especially difficult. Thus, the IRS has to weigh whether to commit resources and pursue a challenge, deny a deduction for nonsubstantiation, or do nothing.

Given the resource-intensive nature of establishing value, it should come as no surprise that when the IRS does undertake a challenge, it often argues that defects in the substantiation or appraisal process are sufficient to disallow a deduction.[128] If accepted by the courts, this allows the IRS to win on a brighter-line. The required substantiation either exists or not. The appraisal process was followed, or was not. Such determinations make litigation on valuation unnecessary and reduce the costs of administration as well.

Mohamed v. Commissioner[129] is a (perhaps extreme) example. There, the donor contributed real property that the donor personally valued at about $18.5 million. Although the donor may have undervalued the property, the donor was not a "qualified appraiser." Qualified appraisers must be independent, and may not be the taxpayer or a person related to the taxpayer.[130] Recognizing the "harsh" outcome, the Tax Court nonetheless upheld the IRS's disallowance of the deduction because, the court said, the qualified appraiser requirement is a condition of the deduction and the taxpayer manifestly was not a qualified appraiser. The IRS has prevailed on similar arguments in a number of cases.[131]

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[124] *Id.* at 16.

[125] *Id.* The IRS also directly employs appraisal experts in the areas of engineering and art. *Id.* at 15. For engineers, the IRS maintains a formal training program. *Id.* at 17. The GAO, however, faults the lack of training requirements for their art appraisers. *Id.* at 20.

[126] *See infra* text accompanying notes 209–13.

[127] For assistance in valuing art, the IRS has convened The Art Advisory Board, which meets in closed session to determine the authenticity and fair market value of works of art for income, estate, and gift tax purposes. If a case selected for audit includes an item of artwork valued at $50,000 or more, the item is referred to the panel. For fiscal year 2011, the Panel reviewed 322 items and recommended adjustments to 56% of the appraisals reviewed. *See generally* THE ART ADVISORY PANEL OF THE COMMISSIONER OF INTERNAL REVENUE, INTERNAL REVENUE SERV., ANNUAL SUMMARY REPORT FOR FISCAL YEAR 2011, *available at* http://www.irs.gov/pub/irs-utl/annrep2011.pdf.

[128] The Code is clear that this is the general rule. I.R.C. § 170(a)(1), 170(11)(A)(i) (2006).

[129] T.C.M. 2012-152.

[130] Treas. Reg. § 1.170A-13(c)(5) (2006).

[131] *See, e.g.*, Lord v. Comm'r, T.C.M. 2010-196 (disallowing the deduction because the appraisal did not indicate the date of contribution, the date of the appraisal, or the fair market value of the property as of the contribution date); Hendrix v. United States, 2:09-CV-132, 2010 WL 2900391 (S.D. Ohio July 21, 2010) (disallowing the deduction because the appraisal did not provide the date of contribution, disclose the terms of an agreement between the taxpayer and the donee, did not include the appraiser's qualifications, and did not state that the appraisal was prepared for income tax purposes and the taxpayers failed to obtain a contemporaneous receipt); Gundanna v. Comm'r, 136 T.C. No. 8 (2011) (disallowing the deduction on the ground that the contemporaneous written receipt was inaccurate in stating that no goods or services were provided); Schrimsher v. Comm'r, T.C.M. 2011-71 (disallowing the deduction because the taxpayer failed to obtain a contemporaneous written receipt, and the Form 8283

Mohamed and its ilk represent IRS successes. The IRS prevails because an objective and verifiable requirement is not met. Costs are reduced because adjudication of valuation is avoided. But when the issue differs slightly, and the challenge is to the appraisal process—e.g., the adequacy of an obtained appraisal or the qualifications of an appraiser—the IRS has had mixed success, and valuation often must still be litigated.[132] Indeed, it is ironic that in cases (unlike *Mohamed*) where there appears to be a serious question about the taxpayer's valuation, the IRS has proved largely unable to persuade appellate courts to accept lack of process arguments as a reason to disallow a deduction, leaving the IRS to battle with the taxpayer in a more costly valuation contest.

In *Scheidelman v. Commissioner*,[133] for example, the IRS argued, among other things, that the taxpayer's contribution of a façade easement failed because the appraisal of the easement was not "qualified" under the regulations. The regulations require that an appraisal show the method of valuation, and the specific basis for the result.[134] The appraiser valued the easement by applying a percentage discount to the fair market value of the entire property without much additional analysis.[135] The discount was selected based on ranges of what had been accepted by the IRS in the past for other easement donations.[136] The IRS argued, and the Tax Court agreed, that this did not constitute a method of valuation under the regulations, and so the appraisal was not "qualified."[137]

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omitted certain information and was not signed by the relevant parties); DiDonato v. Comm'r, T.C.M. 2011-153 (disallowing the deduction because the taxpayer failed to obtain a contemporaneous written receipt and did not attach a fully signed copy of Form 8283 to their return); Gaerttner v. Comm'r, T.C.M. 2012-43 (disallowing the deduction because the donee's receipts failed to describe the property donated, or the quantity, age, quality, or condition of the property); Durden v. Comm'r, T.C.M. 2012-140 (disallowing the deduction because the taxpayer's initial and timely written receipt did not include a statement regarding whether goods or services were provided, and the taxpayer's second receipt (which did include such a statement) was not contemporaneous).

[132] The doctrine of substantial compliance often arises. A donor in substantial compliance may be allowed a deduction notwithstanding formal and nonsubstantial defects in secondary substantiation rules. *See, e.g.*, Bond v. Comm'r, 100 T.C. 32 (1993) (holding that attaching an appraisal summary but not the required actual appraisal was substantial compliance with the regulations in part because the essential required information had been provided in the summary itself); Simmons v. Comm'r, T.C.M. 2009-208 (holding that failure to include the contribution date in the appraisal was nonetheless substantial compliance because the Form 8283 attached to the return included such date). This doctrine may have less force after changes to the Code in 2006. *See* Rothman v. Comm'r, T.C.M. 2012-163 ("The substantial compliance doctrine has continuing but limited application in a post-section 170(f)(11) world."). *But see* Scheidelman v. Comm'r, 682 F.3d 189, 199 (2d Cir. 2012), *remanded to* T.C.M. 2013-18 (relying in passing on substantial compliance doctrine to override technical defects of failure to include the date and manner of acquisition of property or the property's cost basis).

[133] 682 F.3d at 193.

[134] Treas. Reg. § 1.170A-13(c)(3)(ii)(J)-(K) (2006).

[135] *Scheidelman*, 682 F.3d at 193.

[136] *Id.*

[137] *Id.*

The Second Circuit reversed, however, stating that: "For the purpose of gauging compliance with the reporting requirement, it is irrelevant that the IRS believes the method employed was sloppy or inaccurate, or haphazardly applied—it remains a method."[138] The purpose of the reporting requirements is to "provide[ ] the IRS with sufficient information to evaluate the claimed deduction and 'deal more effectively with the prevalent use of overvaluations.'"[139] Likewise, in *Kaufman v. Commissioner*,[140] the First Circuit (also overturning the Tax Court and IRS on substantially similar grounds) noted that valuation could not be avoided using a "procedural" regulation.[141] Actual value "is a factual question different from whether the formal procedural requirements were met."[142]

The result in these cases, like the result in *Mohamed*, seems correct. On the one hand, the basic process must be followed. A qualified appraiser must be used to perform a qualified appraisal. So the court in *Mohamed* was right to deny the deduction. On the other hand, the IRS should not be allowed to use the qualified appraisal rules as a way around directly arguing valuation. The value of an item, and whether an appraisal is "qualified," are separate questions. So the courts arguably were right to remand in *Scheidelman* and *Kaufman* for further determinations of value—even though it is more costly.

The problem, however, is that from the standpoint of rewarding charitable behavior, the results in these cases seem precisely wrong. The donor in *Mohamed* should win because he made a substantial gift to a qualified donee. The donors in *Scheidelman*, *Kaufman*, and like cases should lose (and perhaps ultimately will lose)[143] because there is serious question whether anything of value was given away—but the IRS is not permitted to rely on process-based, bright line arguments to prevail.[144]

Nevertheless, the two lines of cases have different impacts on tax administration and policy. *Mohamed* at least sends the message to future do-

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[138] *Id.*

[139] *Id.* at 198. *See also* Consolidated Investors Group v. Comm'r, 98 T.C.M. (CCH) 601 (2009) (regarding the purpose of the regulations: to provide information "sufficient to permit [the IRS] to evaluate the [taxpayer]'s reported contribution and monitor and address concerns about overvaluation").

[140] 687 F.3d 21 (1st Cir. 2012).

[141] *Id.*

[142] *Id.*

[143] On remand from the Second Circuit, the Tax Court held for the IRS concluding that the easement had zero value. Scheidelman v. Comm'r, T.C.M. 2013-18.

[144] Cases involving easement contributions have been especially numerous, and resource intensive. The IRS conducted a special examination project with respect to easements from 2008–2010 covering 152 tax returns. Of sixty closed cases, there was a recommended average adjustment of $252,067 per return. From 2007 to 2012, the IRS closed examinations on 3,384 returns on deductions relating to conservation easements. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 123, at 12. Problems with the easement deduction have led some to call for its repeal and others to call for major changes. *See, e.g.*, Daniel Halperin, *Incentives for Conservation Easements: The Charitable Deduction or a Better Way*, 74 LAW & CONTEMP. PROBS. 29 (2011); Roger Colinvaux, *The Conservation Easement Tax Expenditure: In Search of Conservation Value*, 37 COLUM. J. ENVTL. L. 1 (2012).

nors that the rules must be followed if a tax benefit is claimed. The appraisal process thus just adds a layer of costs to taxpayers in search of better outcomes. Failure to follow rules may lead to harsh results in some cases, but following a process is par for the course in tax planning.

The message in *Scheidelman* and *Kaufman* is different, however, and the risks to tax administration and policy are greater. Because value is costly to litigate, if the IRS cannot prevail by attacking the appraisal process, taxpayers will know that if the process is minimally adhered to, the IRS may well not seek any challenge.[145] In other words, the administration of the value-based deduction may well be feasible at the level of process, i.e., whether an appraiser is "qualified." But the costs may become too high if the IRS is forced to engage on the question of value. Accordingly, if the IRS loses the ability to use process arguments as a way to attack value without addressing the merits directly, the taxpayer may be in a position of permanent advantage.[146]

This is especially true when small amounts are involved. Unfortunately, for an enforcement effort to be worth its cost, the revenue at issue generally must be significant, meaning that overvaluation of small contributions is largely unenforceable. Recall that several billion dollars each year in small contributions are claimed by individuals as noncash property donations.[147] Such contributions themselves would rarely result in an audit, and potentially would be challenged only if there were other issues on the return, and even then would be hard to contest if the taxpayer had the necessary paperwork.[148] For contributions that are reported ($500 or more) and for

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[145] One tactic is for the IRS to assert that contributed property has a zero value. *See* Scott D. McClure, Steven E. Hollingworth & Nicole D. Brown, *Courts to IRS: Ease Up on Conservation Easement Valuations*, 124 Tax Notes 551, 555 (2009) (noting that in nine of twenty-six easement valuation cases, the IRS asserted a zero value, but "[t]he court rejected the IRS's zero valuation in each of those cases, assigning values ranging from $65,860 to $1,992,375"). In many cases, the tactic may often be intended to broker a settlement, with the settled value somewhere in between the taxpayer's arguably inflated value and the IRS's hard line. The result bears little relation to the value of the gift, but does produce a number, and a deduction.

[146] The *Kaufman* court invited the Treasury to write tougher regulations, requiring more detail than present for an appraisal to be qualified. The *Kaufman* court also believed that abuses can be addressed through the "formidable" penalty regime, and also notes the Department of Justice's securing of a permanent injunction against the donee organization that accepted the donation in *Kaufman*. Along these lines, it is important to note that Congress tightened the penalty regime in 2006, though some, including the author, remain skeptical that penalties will have much impact. *See also* Halperin, *supra* note 144. The problem is the value-based deduction. Penalties may deter abuse on the margin, but the odds still favor taxpayers.

[147] The Government Accountability Office estimates that "less than 1 percent [of] individual returns with noncash charitable contributions were likely to need an appraiser." U.S. Gov't Accountability Office, *supra* note 123, at 6.

[148] For property contributions under $250 donors must either obtain a receipt from the donee or, if a receipt is impractical under the circumstances, keep reliable written records. Treas. Reg. § 1.170A-13(b)(1), (2) (2006). For gifts of $250 or more (cash or noncash), the Code requires donors to obtain a "contemporaneous written acknowledgement" from the donee. To be "contemporaneous" the acknowledgment must be received by the date the donor's tax return is filed or due to be filed. I.R.C. § 170(f)(8)(C) (2006); Treas. Reg. § 1.170A-13(f)(3) (2006). The acknowledgement must provide: (1) the amount of cash and a description

which an appraisal is required ($5,000 or more), there still is only slight chance of audit. According to the IRS, it is "up to the judgment of the individual examiner to decide whether the potential additional tax to be gained from investigating appraisals in detail warrants the investment of audit resources."[149] For these contributions, the system relies for the most part on the process to police abuse.[150]

The simple fact is that a value-based deduction is extremely difficult and costly to administer. Small contributions will mostly pass unchecked. For larger contributions, if checked,[151] the IRS often resorts to arguments based on other, brighter lines, but with mixed success. Further, adding to the overall cost of administration, the multiple measures and special rules that have arisen in response to abuses present challenges for administrators on the very practical level of training agents in the law,[152] not to mention educating the public.[153] The Code and regulations on noncash property constitute tens of thousands of words, potentially rendering the simple act of giving into a very complex transaction.

In sum, if claimed deductions were always equal to lawful deductions, there would be minimal administrative cost. Similarly, if the IRS decided not to police property contributions, the administrative burden would be slight (but presumably, the revenue and reputation cost (discussed below) would increase dramatically with flagrant abuse). The fact is, however, that the propensity for abuse of a value-based deduction means that the IRS is obliged to commit administrative resources to policing noncash contributions.[154] Hopefully, the effort deters abuses. History has shown, however, that abuses continue, and will be costly to combat if they are fought at all.

(but not the value) of any property contributed, (2) whether any quid pro quo was provided by the donee, and (3) a description and good faith estimate of the value of any such quid pro quo.

[149] U.S. Gov't Accountability Office, *supra* note 123, at 13.

[150] However, the GAO concludes that the appraisal threshold of $5,000 may be too low. *Id.* This conclusion seems at odds with the goal of the appraisal requirement to produce better outcomes. Raising the threshold would merely increase the number of noncash items that may be donated without any real process-based check on value. The GAO reached its conclusion after noting that in only a small percentage of cases were changes made due to a problem with an appraisal.

[151] *See supra* text accompanying notes 115–19.

[152] *See*, *e.g.*, Internal Revenue Serv., I.R.S. Conservation Easement Audit Techniques Guide (2012), *available at* http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Conservation-Easement-Audit-Techniques-Guide.

[153] Internal Revenue Serv., I.R.S. Valuation Guide for Income, Estate and Gift Taxes—Valuation Training for Appeals Officers (2006); *see also* Determining the Value of Donated Property, I.R.S. Pub. 561 (Apr. 2007).

[154] That said, the GAO found no "statistically significant differences in audit rates based on the likeliness that a Form 8283 filer required a qualified appraisal." U.S. Gov't Accountability Office, *supra* note 123, at 7. This could mean that amounts involved are too low to extend the effort or that the IRS often believes there is no issue, or a mixture of both.

C. Costs to the Reputation of the Charitable Sector

Another cost of the value-based deduction for property contributions is the damage to the integrity and reputation of the charitable sector that can result. Unfortunately, property contributions often make section 501(c)(3) organizations a party—wittingly or not—to abusive transactions that cheat the Treasury.[155] The result is an ongoing stain on the reputation of the charitable sector, a sector that to a certain extent relies on trust and good will for its effectiveness.

Valuation abuse, as already discussed, is a leading offender,[156] and may occur with or without the knowledge of the donee.[157] Other forms of abuse occur when the deduction primarily benefits donors or other third parties.[158] Donees also may be used in "asset parking" arrangements under which donors give property and take a fair-market-value deduction, yet the property indirectly remains under the donor's control. Continued control by the donor can produce benefits to the donor, and also may limit the ability of the donee to use the property for exempt purposes.[159] One example was the "SC2" tax shelter arrangement, in which interests in an S Corporation were donated and later sold back to the donor in order to convert ordinary income to capi-

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[155] For additional discussion of abuses relating to noncash property contributions and how abuses led to legislation, see Roger Colinvaux, *Charity in the 21st Century: Trending Toward Decay*, 11 FLA. TAX REV. 1, 23–28 (2011). *See also* Paul C. Light, *How Americans View Charities: A Report on Charitable Confidence, 2008*, ISSUES IN GOVERNANCE STUD., Apr. 2008, at 1, 3 (noting that "public confidence in charities remains at contemporary lows" perhaps because of widely reported charitable scandals (not exclusive to property donations)). Although such measures of public confidence take into account more than reputational damage from property donations, there is little doubt that property donations are a source of abuse, contributing to lack of confidence.

[156] *See* STAFF OF JOINT COMM. ON TAXATION, *supra* note 121, at 293–307 (proposing to reform the charitable deduction for contributions of property largely because of problems of valuation).

[157] Donees are not required to know of the donor's valuation. *See, e.g.*, INTERNAL REVENUE SERV., INSTRUCTIONS FOR FORM 8283: NONCASH CHARITABLE CONTRIBUTIONS (Dec. 2012), *available at* http://www.irs.gov/pub/irs-pdf/i8283.pdf (noting that the donor does not have to complete the valuation of contributed property prior to obtaining the donee's signature on the form).

[158] As discussed in considering problems of measuring the benefit to the donee, vehicle contributions (especially prior to 2004) are an example. *See supra* text accompanying note 96.

[159] *See, e.g.*, Charles T. Clotfelter, *What is Charity? Implications for Law and Policy: Tax Induced Distortions in the Voluntary Sector*, 39 CASE W. RES. L. REV. 663 (1989) (noting the concern that exists when a donor retains part ownership or active role in management of the assets, there is a continuing donor-donee relationship not present with cash). In 1969, asset-parking concerns led to restrictions on the value-based deduction for gifts to private foundations and to the imposition of payout rules and limits on the amount of holdings a foundation may have in any particular business. *See* Troyer, *supra* note 58, at 59–60. In recent years, asset parking issues have emerged at donor-advised funds and supporting organizations. *See* Colinvaux, *supra* note 155, at 31–33 (summarizing concerns relating to use of donor-advised funds and supporting organizations); MOLLY F. SHERLOCK & JANE G. GRAVELLE, CONG. RESEARCH SERV., R42595, AN ANALYSIS OF CHARITABLE GIVING AND DONOR ADVISED FUNDS (2012).

tal gains.[160] Another example, which the IRS listed as a "transaction of interest,"[161] is for a donor to acquire property by purchase, donate the property valued by appraisal at far more than the acquisition cost, and obtain the agreement of a donee not to sell the asset until after the reporting period on any such sale has expired. These transactions, and others like them,[162] utilize the ownership of an asset by an eligible donee—effectively involving the donee in a property transaction they otherwise would not have any interest in—in order to secure tax or other economic benefits.

Perhaps it is not surprising that the IRS identifies noncash contributions as one of the most abusive areas in the tax code.[163] These abuses have a cumulative effect and cause sector-wide damage, beyond the particulars of the organizations involved.[164]

D. Costs to the Tax System

The costs of property donations are not limited to the significant revenue, administrative, and reputation costs discussed above, but also entail costs to the workings and perception of the tax system as a whole.

As noted, a historic and continuing criticism of the fair market value measure as applied to appreciated property is that it is too generous. On its face, an overly generous benefit does not trouble donors, so long as all donors generally are able to use the benefit. But the benefits of the fair market value measure are not equally distributed. Rather, they predominantly flow to the most affluent.

In 2010 for example, of all itemized charitable contributions, 25% were of property (see Table 3).[165] Of these property contributions, 39% were made

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[160] For a more detailed description of the SC2 transaction, see PERMANENT SUBCOMM. ON INVESTIGATIONS, STAFF OF S. COMM. ON HOMELAND SEC. & GOVERNMENTAL AFFAIRS, 109TH CONG., THE ROLE OF PROFESSIONAL FIRMS IN THE U.S. TAX SHELTER INDUSTRY (Comm. Print 2005). Note that fair market value deduction was not a significant reason for the transaction. Nonetheless, the normalcy of property contributions to section 501(c)(3) organizations facilitates other abuses related to property.

[161] I.R.S. Notice 2007-72, 2007-2 C.B. 544.

[162] One commentator explains another type of asset resting arrangement involving a split interest gift. One problem is that "[c]harities will not complain about donations even in much smaller amounts than the donor has claimed as a charitable deduction; it is in the charity's interest to be known as compliant in almost any transaction." Gerzog, *supra* note 34, at 1174.

[163] I.R.S. News Release IR-2012-23 (Feb. 16, 2012) (listing abuse of charitable organizations and deductions as tenth on the list and noting that schemes "involv[ing] the donation of non-cash assets" often involve "highly overvalued" donations).

[164] The deduction for property contributions also entails a cost to mission. Property contributions can be distracting and consume the resources of a donee organization. Property may have to be held for investment, managed, sold, maintained, etc. Some property may be difficult to dispose of, entailing costs. Related use property may not be all that useful, or, though welcome, might not be a property that otherwise would have been desired, adversely affecting the donee organization's operations.

[165] *SOI Tax Stats—Individual Statistical Tables by Size of Adjusted Gross Income, Returns with Itemized Deductions: Itemized Deductions by Type and by Size of Adjusted Gross Income, Tax Years 2010, 2009, 2008, 2007, 2006, 2005*, Internal Revenue Serv., http://www.irs.gov/

by individuals earning $1 million or more of adjusted gross income, representing a mere .553% of total returns reporting property contributions (or six-tenths of 1%).[166] As Table 3 shows, the numbers are similar in prior years.

Table 3. Property Contributions as Part of the Total, and By the Affluent

Year	Property contributions as % of total itemized charitable contributions	% of property contributions made by donors with AGI ≥ $1 million and % of total returns of such donors	% of property contributions made by donors with AGI > $200,000 and < $1 million and % of total returns of such donors
2010	25%	39% of value and .553% of returns	13% of value and 9.7% of returns
2009	20%	34% of value and .457% of returns	15% of value and 9% of returns
2008	23%	40% of value and .589% of returns	16% of value and 9.3% of returns
2007	29%	50% of value and .73% of returns	18% of value and 9.1% of returns
2006	27%	52% of value and .644% of returns	13% of value and 8.1% of returns
2005	26%	45% of value and .545% of returns	15% of value and 7.1% of returns

In other words, a very generous tax benefit—one that is widely viewed as subject to abuse (and thus even more generous), but that is difficult to administer and enforce—is used mostly to reduce the tax liability of the affluent. This damages perceptions of the tax system as fair, and further fuels, with greater emphasis, a broader perception that the charitable deduction as a whole is inequitable.[167]

taxstats/indtaxstats/article/0,,id=96981,00.html (last modified Feb. 26, 2013) (calculations in column one taken from Table 1, *supra* text accompanying note 103; calculations in columns two and three taken by adding amount contributed and returns for AGI group specified and dividing each sum by the total amount claimed and total returns for noncash contributions, respectively).

[166] *Id.*

[167] *See e.g.*, Brody, *supra* note 32, at 714 (discussing the "upside-down," inequitable nature of the subsidy). As one commentator has noted, "Congress's preference for charitable gifts of appreciated property over cash gifts is inequitable as it disproportionately benefits wealthier donors." Gerzog, *supra* note 34, at 1158. *See also* Gerard M. Brannon, *A Pro-Charity Substitute for the Present Law Tax Treatment of Appreciated Property Contributed to Charity, in* RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS 2273 (1977) (noting that the fair market value measure is "particularly inequitable because of its concentrated effect for the very rich"), *available at* https://archives.iupui.edu/

Another systemic cost of the value-based deduction again impacts fairness, not on vertical equity grounds, but more on the level of rationality or fundamental fairness. The perfect illustration is the *Mohamed* case. As previously discussed,[168] in *Mohamed*, the Tax Court upheld the IRS's denial of a deduction for property worth $18.5 million on procedural grounds. Though defensible, and correct, this is a shockingly unfair result. The general policy and rule of the charitable deduction is to encourage and allow tax benefits for such contributions. Everyone agreed that the taxpayer donated something of considerable value.

However, because the potential for abuse of the value-based deduction is so great, Congress chose to condition the deduction on a process. This is a reasonable response to a serious problem that the court in *Mohamed* appropriately recognized, even though the result was harsh.[169] If a donor's failure to follow the rules for property contributions were excused, then the process would become optional—necessary only for abusive taxpayers.

The cost of the value-based deduction highlighted here is a problem that often occurs when bad actors take advantage of well-intentioned policy. The value-based deduction spawned a need for an anti-abuse process, but the process can then hold fairness hostage. What should be allowed as a deduction for all the right reasons is disallowed because of rules enacted to stop abuses. In other words, unfair, even perverse outcomes[170] like *Mohamed* are a direct result of allowing the value-based deduction.

E. Summary

The costs of the value-based deduction for property contributions are significant. Revenue losses attributable to property donations (again for individuals only) are roughly in the range of $77 to $92 billion from 2005 to 2010.[171] Most of these tax benefits flow to the most affluent, in large part because they have valuable property to give, and because the fair market

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bitstream/handle/2450/808/ResPprVol1.pdf; Kovach, *supra* note 121, at 79 ("Valuation difficulties undermine public faith in the fairness and integrity of our federal taxation systems.").

[168] Mohamed v. Comm'r, T.C.M. 2012-152, Nos. 13947-07, 12882-08, slip op.; *see supra* text accompanying notes 129–49.

[169] *Mohamed*, T.C.M. 2012-152.

[170] Fairness is relative. One could argue that the result, though harsh, nonetheless is fair. Notwithstanding IRS errors in explaining the rules, Mohamed could have done much more to understand and comply with the formal requirements. He did not read the instructions to the Form 8283 or consult a lawyer with respect to such a substantial transaction. Still, decisions like *Mohamed* likely result in increased ire at the IRS and on calls for courts and Congress to relax the rules. It should be noted, however, that in cases with likely less revenue at stake, the IRS often chooses not to contest the deduction. *See* U.S. Gov't Accountability Office, *supra* note 123, at 13 (noting that in eighty examination cases with more than $5,000 of noncash contributions, seventeen returns (Form 8283) were incorrectly filled out but the IRS did not contest the deduction); *see also* Treasury Inspector General for Tax Administration, *supra* note 115, at 7.

[171] *See supra* notes 106–07 and Table 2 (totaling amounts in columns). As noted there, this does not include revenue losses attributable to a capital gain exclusion.

value measure favors property over cash. But this fosters unfairness in the tax code because an overly generous benefit (for appreciated property) is available mostly to a select few. The unfairness is made worse by the fact that the value-based deduction is very hard (and costly) to administer, meaning that abuse and the perception of abuse run in tandem with the value-based deduction—further fostering unfairness, as a generous and sometimes unwarranted tax benefit is used by those with means.

V. Assessing the Benefits of Property Contributions

As discussed in Part II, viewed as a subsidy, the principal if not exclusive reason for the charitable deduction for property contributions is that the donee receives property. Property has value, and can be used, directly or indirectly, in furtherance of exempt purposes. (By contrast, cash contributions are encouraged not only because cash is valuable, but also for reasons related to the behavior of donors.) As an initial matter then, the charitable deduction for property can be justified if the value received by donee organizations[172] exceeds the costs.

In the case of cash, a conclusion that benefits exceed costs in the aggregate is fairly easy to make because the measure for the tax benefit and the benefit to the donee are the same[173]—the amount of cash contributed. As a result, revenue cost (likely the main cost for cash contributions) will always be a percentage of donee benefit.[174] But property contributions do not provide the same assurance. As discussed, the cost of property contributions are various, with revenue loss being one of several. Further, the measure for the deduction for property contributions (the amount of property contributed or claimed value) is not the same as the benefit to the donee. As discussed below, this lack of symmetry between claimed value and donee benefit further complicates evaluating the deduction for property contributions.

A. Assessing the Benefit to Donees Generally

That donee organizations receive value from property contributions is beyond doubt. Universities rely on contributions of investments as an important source of revenue. Museums rely on contributions of cultural property to stock collections. Food banks rely on contributions of food inventory to

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[172] Another perhaps better way to conceive of the benefit of property contributions is as the social benefit derived from the property by the donee. Identifying social benefit, however, is in many ways to question the effectiveness of a particular donee organization, as well as measuring the extent to which the actual activities of the organization advance public goals. This sort of inquiry is vital, but perhaps more appropriately directed to standards for section 501(c)(3) status or tailored toward crafting a tax incentive to benefit certain organizational purposes over others.

[173] *But see infra* note 184.

[174] The revenue cost will be the highest marginal rate of the taxpayer times the amount of cash contributed, i.e., a percentage of donee benefit.

feed the hungry. Nevertheless, actually accounting for donee benefit is harder than it would seem at first glance. The difficulty is that, apart from general statements about the importance of property contributions to various donee organizations, there is no readily available measure of the resulting benefit.

One possible, and objective, measure of donee benefit is the claimed value of noncash contributions by donors. In 2010, for example, the total claimed value of individual contributions stated on Form 8283 was $39.4 billion.[175] Added to this would be the claimed value of contributions not reported on the Form 8283 (i.e., contributions of less than $500), or $9.4 billion in 2010, for a total claimed value in 2010 of $48.8 billion. Table 4 shows a rough estimate of the claimed value of all individual noncash contributions from 2005 through 2010.

Table 4. Claimed Value of Individual Noncash Contributions

Year[176]	Claimed Value of Individual Noncash Contributions Reported on Form 8283	Claimed Value of Individual Noncash Contributions Not Reported on Form 8283[177]	Total Claimed Value of Individual Noncash Contributions
2010	$39.36 billion	$9.4 billion	$48.76 billion
2009	$30.95 billion	$3.8 billion	$34.75 billion
2008	$39.34 billion	$5.8 billion	$45.14 billion
2007	$58.66 billion	$5.9 billion	$64.56 billion
2006	$50.31 billion	$5.8 billion	$56.11 billion
2005	$49.01 billion	$7 billion	$56.01 billion

Although the claimed value of contributed property is a useful benchmark, it is not a good measure of donee benefit for several reasons. Most

[175] *See* Liddell & Wilson, *2010*, *supra* note 103, at 76 tbl.1a. Not all of this is deducted, however. Table 1, *supra* text accompanying note 103, shows the amount reported on Form 8283 and claimed as deductions, for example, as $34.9 billion in 2010. This amount differs from the claimed value of contributions. Some property contributions receive a basis deduction, or are enhanced deductions.

[176] The numbers for 2010 are derived from Liddell & Wilson, *2010*, *supra* note 103, at 76 tbl.1a. The numbers for 2009 are derived from Liddell & Wilson, *2009*, *supra* note 103, at 73 tbl.1a. The numbers for 2008 are derived from Liddell & Wilson, *2008*, *supra* note 103, at 86 tbl.1a. The numbers for 2007 are derived from Liddell & Wilson, *2007*, *supra* note 103, at 61 tbl.1a. The numbers for 2006 are derived from Liddell & Wilson, *2006*, *supra* note 103, at 76 tbl.1a. The numbers for 2005 are derived from Wilson, *2005*, *supra* note 103, at 76 tbl.1a.

[177] The claimed value of amounts not reported on Form 8283 is derived by subtracting total deductions claimed for all noncash property less total deductions claimed for items reported on Form 8283. This is a rough estimate of claimed value, but is likely somewhat overstated because not all contributions valued under $500 will receive a fair market value deduction (i.e., some could be basis or enhanced deduction property), though this is likely a very small amount.

importantly, claimed value and donee benefit differ because over (or under) valuation must be taken into account. For instance, a contribution of property with a value of $500,000 but that is wrongly appraised at $1 million does not yield a donee benefit of $1 million. Clearly donee benefit should not be based on over- or understated values. Widespread valuation errors[178] thus make it hard, if not impossible, to know with any certainty the actual value of donated property to the donee.

In addition, donee benefit in many cases is less, sometimes much less, than the claimed value of the property. Vehicle contributions are a notorious example. Prior to 2004, a donated vehicle produced a deduction based on (often exaggerated) fair market value. The benefit to the donee, however, was not the claimed fair market value (whether or not exaggerated) but a portion of the exchange value once the vehicle was sold by a third party, with the balance going to the third party.[179] Because vehicles often would sell for far less than the claimed value, there was a real difference between claimed value and the exchange value.[180] This problem occurs whether or not the property is correctly valued for tax purposes.[181]

A related issue in determining donee benefit is the difference between the gross benefit to the donee and the net benefit. Vehicles again are a good example. The net benefit to the donee is not the exchange value, but the exchange value less the portion paid to the third party managing the car donation program. Another example is the donation of intellectual property such as a patent. Patents are costly to own because the patent owner must pay registration fees.[182] Thus, the net benefit to the donee from a patent contribution would be the value of the patent, less any such fees. Similar carry-

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[178] For example, an IRS study showed a forty-five percent error rate on property donations in one year, resulting in about $4.6 billion in lost revenue. U.S. Gov't Accountability Office, *supra* note 123, at 1. The study reported that for every five errors in favor of the taxpayer (overvaluation) there was one error unfavorable to the taxpayer (undervaluation). *Id.*

[179] *See generally* Gen. Accounting Office, GAO-04-73, Rep. to S. Comm. on Fin., Vehicle Donations: Benefits to Charities and Donors, but Limited Program Oversight (2003).

[180] Accordingly, the rules were changed to base the deduction on the exchange value. *See also* Ackerman & Auten, *supra* note 108, at 683 (concluding that "the evidence suggests that the taxpayer valuations are much higher than the prices of most . . . auction sales").

[181] This stems from the difference between appraised value and the actual or true exchange value. The regulatory definition of fair market value refers to a *price*, i.e., 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." Treas. Reg. § 1.170A-1(c)(2) (2008). In other words, "fair market value" for tax purposes is really just a (hopefully well-reasoned) guess of an item's price. The point is that if the guess as to price turns out to be wrong as a matter of fact, it need not be wrong as a matter of law. But the benefit to the donee is not, or should not be, a legal concept. *See* Kovach, *supra* note 121, at 107 (noting that "[t]he 'willing buyer and seller' definition of fair market value is not at all useful").

[182] Don MacBean, *Better to Give Than to Receive: Evaluating Recent IP Donation Tax Policy Changes*, 2005 Duke L. & Tech. Rev. 19, *available at* http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1139&context=dltr.

ing costs are incurred for other property types.[183] The net benefit concept can also apply in cases where, for example, a donee accepts five items of property but can use only four. From the donee's perspective, the net benefit is the value of four items, but the donor will claim a deduction for all five.[184]

Considerations of exchange value and net benefit also raise a timing issue as to when to measure the benefit to the donee. Should it be measured at the time of the contribution, as under the general rule of current law, or upon the disposition date of the property by the donee? A comparison with cash highlights the problem. Cash contributions present no valuation or timing questions relating to donee benefit. So long as the donee has control over the cash, the benefit is realized immediately.[185] Because cash is the benchmark for value and the means of exchange, the benefit is known. By contrast, the benefit of property is largely unknown until it is translated into cash. The donee may be in possession of a sweater, a vehicle, an investment, or a computer. But what is the benefit from the contribution?

A critical factor is the use of the property by the donee. If the property is not for a related use, the donee benefit from the property generally is realized at the time of disposition and not at the time of the contribution. For vehicles, the benefit to the donee from the vehicle contribution (typically) is not possession of the vehicle. Rather, the donee benefit inures upon sale of the vehicle. Thus, donee benefit is better captured at the point of disposition, not contribution. The same timing issue arises, and is more complex, in cases where, unlike vehicles, the property may be held for a long time before disposition. In such cases, the realization of the benefit by the donee is delayed well beyond the contribution date, raising the question whether the tax benefits, or their final accounting, should also be delayed.[186]

The timing question of when to measure donee benefit is not a concern, however, if the property is for a related use. For related use property, the intent is for the donee to dispose of the property through use, not sale. Thus, capturing the value of the property at the contribution date generally makes sense. The best starting measure of donee benefit likely is the current measure—appraised value—with the object of the appraisal being to estimate

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[183] *See generally* Clotfelter, *supra* note 159.

[184] That said, the distinction here between gross benefit and net benefit can also be applied to cash that is converted to property, or more broadly to take into account the costs to the donee of securing the contribution. Again, this can be applied to cash and property, as donees typically will have fundraising and other costs to "pay for" the contributions. The measure for the deduction, whether for cash or property, could and perhaps should take into account a net benefit analysis.

[185] The main issues with a cash contribution in terms of donee benefit relate to internal governance and the efficiency of the donee: i.e., questions about how well the money is spent, and how much each contribution costs the organization to raise.

[186] *See e.g.*, Gerzog, *supra* note 34, at 1180 (arguing that in some cases "the taxpayer's deduction should parallel the timing of the charity's benefit"). Contributed vehicles typically are sold promptly after the contribution, which strengthens the argument that the deduction should at least be based on the realized exchange value. Note that exchange value here differs from the net benefit to the donee.

the price at which the contributed item would be acquired by the donee. Ideally, however, this measure should be discounted to account for whether the contributed property is actually property that would have been acquired and used by the donee if cash were given instead of property.

For example, if a museum were given $1 million in cash and the museum acquired a painting—"True Blue"—with the cash, it would be a reasonable conclusion that the donee benefit was $1 million. As art consumers, we might have preferred that the museum acquired "Red and Yellow," but that seems irrelevant to assessing donee benefit. If instead, a museum is given Red and Yellow, which is reasonably appraised at $1 million, but the museum actually wanted True Blue and does not have a place for Red and Yellow in its collection, is the donee benefit still $1 million? Some might argue yes, because the museum has an asset worth $1 million. But even so, the asset might not be put to use, and so its value not realized.

Further, sale of Red and Yellow likely is not a realistic choice for the museum. Sale of such contributed property not only might harm donor relationships, but sale within three years of the contribution date could have adverse tax consequences for the donor. Upon sale, the painting would be presumed not to be related use property and the donor's deduction would be reduced by any long-term capital gain to basis.[187] Thus, for related-use property, a quick sale or exchange for a more desired asset is not feasible—locking the donee into use of perhaps unwanted property. In short, donee benefit in the case of related use property should not strictly be based on exchange value, but qualitative factors such as the need of the donee for the property should be taken into account.

As the foregoing discussion demonstrates, the benefit to the donee organization is hard to generalize, but claimed value is not the right measure. Donee benefit will depend on the type of property, whether the property is for a related use, how hard the property is to value, and the costs associated with the property. Nonetheless, an effort can be made to identify some of the issues involved in assessing donee benefit.[188] Thus, the next section undertakes an overview of some of the issues affecting determinations of donee benefit for the main property types.

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[187] I.R.C. § 170(e)(7) (2006).

[188] It is beyond the scope of this Article to present an exhaustive analysis of the benefits to donee organizations of each of the property types. The intent of the discussion here is to identify key issues that affect each property, with the goal of making judgments about the degree to which a particular property type presents cause for concern about the amount of donee benefit from the contribution.

B. Donee Benefit, By Type of Property

1. Corporate Stock, Mutual Funds, and Other Investments

Corporate stock, mutual funds, and other investments are consistently the largest component of property contributions each year measured by claimed value. In 2010, for example, this category accounted for 45% of the total claimed value of property contributions reported on Form 8283, but just 1.4% of total donations. Table 5 shows the amounts for 2005 to 2010.

Table 5. Claimed Value of Corporate Stock, Mutual Funds, and Other Investments.

Year	Claimed Value on Form 8283[189]	% of Total Value[190]	% of Total Donations[191]
2010	$17.78 billion	45%	1.4%
2009	$11.47 billion	37%	1.3%
2008	$15.7 billion	40%	1.45%
2007	$27.71 billion	47%	2.6%
2006	$26.45 billion	53%	2.9%
2005	$19.76 billion	40%	2.5%

For this property category, donee benefit is perhaps quite close to the claimed value, with important caveats. To the extent the investments are publicly traded, valuation on any given date is not a serious concern because

[189] The numbers for 2010 are derived from Liddell & Wilson, *2010*, *supra* note 103, at 64 fig.A. The numbers for 2009 are derived from Liddell & Wilson, *2009*, *supra* note 103, at 63 fig.A. The numbers for 2008 are derived from Liddell & Wilson, *2008*, *supra* note 103, at 77 fig.A. The numbers for 2007 are derived from Liddell & Wilson, *2007*, *supra* note 103, at 53 fig.A. The numbers for 2006 are derived from Liddell & Wilson, *2006*, *supra* note 103, at 68 fig.A. The numbers for 2005 are derived from Wilson, *2005*, *supra* note 103, at 69 fig.A.

[190] The numbers for 2010 are derived from Liddell & Wilson, *2010*, *supra* note 103, at 76. The numbers for 2009 are derived from Liddell & Wilson, *2009*, *supra* note 103, at 73. The numbers for 2008 are derived from Liddell & Wilson, *2008*, *supra* note 103, at 86. The numbers for 2007 are derived from Liddell & Wilson, *2007*, *supra* note 103, at 61. The numbers for 2006 are derived from Liddell & Wilson, *2006*, *supra* note 103, at 76. The numbers for 2005 are derived from Wilson, *2005*, *supra* note 103, at 76. The numbers result from dividing the total fair market value column of Tables 1b by the total fair market value column of Tables 1a.

[191] The numbers for 2010 are derived from Liddell & Wilson, *2010*, *supra* note 103, at 76. The numbers for 2009 are derived from Liddell & Wilson, *2009*, *supra* note 103, at 73. The numbers for 2008 are derived from Liddell & Wilson, *2008*, *supra* note 103, at 86. The numbers for 2007 are derived from Liddell & Wilson, *2007*, *supra* note 103, at 61. The numbers for 2006 are derived from Liddell & Wilson, *2006*, *supra* note 103, at 76. The numbers for 2005 are derived from Wilson, *2005*, *supra* note 103, at 76. The numbers result from dividing the total donations column of Tables 1b by the total donations column of Tables 1a.

the claimed value of highly liquid, publicly traded property is roughly equivalent to the exchange value. For this reason, appraisals are not required for publicly traded securities.[192] Valuation issues still arise, however, if restrictions are placed on the gift.[193] Such restrictions may not always be properly accounted for in valuation. In addition, many of the "other investments" will include nonpublicly traded securities and so will present valuation difficulties, sometimes serious ones.[194]

Apart from the valuation of nonpublicly traded securities and the issue of restricted gifts, another reason to discount the claimed value in arriving at donee benefit relates to the timing of the contribution. Donors have every incentive to time a contribution at an asset's peak exchange value. For instance, one study found a "pattern of excellent timing" of donations of company stock by CEOs to controlled private foundations.[195] "On average these gifts occur at peaks in company stock prices, following run-ups and just before significant price drops."[196] When this occurs, the donee receives an asset soon-to-be worth much less than the claimed value. Backdating transactions and fraud[197] could also result in significant differences between claimed value and the actual donee benefit.

Another reason to question the identity of claimed value and donee benefit exists if the donee is a private foundation or a donor-advised fund. These are primarily grant-making organizations in which the donor retains a degree of control or influence over the disposition of the contributed asset even after the contribution date.[198] The issue is that the exercise of such control can affect the timing of the realization of the donee benefit. That is, even though there has been a formal transfer of ownership from donor to donee,

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[192] Determining the Value of Donated Property, I.R.S. Pub. 561, 5–6 (Rev. April 2007).

[193] *See e.g.*, Clotfelter, *supra* note 159, at 676. Professor Clotfelter writes that "[f]or nonprofit organizations, receiving gifts in asset form is no more than an inconvenience when they are marketable assets such as stock. But this bias in favor of appreciated assets may have a significant impact on the asset holdings of some nonprofit organizations, those which receive gifts of real property, closely-held businesses, or works of art." Further, "[g]ifts of appreciated assets, however, often place effective limits on their disposition by donee organizations. Some appreciated assets, such as real estate or closely-held corporations, are not readily marketable, leaving the donee organization to choose between holding it or disposing of it at a price significantly below its long-term value." *Id.* at 688.

[194] *See e.g.*, McCord v. Comm'r, 461 F.3d 614 (5th Cir. 2006) (involving the valuation of donated partnership interests and the relevance of post-gift events to determining value); Gerzog, *supra* note 34, at 1172–77 (discussing *McCord*).

[195] David Yermack, *Deductio ad absurdum: CEOs Donating Their Own Stock to Their Own Family Foundations*, 94 J. FIN. ECON. 107, 108 (2009).

[196] *Id.*; *see also* Gerzog, *supra* note 34, at 1169 (citing Yermack, *supra* note 195, and noting that "[i]ncredibly, CEOs donate company stock to their family foundations immediately before a steep loss in their value while they retain powers to vote those shares because they are not subject to insider trading laws for charitable deductions"). Professor Gerzog argues that in some cases the benefit to the donor will exceed the benefit to the donee, which should result in disallowance of the deduction under a quid pro quo analysis.

[197] Gerzog, *supra* 34, at 1170 (citing Yermack, *supra* note 195).

[198] For a general discussion of donor-advised funds and private foundations, see generally SHERLOCK & GRAVELLE, *supra* note 159.

until such time as the donor directs or advises the disposition of the asset, there are questions about the extent to which the donee truly has independent control of the asset, and so is unfettered in realizing the benefit.[199] As one commentator has noted, "the benefit of the full current deduction the taxpayer receives may be greater than the benefit derived by the charities who may not receive the funds until future years."[200] Because donor-advised funds and private foundations receive a significant amount of the total value of investment contributions,[201] this is an important part of assessing the overall donee benefit for such contributions.

2. *Real Estate, Land*

Publicly available data do not provide a clear picture of the claimed fair market value of real estate and land contributions. For 2010, the total claimed fair market value of real estate, land, *and* easement contributions was $5.47 billion,[202] or 13.9% of total noncash contributions reported on Form 8283.[203] Real estate and land accounted for $1.34 billion in deductions,[204] but because of the percentage limitations and carryforwards, this amount does not represent the claimed fair market value for the year. Easements accounted for $765.5 million of deductions.[205]

Determining the donee benefit from contributions of real estate and land depends largely on two factors—the difference between appraised value and exchange value and whether the property is for a related use.[206] Because real estate and land are unique, determining an exchange value is less precise than for publicly traded securities. Thus, appraisals are required for such contributions, meaning again that the valuation process creates a

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[199] This is an aspect of the issue of pay outs by grant-making 501(c)(3) organizations. As the Congressional Research Service recently noted, many donor-advised funds do not pay out significant amounts. *See id.* at 14–18. There is a broader policy issue here that affects gifts of both cash and property. Property contributions raise more issues than cash, however, because the donor may retain benefits from not fully relinquishing control of the property.

[200] Gerzog, *supra* note 34, at 1170.

[201] The total claimed value of property contributions received by private foundations in 2010 for example was $8.93 billion. Liddell & Wilson, *2010*, *supra* note 103, at 85 tbl.2j. Although the type of property received by private foundations is not specified in this data, most property contributions to private foundations would be of publicly traded stock because any other type of property contribution would receive only a deduction of basis (or fair market value if the property is depreciated). Assuming, for example, that $8.75 billion of this claimed value was of publicly traded securities, it would account for forty-nine percent of the claimed value of all contributions of corporate stock, mutual funds, and other investments. (Figure derived by dividing $8.75 billion over total fair market value of corporate stock, mutual funds, and other investments.) *Id.*

[202] *Id.* at 77 tbl.1c.

[203] *Id.* (deriving percentage by dividing the fair market value reported in Table 1c by fair market value reported in Table 1a).

[204] *Id.* at 64 fig.A (adding amount carried to Schedule A for land and real estate).

[205] *Id.*

[206] Related use of real property does not affect the amount of the deduction. A related use is relevant to the deduction amount only for tangible personal property.

gap between claimed value and the exchange value. That said, robust markets of comparable properties in real estate and land, where they exist, impose constraints on appraisals, minimizing to some extent the potential for abuse. Nevertheless, valuation and enforcement uncertainties mean that claimed value is not a solid proxy for donee benefit. This is so especially for related-use land and real estate to the extent that the related use is not the "highest and best use," which generally would be the basis for the appraised value.

For real estate and land not for a related use, the net donee benefit generally should take into account costs of maintaining the property, which could be significant.[207] In addition, the donor control issues discussed above with respect to corporate stock apply here as well. Donors, by shifting assets to a donor-advised fund or supporting organization (or other public charity), may be able to claim a fair market value deduction, and maintain effective control of the asset,[208] undermining donee benefit. In short, flaws in the appraisal process, the costs of owning unrelated use property, and donor control issues mean that claimed value is a deficient measure of donee benefit.

3. Easements, Conservation and Façade

Easement contributions are exceptional in many ways,[209] and present unique challenges to measuring donee benefit. Unlike other property contributions, the claimed value of an easement for tax purposes bears no relation to the donee benefit. This is because the benefit to the donee depends upon the conservation value of the easement, not the before-and-after market value that is appraised for tax purposes.[210] Accordingly, it is very difficult to quantify the donee benefit of easement contributions.

Notwithstanding this issue, concerns about valuation and donee benefit of easement contributions have led to hundreds of audits, many litigated cases, calls for repeal of the deduction,[211] replacement of the deduction with a credit,[212] among other reforms.[213]

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[207] Although such costs could also be included in determining the net benefit for related use property, the theory of related use is that the costs associated with the property generally would have been incurred as costs in direct furtherance of an exempt purpose, and so are not directly attributable to the contribution.

[208] *See* SHERLOCK & GRAVELLE, *supra* note 159, at 3–4.

[209] Easement exceptionalism has several aspects. Easements are contributions of a partial interest in property, for which deductions normally are not allowed. I.R.C. § 170(f)(3)(B)(iii) (2006). Easement contributions must be for a conservation purpose; other property contributions to section 501(c)(3) organizations do not have a purpose test. I.R.C. § 170(h)(1)(C) (2006). Easements receive the benefit of special rules for percentage limitation and carryover purposes. I.R.C. § 170(b)(1)(E), (2)(B) (2006). Numerous other statutory and regulatory requirements apply to easement contributions. *See generally* I.R.C. § 170(h) (2006); Treas. Reg. § 1.170A-14 (2012).

[210] For extensive discussion, see generally Colinvaux *supra* note 144.

[211] *See, e.g.*, Daniel Halperin, *A Better Way to Encourage Gifts of Conservation Easements*, 136 TAX NOTES 307 (2012).

[212] *See, e.g.*, Colinvaux, *supra* note 144, at 49–59.

As noted above, publicly available data do not show the claimed fair market value of easement contributions. The amount claimed as deductions, $765.5 million in 2010, or 2.2% of total deductions,[214] however, provides a sense of the scope.

4. Clothing, Accessories, Household Items, Electronics

The category of clothing, accessories, household items, and electronics ("clothing and household items" for short) is a close second to investments as the largest category of noncash property contributions by value.[215] By number of total donations, it is by far the largest category, as shown in the last column of Table 6, below. In 2010 for example, the total claimed value of clothing and household items was $12.05 billion,[216] or 30.6% of total noncash contributions reported on Form 8283.[217] Of this amount, $8.33 billion was clothing and accessories.[218] Table 6 shows the figures for earlier years.

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[213] *See, e.g.*, Nancy A. McLaughlin, *Increasing the Tax Incentives for Conservation Easement Donations – A Responsible Approach*, 31 ECOLOGY L. Q. 1 (2004); *see also* JEFF PIDOT, REINVENTING CONSERVATION EASEMENTS: A CRITICAL EXAMINATION AND IDEAS FOR REFORM (2005), *available at* http://www.lincolninst.edu/pubs/1051_Reinventing-Conservation-Easements.

[214] Liddell & Wilson, *2010*, *supra* note 103, at 64 fig.A.

[215] Indeed, in some years it could exceed investments, assuming that many of the noncash contributions below $500 (and so not reported on Form 8283) fall into this category.

[216] Liddell & Wilson, *2010*, *supra* note 103, at 78–79 (deriving amount by adding the fair market values in Tables 1f, 1g, and 1h).

[217] *Id.* at 76, 78–79 (deriving percentage by dividing the sum of fair market values in Tables 1f, 1g, and 1h by the fair market value in Table 1a).

[218] *Id.* at 78 tbl.1f.

Table 6. Claimed Value of Clothing and Household Items and Number of Donations

Year	Total Claimed Value of Clothing, etc. Contributions on Form 8283[219]	% of Total Claimed Value of All Contributions on Form 8283[220]	% of Total Donations Reported on Form 8283
2010	$12.05 billion	30.6%	87%
2009	$11.2 billion	36.2%	88%
2008	$11.51 billion	29.25%	88%
2007	$12.05 billion	20.55%	86%
2006	$10.59 billion	21.05%	85%
2005	$11.42 billion	23.3%	85%

Assessing the donee benefit from donations of clothing and household items is complex. Initially, claimed value likely is not a very useful measure of donee benefit. This is because the opportunities for overvaluation of such items are considerable. Appraisals are not required for contributions under $5,000,[221] meaning that the claimed value for these contributions (i.e., the amount of the deduction) in effect is up to the judgment of the donor. Donors are given non-binding guidance in deciding on a value. The IRS suggests "thrift shop value" as a basis for determining the amount of the deduction.[222] Both Goodwill and the Salvation Army, two major donees for such items, provide valuation guides.[223] Goodwill, for example, suggests a

[219] The numbers for 2010 are derived from Liddell & Wilson, *2010*, *supra* note 103, at 78–79. The numbers for 2009 are derived from Liddell & Wilson, *2009*, *supra* note 103, at 75–76. The numbers for 2008 are derived from Liddell & Wilson, *2008*, *supra* note 103, at 88–89. The numbers for 2007 are derived from Liddell & Wilson, *2007*, *supra* note 103, at 63–64. The numbers for 2006 are derived from Liddell & Wilson, *2006*, *supra* note 103, at 78–79. The numbers for 2005 are derived from Wilson, *2005*, *supra* note 103, at 78–79. The amount results from adding the fair market values in Tables 1f, 1g, and 1h.

[220] The numbers for 2010 are derived from Liddell & Wilson, *2010*, *supra* note 103, at 78–79. The numbers for 2009 are derived from Liddell & Wilson, *2009*, *supra* note 103, at 73, 75–76. The numbers for 2008 are derived from Liddell & Wilson, *2008*, *supra* note 103, at 86, 88–89. The numbers for 2007 are derived from Liddell & Wilson, *2007*, *supra* note 103, at 61, 63–64. The numbers for 2006 are derived from Liddell & Wilson, *2006*, *supra* note 103, at 76, 78–79. The numbers for 2005 are derived from Wilson, *2005*, *supra* note 103, at 76, 78–79. The amount results from dividing the sum of fair market values in Tables 1f, 1g, and 1h by the fair market value in Tables 1a.

[221] I.R.C. § 170(f)(11) (2006).

[222] INTERNAL REVENUE SERV., INSTRUCTIONS FOR FORM 8283: NONCASH CHARITABLE CONTRIBUTIONS (2012), *available at* http://www.irs.gov/pub/irs-pdf/i8283.pdf; *see also* Charitable Contributions, I.R.S. Pub. 526, 10 (Jan. 2013) (noting that "[t]here are no fixed formulas or methods for finding the value of items of clothing" and that "you should claim as the value the price that buyers of used items actually pay in used clothing stores").

[223] *Valuation Guide for Goodwill Donors*, GOODWILL INDUS. INT'L, INC., http://www.goodwill.org/wp-content/uploads/2010/12/Donation_Valuation_Guide.pdf (last visited Feb. 21, 2013); *Donation Receipts—Valuation Guide*, THE SALVATION ARMY, http://www.salvation

value for child's shorts or tee-shirt ($.50), and for a man's or woman's coat ($40).[224] But the extent to which donors follow such guidance is not known.

As with all contributions, substantiation rules apply. These rules, however, can do little to combat overvaluation. For gifts under $250, donors are required to obtain a receipt from the donee, unless "the contribution is made in circumstances where it is impractical to obtain a receipt (e.g., by depositing property at a charity's unattended drop site)."[225] Because clothing donations are often made in such circumstances, substantiation of many gifts is therefore entirely dependent on "reliable written records" maintained by the donor.[226] Although most donors are likely honest and do their best, there is in effect no meaningful check on claimed values.[227]

For gifts of $250 or more, the donor must substantiate the contribution with a receipt issued contemporaneously by the donee.[228] So at least for these gifts, third-party verification of the donation is always required. But donees do not have to provide any estimate of the value of the contribution. Donee practices for providing receipts vary. The Salvation Army, for example, allows donors to receive receipts from a clerk or receptionist at a drop-off location, or from the truck driver who picks up the donation.[229] The Military Order of the Purple Heart of the U.S.A., Inc., another prominent donee of clothing and household items, tells donors that the driver picking up the donation will leave a receipt, but that it will not estimate a monetary amount.[230] This donee explains that the "Internal Revenue Code places the responsibility for the 'Fair Market Value' upon the donor. The driver is not qualified to make that determination and in most cases never sees the items donated since they are in bags and boxes."[231] For contributions of $500 or more, donees must list the property and declare its value on the Form 8283. The information requested is largely duplicative of the "reliable written records" required for smaller contributions.[232]

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armyusa.org/usn/www_usn_2.nsf/0/d477340ffa28755c8525743d0049d1ef?opendocument (last visited Feb. 22, 2013).

[224] *Valuation Guide for Goodwill Donors*, *supra* note 223.

[225] Treas. Reg. § 1.170A-13(b)(1)(iii) (2006).

[226] Such records require the name and address of the donee, the date and location of the contribution, a description of the property in reasonable detail, the fair market value of the property, and the method used in determining value. Treas. Reg. § 1.170A-13(b)(2)(ii) (2006).

[227] *See, e.g.*, President's Advisory Panel, Report on Federal Tax Reform, Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System 75–78 (2005) (criticizing the "do-it-yourself" nature of receipts and the problem of inflated valuations).

[228] I.R.C. § 170(f)(8) (2006).

[229] *See Donation Receipts—Valuation Guide*, *supra* note 223.

[230] This is a bit like the taxi driver who issues a blank receipt, leaving the rider the discretion to fill in the amount for purposes of reimbursement by his employer.

[231] *Tax Deductible Clothing Donations FAQ's*, The Military Order of the Purple Heart of the U.S.A., Inc., http://www.veteranpickup.org/faq (last visited Feb. 22, 2013).

[232] *Compare* Treas. Reg. § 1.170A-13(b)(1), (2) (2006) (reliable written records) *with* I.R.C. § 170(f)(11) (2006) (contributions of more than $500).

Stamoulis v. Commissioner[233] is a useful illustration of the hazards of the deduction for clothing and household items. In *Stamoulis*, the taxpayer, an investment banker and self-proclaimed "impulsive buyer," listed $48,954 in property contributions, most of which were to a "high-end" thrift shop in New York City. Donations included "clothing, shoes, rags, furniture, jewelry, books, CDs, DVDs, tapes, a cellular phone, 'kitchen accessories/appliances' and 'other accessories,' 'household goods,' antiques (e.g., vases, sculptures, and other 'decorative items'), and electronic devices."[234] The IRS challenged the valuation of the items.

The Tax Court, in a nonprecedential summary opinion, noted that "the fair market value of an item involves an approximation, and is, at best, an inexact science."[235] The court found the taxpayer's estimates of value "optimistic" and reduced the allowed amount to $8,949.[236] The court arrived at this amount by measuring the taxpayer's claimed deduction "against the average for similarly situated taxpayers."[237] In deciding whether to impose an accuracy-related penalty, the court again commented on the "inexact science" of valuation and thus concluded that the taxpayers "overly optimistic valuation" was not negligent and that no accuracy-related penalty would be imposed.[238]

Stamoulis is unusual in that the amount at stake, almost $50,000, was high enough to warrant attention and challenge. Other, lesser amounts will normally go unchallenged. Further, although the IRS prevailed, it is noteworthy that to a certain extent, the taxpayer's "optimistic" valuation was, if not embraced by the court, not punished either. It is as if, given the inherent imprecision involved, it would not be fair to hold a taxpayer's hopes to account.

Taxpayers clearly utilize the tax benefit for clothing and household items. The number of returns with such donations in 2010 was 8.78 million, for a total of 18.15 million donations.[239] The average amount of each donation in 2010 was $644 for clothing, $385 for accessories,[240] $676 for elec-

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[233] Stamoulis v. Comm'r, T.C. Summ. Op. 2007-38 (2007).

[234] *Id.* at 2 n.4.

[235] *Id.* at 3. Similar statements appear as virtual boilerplate in many decisions. *See, e.g.*, Akers v. Comm'r, 48 T.C.M. (CCH) 1113 (1984) ("[V]aluation is not an exact science and cannot be determined with mathematical precision. It is a subjective determination which requires the exercise of our best judgment considering all the facts and circumstances of record." (citing Messing v. Comm'r, 48 T.C. 502, 512 (1967))).

[236] T.C. Summ. Op. 2007-38 at 3–4.

[237] *Id.* at 4.

[238] *Id.*

[239] Liddell & Wilson, *2010*, *supra* note 103, at 64 fig.A (adding total returns and total donations for clothing, household items, accessories, and electronics).

[240] Although the $300 figure is below the $500 filing threshold for the Form 8283, the $500 threshold is met by aggregating similar items. I.R.C. § 170(f)(11)(F) (2006).

tronics, and $719 for household items.[241] As noted, this does not include donations of less than $500.[242]

Needless to say, administering the clothing and household items deduction is daunting. A high number of low value contributions means that most will escape notice—a fact that only contributes to further utilization of the tax benefit and possible exploitation of valuation uncertainties. Thus, it is no surprise that the deduction for the value of clothing and household items is promoted as a good way to minimize the tax bill,[243] further calling into question the relationship between the claimed value and donee benefit.

In addition, as with other property contributions, measuring donee benefit depends upon how the donee uses the contributed property. As discussed, a donee organization might use the property for a related use, hold the property for investment purposes, or, relatedly, dispose of it and use the proceeds either for a related use or an investment.

Another possible use, however, is to establish a business that is unrelated to exempt programs, as a dealer or seller of contributed property. Normally, if an unrelated business is regularly carried on, it is considered an "unrelated trade or business" and so subject to the unrelated trade or business income tax.[244] However, the Code provides that an "unrelated trade or business" does not include a trade or business "which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions."[245] Because of this rule, donees of clothing and household items especially have incentives to use the contributions in an unrelated use. In other words, what appears on its face to be a tax benefit to encourage donations of related-use property also facilitates unrelated, and untaxed, trades or businesses in contributed property.

Goodwill explains what happens to some donations that are not sold in their thrift stores: "[W]e've found other creative uses for them. For instance, some member Goodwills recycle old clothing scraps into industrial wipes (cleaning cloths) for industrial buyers. Other items that are too damaged for retail sale are sold to salvage brokers."[246] It is worth noting that the items

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[241] Liddell & Wilson, *2010*, *supra* note 103, at 64 fig.A.

[242] Concern about abuse of the donation for clothing and household items led the staff of the Joint Committee on Taxation to propose eliminating the deduction for amounts over $500. JOINT COMM. ON TAXATION, *supra* note 121, at 290. Instead, Congress enacted I.R.C. § 170(f)(16) (2006), requiring that the items be in "good used condition or better" in order to qualify for deduction.

[243] *See e.g.*, Bruce Watson, *How to 'Cheat' on Your Taxes. . .Legally!*, DAILYFINANCE (Mar. 26, 2012, 1:25 PM), http://www.dailyfinance.com/-2012/03/26/how-to-cheat-on-your-taxes-legally (noting that the rule of thumb is that one can deduct the resale price of donations and one can also deduct the cost of gas incurred in dropping the items off).

[244] I.R.C. §§ 511-514 (2006).

[245] I.R.C. § 513(a)(3) (2006).

[246] FREQUENTLY ASKED QUESTIONS, GOODWILL INDUSTRIES INT'L, INC. (Sept. 3, 2009), http://www.goodwill.org/uncategorized/faqs. Additional evidence of donee use of donated clothing and household items is detailed in a 2006 ABC News article, reporting that a fraction of the best clothing donations are kept by the donee for resale, while "[t]he remaining 90 percent or more of what you give away is sold by the charitable institution to textile recycling

"too damaged for retail sale" presumably also are items "not in good used condition or better" and for which donors should not claim a deduction.[247] Whether donors claim a deduction for such items cannot be verified.

As another example of donee use, The Purple Heart explains that "[t]he donations of clothing and household items that are collected are not given to veterans themselves. Instead, they are sold to various thrift stores. The proceeds from these sales help support programs sponsored by the [Purple Heart]."[248] To the extent this occurs, it raises a clear differential between the claimed value of contributions and the donee benefit. Recall that the IRS suggests thrift shop value as the deductible amount. Presumably the thrift shop, when purchasing items, pays less than the thrift shop value, perhaps much less, meaning that the benefit to the donee (the Purple Heart in this case) should be based on the sales price to the thrift shop.

An additional reason to doubt that the claimed value provides a reasonable basis for determining donee benefit involves practices by for-profit companies. As documented by press accounts, some companies that can use clothing as raw material in their business put out collection bins as a way to entice individuals to "donate."[249] Mistaking the collection bin for one operated by a charitable donee, taxpayers may be claiming donations (which themselves may be overvalued) for contributions that have zero donee benefit, because the donee is not in fact eligible to receive deductible contributions.

In sum, the donee benefit from contributions of clothing and household items is difficult to quantify. It is a widely-used deduction, of relatively small amounts, dependent almost entirely on taxpayer judgment (and goodwill) as to amount, susceptible to fraud, difficult if not impossible to administer, and is not solely for a related use of the donee. In some respects, the donation for clothing and household items resembles the donation for vehicles before legislative changes in 2004 in that the benefit to the donee appears to bear little relationship to the amount claimed as a deduction.

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firms." Mike Lee, *The Truth About Where Your Donated Clothes End Up*, ABC News (Dec. 21, 2006), *available at* http://abcnews.go.com/WNT/story?id=2743456&page=1. The textile recycling firms profit, in part, by finding a market for the left-over clothing donations in developing countries. *Id.*

[247] I.R.C. § 170(f)(16)(A) (2006).

[248] *Tax Deductible Clothing Donations FAQ's, supra* note 231.

[249] Huey Freeman, *No Charity Cases: Some Clothing Boxes are Not What They Seem to Be*, Herald-Review.com (Feb. 9, 2011, 12:00 AM), http://herald-review.com/news/local/article_b3869dde-3401-11e0-ae2a-001cc4c03286.html (arguing that "[b]ecause of the misleading nature of USAgain boxes, which consumers often associate with charities, several U.S. jurisdictions have passed laws mandating that the company must clearly state the purpose of its boxes, or outright banning the receptacles."); Linda Saslow, *Laws Seek to Counter Clothing-Bin Fraud*, N.Y. Times (Dec. 5, 2008), *available at* http://www.nytimes.com/2008/12/07/nyregion/long-island/07clothingli.html?_r=0.

5. *Art and Collectibles*

Determining the donee benefit from gifts of art and collectibles[250] ("art" for short) again turns initially on valuation. The claimed value of contributed art and collectibles in 2010 was roughly $1.28 billion, or 3.2% of the total claimed value of property contributions reported on Form 8283. As shown in Table 7, the numbers for prior years are similar.[251]

Table 7. Claimed Value of Art and Collectibles

Year	Fair Market Value Claimed on Form 8283	Percent of All Property Contributions
2010	$1.28 billion	3.2%
2009	$984 million	3.2%
2008	$1.51 billion	3.8%
2007	$1.26 billion	2.1%
2006	$1.3 billion	2.6%
2005	$1.46 billion	3%

Art, unlike clothing and household items, often is of high value. That fact, combined with difficulties of valuing art,[252] leads to special rules and procedures. Appraisals must be attached to the donor's return for claimed values of $20,000 or more.[253] Taxpayers may request a statement of value from the IRS on items believed to be worth $50,000 or more.[254] The IRS devotes resources to maintaining in-house expertise on art valuation.[255] And an independent expert Art Advisory Panel is convened regularly to value artwork for income, gift, and estate tax purposes.[256] So, ironically, although

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[250] Collectibles include collections of rare books, autographs, sports memorabilia, dolls, manuscripts, stamps, coins, guns, phonograph records, and natural history items. I.R.S. Pub. 561, *supra* note 153, at 5.

[251] The numbers for 2010 are derived from Liddell & Wilson, *2010*, *supra* note 103, at 76–77. The numbers for 2009 are derived from Liddell & Wilson, *2009*, *supra* note 103, at 73–74. The numbers for 2008 are derived from Liddell & Wilson, *2008*, *supra* note 103, at 86–87. The numbers for 2007 are derived from Liddell & Wilson, *2007*, *supra* note 103, at 61–62. The numbers for 2006 are derived from Liddell & Wilson, *2006*, *supra* note 103, at 76–77. The numbers for 2005 are derived from Wilson, *2005*, *supra* note 103, at 76–77. The Fair Market Value column is derived from Tables 1d, and the Percentage column is derived by dividing the fair market value in Tables 1d by the fair market value in Tables 1a.

[252] *See generally* Anne-Marie E. Rhodes, *Big Picture, Fine Print: The Intersection of Art and Tax*, 26 COLUM. J.L. & ARTS 179, 196 (2003) ("The valuation of unique works of art is difficult, and whether for tax reasons or non-tax reasons, there is no doubt that it must depend on expert appraisals by expert appraisers.") (footnotes omitted).

[253] I.R.S. Pub. 561, *supra* note 153, 4.

[254] *Id.*

[255] U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 123, at 15.

[256] *See* discussion *supra* note 127.

in the aggregate, clothing and household items cost the treasury far more,[257] art is subject to relatively greater regulation and oversight.

It may be sufficient to note that valuation is and likely always will be an ongoing problem for art contributions. The problems arise in part because the value of art is, to a certain extent, more subjective than for other property; and often, artwork is unique, making it hard to value because there is nothing comparable. The art market, also, is peculiar. There is both an auction market and a dealer market: prices for artwork may differ depending on the market in which it is sold.[258] Auction prices may not reflect true value so much as competitive bidding, but nonetheless represent a sales price. Items may fluctuate in value depending on trends, and guesses about whether a particular trend will continue. Further, as a general matter, many items of art—much like a new car—may tend to lose value quickly after acquisition.[259]

Donors and donees too have an incentive to take advantage of uncertainties in favor of an inflated value: donors for purposes of a higher tax benefit; donees to show the value of their collections. Collaboration between donor and donee on value can also make oversight harder, considering that donees have expertise in the donated objects, lending a degree of authenticity to the donor's assessment of value (which may be acknowledged by the donee via signature on the Form 8283). Authenticity of items is also an issue.[260] In short, the many serious concerns of valuation of artwork mean that whatever the claimed value, assessments of donee benefit should take into account a strong likelihood of overvaluation.

In addition, the appraised value of art is but one basis for assessing donee benefit. It is important to note here that most donated artwork will be for a related use. This is because, assuming the art has appreciated in the donor's hands, the art must be for a related use of the donee in order for the donor to be eligible for a fair market value deduction. Accordingly, the donee generally must not sell the artwork, at least not within three years of the donation.[261] Although there are good reasons for the related use rule, it also has the perverse result of generally preventing prompt sale of unwanted

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[257] In 2010 the claimed value of clothing and household items on the Form 8283 was $12.05 billion, *supra* note 216, as compared to $1.28 billion for art, Liddell & Wilson, *2010*, *supra* note 103, at 76–77 tbl.1d.

[258] *See, e.g.*, Lightman v. Comm'r, 50 T.C.M. (CCH) 266 (1985) (discussing the effect of auction sales prices on valuation).

[259] Speiller, *supra* note 55, at 223 (discussing interviews with museum personnel who noted that "most art objects decline in value after they are purchased" and "[m]any of the objects dearly purchased can later be disposed of for only a nominal amount").

[260] *See e.g.,* Doherty v. Comm'r, 16 F.3d 338 (9th Cir. 1994) (discussing the effect of authenticity of artwork on valuation).

[261] Sale within three years gives rise to a presumption of an unrelated use, resulting in a reduction of the donor's deduction to basis through a recapture mechanism. This result can be avoided if the donee certifies that there was a related use or such use became impossible. I.R.C. § 170(e)(7) (2006).

donated items—one of the few reliable benchmarks for value—until well after the contribution date.

A museum may have high, medium, or scant interest in any given item. What is vital to many museums, however, is establishing relationships with donors of art. In other words, a museum may be willing to accept contributions of low interest artwork (which may never be displayed)[262] to generate donor goodwill over the long-term, in the interest of acquiring the high donee-benefit items. This could take years, and involve many contributions of low or indifferent-benefit items. Put another way, the cost to the tax system of facilitating the contribution of an item important to a museum may be by allowing deductions (based on uncertain valuations) not only for such item, but also for other items not especially desired by the museum.

Nevertheless, although the difficulties in quantifying donee benefit are considerable, there is little doubt but that the donees of art are heavily dependent on donors as a primary means of attaining artwork. Museum collections often are the direct result of donor generosity (either inter vivos or by bequest).[263] The benefit to the donee (and to the public) of securing museum ownership of artwork is considerable—the alternative may be that artwork of cultural significance remains secluded from public view. In other words, the donee (and public) benefit of contributions of art to a certain extent depends not on the appraised value of any particular work of art, but rather on the more esoteric value of promoting culture. Art, perhaps more than other property types,[264] raises this issue of how to measure donee benefit.

6. Inventory and Other Enhanced Deduction Property

As discussed in Part II, the general rule for contributions of ordinary income property is to allow a deduction equal to the donor's adjusted basis (or, if less, fair market value). But a series of special rules allow in some cases an enhanced deduction by providing for an "enhancement" that is added to basis in the amount of the lesser of one-half of the appreciation of the property or twice the donor's adjusted basis.[265] Accordingly, for enhanced

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[262] Concern about actual use by a museum of donated artwork led to changes in the rules about fractional gifts. *See* Samuel G. Wieczorek, *Winokur, Lose, or Draw: Art Collectors Lose an Important Tax Break*, 8 HOUS. BUS. & TAX L. J. 90, 98-100; I.R.C. § 170(o) (2006).

[263] *See* Sean Conley, *Paint a New Picture: The Artist-Museum Partnership Act and the Opening of New Markets for Charitable Giving*, 20 DEPAUL J. ART TECH. & INTELL. PROP. L. 89, 100 (2009) ("[D]onations are the lifeblood of museums, accounting for approximately eighty percent of all new museum acquisitions in the US, and fully ninety percent of all museum collections."). *See also* Speiller, *supra* note 55, at 241 (noting that if the valuation problem can be controlled, the fair market value measure should be retained for art contributions because gifts are the mechanism for stocking museums with art).

[264] Easements present a similar issue of donee (and public) benefit. Abuses associated with the easement program, and the erroneous emphasis on the before-and-after value of easements as the measure of the deduction, however, has obscured the public benefits to the easement program. *See generally* Colinvaux, *supra* note 144.

[265] I.R.C. § 170(e)(3), (e)(4), (e)(6) (2006).

deduction property ("inventory" for short), an accurate valuation again is important to help assess donee benefit. Unfortunately, publicly available IRS data does not include corporate contributions, meaning that a key benchmark for assessing the donee benefit of, as well as revenue loss from, enhanced deduction contributions is not publicly available.[266]

As with other in-kind contributions, valuation of inventory is a contentious issue.[267] As noted, the regulatory definition of fair market value is, in effect, the arms-length sales price of an item.[268] For inventory, fair market value must be based on the "usual market" of the donor, which can be the wholesale or the retail market.[269] Businesses are in business to profit from their inventory, and if there is a market for their products, then there will be a price upon which to base a deduction.[270] However, logic suggests that if there is a market for the inventory, then the (corporate) donor will sell its inventory and not donate it because sale should be more profitable. It follows that in many cases, if property is donated and not sold, the reason may be that the inventory cannot be sold—either because it is surplus, obsolete, defective, or the market is simply gone[271]—or that the donor is better off with a donation rather than a sale. Treasury regulations provide that in such cases, the value is not the "usual selling price" but rather the amount the item would actually have sold for at the time of the contribution.[272]

Setting aside for a moment the donee benefit issues this raises, the initial point relates to valuation. Because there is (or was) a "market price" for the property, donors naturally are inclined to use such price as the basis for the deduction, and not the actual price that the particular item of inventory would obtain. The IRS is then involved in a classic valuation dispute—arguing the facts and circumstances against the taxpayer's assertion of market price.

Lucky Stores, Inc. v. Commissioner illustrates the point.[273] There the taxpayer gave surplus bread to a food pantry, and claimed as the fair market value the full retail price of the bread. The IRS insisted the value was actually half of the retail price because the bread was days old. The Tax Court

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[266] The number is likely significant. For example, in-kind donations by pharmaceutical companies is reportedly in the billions of dollars. *See infra* note 288.

[267] Ronald Fowler & Amy Henchey, *In-Kind Contributions*, *in* EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION (CPE) TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 1994 (I.R.S., 1993), *available at* http://www.irs.gov/pub/irs-tege/eotopice94.pdf.

[268] Treas. Reg. § 1.170A-1(c)(2) (2008).

[269] *Id.*

[270] For this reason, inventory contributions are exempt from the general rule requiring an appraisal. I.R.S. Pub. 561, *supra* note 153, at 9.

[271] *See* Linda Sugin, *Encouraging Corporate Charity*, 26 VA. TAX REV. 125, 160 (2006) (noting that in-kind donations often are of "obsolete or unprofitable products, which might have been donated anyway and may not be of much use to the recipients").

[272] Treas. Reg. § 1.170A-1(c)(3) (2008).

[273] 105 T.C. 420 (1995).

sided with the taxpayer.[274] But regardless of who prevailed, the point is that valuation disputes of this sort are an inherent aspect of inventory contributions, are difficult and costly to administer,[275] are decided on a case-by-case basis, and, at the end of day, mean that the claimed value of inventory items is a poor measure for donee benefit.[276]

In addition, the business context for inventory gifts also has a detrimental impact on donee benefit. Ultimately, businesses will (and perhaps should) view the deduction as a way to maximize profit. Assume for example that a business makes a widget costing $5. The actual value of the widget is $6. If the business sells the widget it has a gross profit of $1, which, if taxed at the thirty-five percent corporate rate leaves the business with net profit of $.65. If instead, the business donates the widget, it is allowed a deduction of half the appreciation or $.50,[277] which is worth only $.175. Thus, in this simplified example, the business is better off selling rather than giving. But if instead the business can plausibly (or even implausibly) claim that the value of the widget is actually $13, the business would get a deduction of $4 for donating the property (half of the $8 of appreciation). This deduction is worth $1.60, much better than sale.

The importance of this is to note that because value is hard to administer, and because the incentives on the donor are to maximize profit, it would not be surprising if donors, just as a matter of good business practice (if dubious tax practice), seek to donate inventory that cannot be sold where valuation questions can be exploited in the donor's favor. The result for donees, however, is that donors generally are not seeking to maximize donee benefit, or tailor their inventory contributions to the precise needs of donees.

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[274] Intuitively, the IRS argument has appeal because there surely must be a difference in value between fresh and going-stale bread. But the Tax Court sided with the taxpayer. The court appeared to be swayed by the fact that if the IRS prevailed, the resulting deduction would have been basis, meaning that the donor would not have had an incentive to contribute the bread. This result seemed against Congressional intent. This points to a tension in valuation of inventory—the "value" for tax purposes must to a certain extent be high enough to provide an incentive, even if the actual selling price is lower.

[275] If anything, the presence of a market price strengthens the taxpayer's hand.

[276] Indeed, valuation disputes of this type led to proposed special valuation rules for both food and book inventory. For food, it was proposed to disregard reality and determine value by ignoring the "lack of market" for the food and instead looking to the price at which substantially similar items were sold by the taxpayer. *See* S. COMM. ON FIN., CARE ACT OF 2003, S. REP. NO. 108-11, at 17 (2003). For book inventory, a special valuation rule was proposed to allow the donor to use the price at which a book was sold within seven years preceding the contribution. *Id.* at 18. Neither rule passed, but these proposals usefully highlight not only the fact that value is contentious, but that corporate donors push for valuation standards that ignore the actual value of the donated property to the donee. About the only positive aspect of these proposed rules was that they would have provided more certainty, which the Senate Finance Committee emphasized in its report.

[277] Although technically, the $5 cost basis is also deducted, this is not an extra benefit relative to sale or loss, as the company would otherwise recover their $5 of cost as a cost of goods sold. *See, e.g.*, Charitable Contributions, I.R.S. Pub. 526, 10 (2013) ("You must remove the amount of your contribution deduction from your opening inventory. It is not part of the cost of goods sold.").

Rather, donors have an incentive to use the enhanced deduction as a profit-maximizing tool.

There is some evidence that this occurs. Consider the following architecture for an elaborate market in in-kind contributions of inventory. Assume that a cookie maker tries out a new flavor of processed cookie—bubble gum peanut butter—which does not sell well. As a result, the company has thousands of surplus cookies. The company could throw away the cookies and write off its cost as a business expense.[278] Or the company could donate the cookies to charity, and perhaps even value the cookies at the wholesale or retail price and take a deduction for more than its cost. The problem would be finding a donee that would accept such a burdensome donation, one with little direct benefit to the donee.

But the company finds a donee ("Feed the Hungry") that will take the donation. The benefit to the donee is that a high-value in-kind contribution demonstrates public support for the donee and, ironically, donee effectiveness. The donee can report the value of the contribution on its information return (Form 990).[279] This not only shows that the donee is actively receiving valuable contributions but also helps to reduce overhead cost relative to donations received, which makes the donee look more effective to the IRS and to the public. This in turn, enables the donee to raise additional funds.[280] In this scenario, the donee benefit from the in-kind contribution is not the value of the contribution, but how the contribution makes the donee look on paper, which, misleading though it may be, could lead to additional worthwhile contributions of cash.

The donee, however, is still stuck with thousands of bubble gum peanut butter cookies. It could throw them away; but it would be better to use the cookies for an exempt purpose (again, at least on paper). So, Feed the Hungry teams up with other section 501(c)(3) organizations that also accepted odd in-kind donations for similar reasons. Together, the donees contract with a for-profit company to help dispose of all the in-kind donations, for a fee. The for-profit company then acts as a broker, storing the in-kind property and distributing it to other donees that do not, in fact, want the property, even for book keeping purposes. These unsuspecting donees then make do,

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[278] I.R.C. § 162(a) (2006).

[279] Donees have long been criticized for overvaluing in-kind contributions in order to "present [themselves] more favorably in soliciting monetary contributions from the public, and . . . qualify to participate in federated fundraising drives or other programs." Fowler & Henchey, *supra* note 267, at 13. The IRS requires that donees "report fair market value using generally accepted accounting principles for non-profit organizations." *Id.* at 12.

[280] These additional funds could be cash contributions from the public (who like to see that a donee attracts corporate support) or from other charities. Note for example that as of July 2012, the United Way requires a threshold level of public support for its donee organizations. *See* Vanessa Small & Jia Lynn Yang, *D.C. Area's United Way Tightens Requirements for Charity Funding*, WASH. POST, July 27, 2012, http://articles.washingtonpost.com/2012-07-27/business/35489195_1_groups-small-charities-oral-suer.

one way or the other. The entire process becomes a part of a business model for processing in-kind contributions.

Although this may sound like fiction, it is in broad outline an arrangement reported by CNN.[281] Instead of cookies, there were coconut M&Ms, football pants, and chefs coats.[282] One donee organization, organized ostensibly to help veterans, raised substantial sums of cash in addition to its in-kind contributions.[283] Grants from this veterans organization, however, were of the in-kind contributions and were made not to individuals but to other section 501(c)(3) organizations. The ultimate beneficiary of the chef coats and football pants—a homeless veteran's charity—said they did not request the items. The beneficiary of the M&Ms did not want the M&Ms.

Scams such as this are reminders of why Congress moved to a basis rule in 1969, only then to yield to pressure and craft exceptions for enhanced deduction property over the years. It also explains why the rules for the enhanced deduction are like a parallel universe to the baseline charitable deduction rules. Only some donee types are eligible donees.[284] Purpose restrictions are imposed, e.g., to benefit the "ill, the needy, or infants."[285] Donees must make certifications about use, etc.[286] But these existing mousetraps are not catching all the mice. Too many undoubtedly escape detection. Donee benefit, measured in the sense of the value of contributed items for exempt purposes, is diluted and, perhaps, overwhelmed by the cost.[287]

Many of the concerns expressed above regarding the donee benefit from inventory contributions arise also with respect to a large subset of inventory contributions: drug donations. One commentator reports that "[fourteen] pharmaceutical foundations examined in [a Foundation Center] report provided $3.7 billion in in-kind donations in 2009."[288] Without question, donations of drugs and essential medical supplies serve important ends. Indeed,

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[281] David Fitzpatrick & Drew Griffin, *Charities Accused of Overvaluing Donations*, CNN, July 28, 2012, http://edition.cnn.com/2012/07/27/us/charities-overvalued-donations/index.html.

[282] The CNN report focuses on the donee organization and the for-profit distributor. It makes no claim about the valuation of the inventory by the donor. *Id.*

[283] The implication is that the presence of the in-kind donations helped the organization raise the cash contributions. *Id.*

[284] I.R.C. § 170(e)(3)(A), (e)(3)(D)(ii), (e)(4)(B)(i), (e)(6)(B)(i) (2006).

[285] I.R.C. § 170(e)(3)(A)(i) (2006); *see also* § 170(e)(4)(B)(v), (e)(6)(B)(iv) (2006).

[286] I.R.C. § 170(e)(3)(A)(iii), (e)(3)(D)(iii), (e)(4)(B)(vii) (2006).

[287] *See e.g.*, Sugin *supra* note 271, at 160 (citing the problems of valuation of inventory and concluding that "the loss to the fisc may be greater than the public benefit provided through the charity's receipt of the property").

[288] Jennifer Wall, *Pharmaceutical Sector Tops Philanthropic Giving List*, THE CATALYST (May 14, 2010, 9:01 AM), http://catalyst.phrma.org/pharmaceutical-sector-tops-philanthropic-giving-list; *see also* Stephanie Strom, *Closer Look at Deductions for Donations to Charity*, N.Y. TIMES, Dec. 12, 2003, http://www.nytimes.com/2003/12/12/national/12CHAR.html ("Pharmaceutical and technology companies are among the biggest corporate givers because of in-kind donations. According to Business Week, Eli Lilly valued its noncash philanthropy at $204.8 million in 2002, four times its monetary contributions.").

concern about the decline in donations of such items after 1969 was the reason for the initial exception that created the enhanced deduction.[289] But identifying the donee benefit from drug donations is not, however, as simple as citing the important and idealistic ends served, or the claimed value of donations.

The World Health Organization identifies four internationally recognized principles to guide drug donations: "(i) maximum benefit to the recipient; (ii) respect for the wishes and authority of the recipient; (iii) no double standards in quality; and (iv) effective communication between donor and recipient."[290] These sensible guidelines were developed to prevent inappropriate drug donations in emergency situations. Inappropriate donations include shipments of partially degraded or expired drugs, arriving in disorganized or unlabeled shipments.[291] Indeed, the World Health Organization is critical of providing tax deductions for drug donations, viewing the deduction not as an incentive for beneficial corporate giving but as a lucrative way for pharmaceutical companies to dispose of useless drugs that should otherwise be destroyed.[292] Similar criticism has been levied by the AIDS Healthcare Foundation regarding donations of AIDS-related drugs.[293]

Questions have also been raised about drug pricing, whether some drugs are intentionally priced high to establish a baseline for deduction purposes, and whether the donor's basis is manipulated to get higher deductions. Whether drug-related donation programs are a good idea at all has also been questioned because such programs shift the locus of public health decisions from the donee to the donor. Drug companies decide "how much to give, who receives the drugs, and how to design the program."[294] "These are all important public health decisions . . . better made by public health professionals . . . [or] charitable organizations that would choose food over

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[289] *See supra* text accompanying note 65.

[290] Christina P. Pinheiro, *Drug Donations: What Lies Beneath*, 86 BULL. WORLD HEALTH ORG. 580, 580 (2008), *available at* http://www.who.int/bulletin/volumes/86/8/07-048546/en.

[291] *Id.*

[292] *Id.* (concluding that "[d]rug donations provide benefits such as tax deductions and are a very convenient way for industries to get rid of stagnant stocks without having to pay for their controlled and expensive destruction in their country of origin"). This leads some to suggest that cash donations are preferable to property, even in emergency relief situations. Beverly Snell, *Inappropriate Drug Donations: The Need for Reform*, 358 THE LANCET 578, 579 (2001), *available at* http://www.thelancet.com/journals/lancet/article/PIIS0140-6736(01)05712-9/fulltext ("In most humanitarian emergencies, a financial contribution is more appropriate than donation of medicines. Such aid allows purchase and transport from specialist procuring agencies, at a fraction of the cost of supplying products from another country.").

[293] *AIDS Drug Company 'Charity' Programs Fail Patients, Yet Provide Millions in Tax Breaks to Industry*, AIDS HEALTHCARE FOUND. (July 25, 2011), http://www.aidshealth.org/archives/news/pap-scam (alleging in a 2011 press release that AIDS drug companies had been "running cumbersome, largely ineffectual drug giveaway programs that make it extremely difficult for patients in need to enroll and get medications, while at the same time, the companies take millions in tax breaks via enormous deductions for the drugs they do give away").

[294] Sugin, *supra* note 271, at 158.

medicine, or particular drugs compared to others, if they had money instead of products."[295]

In sum, a determination of donee benefit from inventory contributions, as with other in-kind contributions, is hindered by questions of valuation and the use of or need for the property by the donee. Inventory contributions are complicated by the fact that the donor is a business, with business motives for making contributions—which can further undermine donee benefit. Donees may have low interest in in-kind contributions, but accept them anyway—on the theory that something is better than nothing, and perhaps on the promise of useful contributions in the future.[296] The presence of business motives to donate inventory can also lead to creation of demand for in-kind property by donees, of questionable motive, that can use the contributions as proof of legitimacy and so attract cash contributions that may or may not be used for actual exempt programs. All these negative features of inventory contributions cast a shadow on the donee benefit. Without a doubt, the benefit exists, but it is subject to many qualifications.

7. Vehicles, Intellectual Property

Concerns about the valuation of contributions of vehicles and intellectual property led to special legislative regimes for both.[297] Before the changes, vehicles and intellectual property were subject to the general rules. Donors of vehicles, as depreciated property, were allowed to deduct the fair market value of the vehicle. Donors of intellectual property, generally appreciated, also were allowed a fair market value deduction. However, vehicles often were donated at values that did not reflect the actual condition of the property.[298] Intellectual property values were highly suspect in many cases, with donors asserting valuations in the millions of dollars for property the IRS viewed as worthless.[299]

As noted, Congress changed the rules to better align the deduction with the benefit to the donee. For vehicles, the amount allowed was tied to the sales price of the vehicle, with an exception if the vehicle was actually used by the donee.[300] For intellectual property, the deduction was tied to the actual benefit derived from the contributed property.[301] Accordingly, the donor received a basis deduction upon contribution, and additional charitable deduc-

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[295] *Id.*

[296] *See generally* Kovach, *supra* note 121, at 93 (noting that "[o]rganizations sometimes feel obligated to accept even unwanted assets, which are not necessarily valueless, in order to foster good relationships with particular donors or the donating public in general").

[297] Gerzog, *supra* note 34, at 1142–45; I.R.C. § 170(f)(12), (m) (2006).

[298] GEN. ACCOUNTING OFFICE, *supra* note 179, at 15.

[299] MacBean, *supra* note 182, at ¶4; William A. Drennan, *Charitable Donations of Intellectual Property: The Case for Retaining the Fair Market Value Tax Deduction*, 2004 UTAH. L. REV. 1045, 1078 (2004).

[300] I.R.C. § 170(f)(12) (2006).

[301] I.R.C. § 170(m) (2006).

tions in future years based on the income generated for the donee from the property.

Under the new rules, for vehicles, the deduction allowed still misrepresents donee benefit. This occurs when the sales price for donated vehicles is split between the donee and a third party, meaning that the net benefit to the donee is considerably less than the sales price. The intellectual property rules, though complex, come much closer to basing the deduction on actual donee benefit.

C. Summary Discussion of Costs and Assessing Donee Benefit

Viewed as a subsidy for "property," it is especially important to know the donee benefit from the property, as this is the very purpose of providing the tax benefits. Unfortunately, donee benefit is far from clear. Without a doubt, many gifts of property are valuable, and vital for some donee organizations. But the aggregate picture is very murky, and troubling.

As shown, claimed value is a poor measure of donee benefit. Overvaluation means in the first instance that claimed value must be discounted to arrive at a more accurate accounting of the actual value of contributed property. But even after accounting for overvaluation, the benefit from property donations remains uncertain. This is because the actual benefit to the donee from a contribution depends less on a "fair market value" determined as of the contribution date, than on a multitude of other factors, including the use of the property by the donee, the need of the donee for the property, the net benefit to the donee (taking into account the costs incurred to acquire and carry the property), and the timing of the disposition of the property by the donee. As the discussion of the many types of property indicates, the ability to assess donee benefit varies widely, but in each case, there are serious questions about donee benefit. This makes the costs of the deduction and the policy supporting it that much more important in evaluating the deduction.

VI. A New General Rule for Property Contributions: No Deduction, With Any Exceptions to be Based on Measurable Donee Benefit

The charitable deduction for property contributions reflects a policy tension. Since the initial "mistake" of equating the amount of the deduction with fair market value, Congress has been balancing a desire to encourage charitable contributions with the need for a functioning and fair tax system. The Joint Committee on Taxation staff summarized the tension in 1984, in explaining Congress's reasons for introducing an anti-abuse appraisal regime.

> The Congress recognized that the tax benefits provided to taxpayers who contribute appreciated capital-gain property to charities

> create opportunities for overvaluations because the donor is entitled to deduct the fair market value of the property, but does not realize taxable gain equal to the appreciation. One way to reduce these opportunities to overvalue would be to eliminate the advantage that charitable gifts of appreciated property have over gifts of cash. The Congress understood, however, that many charitable organizations depend on this tax benefit for fund-raising and as a means of acquiring valuable property.[302]

In other words, Congress struck a balance. The need of donee organizations for "valuable property" led Congress to retain the policy preference for property over cash and reject a bright-line basis rule for gifts of appreciated property in favor of an anti-abuse process directed at overvaluation.

It was true then and it is true today, that property contributions provide some benefit to donee organizations. However, this justification for current law does not adequately take into account the significant costs of the value-based deduction, the uncertainty of the donee benefit, the fact that cash and property are not equivalents, or that pursuing a value-based deduction for property comes at the expense of cash contributions. In short, the policy of the charitable deduction as it relates to property has never been correct and needs to be reimagined.

A. Reimagining the Charitable Deduction for Property Contributions

A reimagining of the charitable deduction for property contributions should again consider the two main rationales supporting it—the base-defining and the subsidy rationales. As discussed in Part II, both approaches ultimately point in the same direction—toward a reversal of the general rule, meaning no allowance for a charitable deduction for property contributions.

1. The Base-Defining Approach

The base-defining approach provides a definite answer to at least part of the problem: require that the deductible amount be reduced from fair market value for all gain, whether short- or long-term. This would eliminate the ability to deduct unrealized gain and remove the fair market value measure of the deduction for appreciated property. As noted in Part II, this clearly follows from the base-defining approach, which holds that a charitable deduction should be allowed only to the extent that the amount contributed is realized income of the taxpayer.[303]

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[302] STAFF OF JOINT COMM. ON TAXATION, *supra* note 58, at 503. Notably, this understates the problem of overvaluation by neglecting to mention depreciated property.

[303] *See supra* text accompanying notes 31–35.

This result has been advocated by some commentators and was acknowledged as a possible reform by Congress in 1984.[304] As a practical matter, it would mean the end of all enhanced deductions, as well as the incentive to give appreciated related-use property and other appreciated assets such as stock and other investments, real estate, and land. This solution would simplify the charitable deduction rules, ease tax administration, appropriately end the preference for appreciated property over cash, and make the Code more equitable by removing a tax preference that favors the most affluent.

Still extant under a base-defining approach though is a rule for contributions of depreciated property. As argued in Part II, the base-defining approach also can persuasively be applied to deny a deduction for many contributions of depreciated property. Depreciated property such as clothing and household items and vehicles often are donated after the donor has consumed most of the value and so already recovered the cost. Under such circumstances, upon contribution, the taxpayer has not parted with anything of value for purposes of a deduction under a base-defining approach. Rather, the taxpayer is better viewed as disposing of "used" property. Although value remains, its original value to the taxpayer is essentially used up. Admittedly a general rule under a base-defining approach that denied a deduction for all contributions of depreciated property would be unfair in cases where there clearly is considerable value to the donor remaining in the property. But arguably, strict application of a bright line rule denying a deduction for depreciated property would still be sensible in light of other goals: encouraging the donation of cash instead of depreciated property, removing valuation uncertainties (and so abuses), and improving tax administration.

A remaining question under the base-defining approach is whether a charitable contribution basis deduction should be allowed for contributions of appreciated property. This question is rarely asked because the answer is assumed to be yes. The reason again is that under a base-defining approach, a deduction for charitable expenses should be in the amount of the cash or property given away that represents realized income of the taxpayer (not to exceed fair market value). A charitable deduction equal to the donor's basis in appreciated property represents such income. For example, if a donor earns $10,000 cash in a year, purchases stock with the cash (thus yielding a basis of $10,000), and then that same year donates the stock to charity at a time when the stock's fair market value is $10,500, allowing a charitable deduction of $10,000 makes sense under the base-defining approach. This amount is the amount of income that would be realized and taxed to the

[304] *See generally* Halperin, *supra* note 34 (arguing for a constructive realization of gain upon contribution); Johnson, *supra* note 35; Schmalbeck, *supra* note 33.

donor (as cash) but "given away" (as property), and not the $500 of gain (which is unrealized appreciation).[305]

Nevertheless, there are reasons to consider denying even a deduction of basis in this case, albeit reasons not derived from the base-defining approach. First, if the general rule under a base-defining approach is to allow a deduction only for appreciated property and only of basis, donors will have little reason to donate any such property. Instead, if cash was not available and donors wanted to make a charitable contribution, a donor would sell property, pay tax on the gain, and make a contribution of what remains. In other words, donating the property as property for a basis deduction would not make sense in most cases. Thus, denying a deduction even of basis would be a rule likely of limited application.

But if so, then the question is why deny a basis deduction in those rare cases when a donor nonetheless gives appreciated property, either because the amount of the appreciation was low[306] or the donor just did not want to be bothered to sell and donate the proceeds. The reason is related to abuse. If a basis deduction is retained pursuant to strict application of a base-defining approach, kept with it is the relevance of determining the value of property for deduction purposes. Taxpayers would have an incentive to exploit valuation uncertainties, where possible, to argue that depreciated property (for which no charitable deduction was available) was actually appreciated so as to obtain a basis deduction (which would be more than the property was worth). Although this sort of abuse likely would be limited, as indicated above, denying the deduction even of basis should only affect few taxpayers (those who would give appreciated property even if the only deduction was basis), and even those taxpayers would still have the option of selling the property and contributing cash.

In short, a base-defining approach clearly calls for elimination of the charitable deduction for any unrealized appreciation and is supportive in many cases of no deduction for depreciated property. In cases where a base-defining approach might support a charitable deduction—depreciated property with significant remaining value, and a deduction of basis for appreciated property—other reasons, including preferring donations of cash to property, administrative convenience, and preventing abuse, argue in favor of no deduction.

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[305] Note that even under current law, no deduction of the gain would be allowed because the property was held for less than a year. I.R.C. § 170(e)(1) (2006).

[306] Note that if a donor had an asset with substantial value and low or even no appreciation, denying a charitable deduction is not as harsh as it may seem. The donor always has the option of selling the property and donating the proceeds—a generally desirable outcome because then the donor will bear the cost of sale and not the donee. If the property was specifically desired by the donee, like a painting, the donee could purchase the property, thereby triggering a tax on any appreciation, and the donor could then donate some or all of the proceeds back to the charity.

2. *The Subsidy Approach*

The charitable deduction for property contributions must also be reimagined under the more widely accepted subsidy rationale.[307] As a subsidy, the driving concern is not whether a donor is allowed in effect an extra deduction (as under the base-defining approach), but whether the amount of the subsidy is too high or too low to have the desired incentive effect.[308] In other words, if the policy of the charitable deduction for property contributions is to encourage charitable contributions of property, which as discussed in Part II, presumably it is, then a basis deduction (for appreciated property), or no deduction, would not be the right outcome because the incentive will be too low to generate property contributions.[309] Some additional incentive is needed, and it may not matter much whether the subsidy takes the form of a deduction of unrealized gain or not—the point is to encourage and so reward the donor. Further, viewed as a distinct policy of favoring property contributions, the equitable concerns stemming from the fair market value measure are diminished because the subsidy sensibly is targeted at those with property to give, namely the more affluent.

In short, under a subsidy theory, the ability to deduct unrealized gain need not be offensive, or even a "mistake." Rather, it is just a consequence in furtherance of a policy choice to encourage gifts of property to qualified donee organizations. Congress (and of course donee organizations and donors) has been willing to live with this consequence for decades—again, presumably because the benefit to the donee is worth the cost.

This then raises the critical question under the subsidy approach: whether it makes sense to have a blanket subsidy for contributions of property. As indicated in Part II, evaluating this question depends largely on an assessment of the costs and benefits of property contributions. As discussed in Part IV, the costs are significant. But significant costs, standing alone, are not a reason to change a policy. As Part V argues, however, because the measure for the tax benefit is not closely related to the benefit to the donee, the benefits from property contributions are very difficult to assess, directly

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[307] The present law rule allowing a fair market value deduction for appreciated property is not base-defining and must be viewed and analyzed as a subsidy. *See* Andrews, *supra* note 27, at 372.

[308] It is evident that Congress views the deduction for property contributions as a subsidy. Congress chose in 1969 to preserve the deduction for unrealized gain for tangible related use property, real property, and intangible property, allowed (and then built upon) an enhanced deduction, and extended the deduction for gifts of publicly traded stock to private foundations. As the excerpt from the 1984 legislative history previously cited, *see supra* text accompanying note 295, shows, Congress is fully aware of what the deduction allows and has chosen to continue the policy.

[309] Indeed, this was the rationale cited for the initial enhanced deduction. *See supra* text accompanying note 65–68.

raising the question of whether a costly subsidy should continue given uncertain benefits and its effect of preferring property to cash.[310]

Moreover, there is no overwhelming reason categorically to subsidize contributions of property. One reason might be that any and every contribution to a qualified donee, in whatever form, should uncritically be encouraged on the theory that receipt of something of value is better than nothing. Indeed, this appears to be the main justification for the blanket subsidy. But this should be persuasive only if the something of value received is ascertainable and clearly greater than the cost, which is in doubt. Further, the permissive general rule depends for its credibility on determining the "something of value" contributed, and all the difficulties this entails.

In short, the case for a subsidy for property contributions as property is weak. The history of the rules of property contributions is a history of futility—trying to make the general rule of equivalence work—stemming largely from an initial failure to differentiate between cash and property.

B. New General Rule: No Deduction for Charitable Contributions of Property

Admitting the failure of the current regime, the next step is to fashion a new policy, and so a new general rule, for property contributions. The best, from many standpoints, is to provide, as a general rule, that there is no deduction for contributions of property. In other words, given the many problems and uncertain benefits, and the lack of an affirmative policy supporting the general rule, the opposite rule should prevail: property contributions should not be deductible as charitable contributions.

Such a reversal from present law would convey several immediate benefits; namely, the elimination of the many direct and indirect costs discussed. At the risk of repetition, these would include a reduced loss of revenue, significant gains to tax administration, eradication of a prime source of abusive transactions,[311] a related improvement to the reputation of the charitable sector, simplification of the tax law, and a more equitable tax code.

Further, disallowing a deduction for property contributions would end the current bizarre policy preference for property instead of cash, for both

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[310] *See supra* text accompanying note 37.

[311] A regime in which charitable deductions for property were not allowed would undoubtedly generate its own abusive transactions, thus undermining some of the gains to tax administration and to simplification. Although it is hard to predict, one scenario might be for a donor to ask a related party to purchase property from the donor for cash, contribute the cash to charity for a deduction, and then (by pre-arrangement) have the charity purchase the property from the related party with the cash. This sounds abusive, but whether it is abusive or not depends in large part on whether the charity wants the property. If so, then there is no abuse. The charity acquires desired property for the amount deducted, and any gain on the property is (or should be taxed) in the related-party transaction. If the charity does not want the property, then the charity might think twice about acquiring it in an artificial manner, with a risk of being accused of facilitating tax avoidance. And even if the charity participates, tax on the gain still should be collected minimizing the tax avoidance potential.

appreciated and depreciated property. A rule that results in preferring property to cash seems plainly wrong—the federal policy should be affirmatively to favor cash gifts.[312] From the standpoint of the donee, cash is of indisputable, measurable benefit and allows the donee maximum flexibility of use. From the standpoint of tax administration, cash gifts are easy to administer. Cash gifts merely raise questions of verification, which can be (and already are) resolved with substantiation rules[313]—a matter well within the province of an auditor. A general rule allowing deductions only for cash would just be a matter of good and effective government: federal tax dollars will support only contributions with known value—for purposes of measuring both the tax benefit and the donee benefit.

It remains to note the resulting tax treatment for property contributions under a general rule for charitable contributions that did not allow a deduction. In the absence of a charitable deduction, a gift of property is just that, a gift of property—no longer a "charitable contribution." As a gift, the general income tax rules for gifts should apply. The donor gets no deduction, even of basis.[314] The donee has no income;[315] and, to the extent it is relevant, takes the donor's basis in the contributed property.[316] This treatment would apply to gifts of both appreciated and depreciated property.[317]

C. Exceptions to Disallowance: Any Deduction Should Be Based on Measurable Donee Benefit

After positing a new general rule that does not allow a charitable deduction for contributions of property, the question becomes whether the federal government should specifically subsidize, or allow a deduction for, any particular form of property contribution, i.e., whether there should be exceptions to the general rule.

To think about exceptions, it is useful to articulate a policy or general principle for implementing a charitable giving incentive. The experience

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[312] The weight of the commentary is clear on this point. *See* George K. Yin, *JCT Chief Discussed the Tax Gap*, 107 TAX NOTES 1449, 1450 (2005) ("[C]ash gifts are less susceptible to noncompliance than are gifts of property with uncertain values, and we see a rather odd outcome. Under current law, the incentive structure encourages gifts that are most vulnerable to noncompliance, and in effect discourages gifts that are less vulnerable."); Sugin, *supra* note 271, at 160 (Sugin criticizes the enhanced deduction for inventory, arguing that "[t]here is little reason why the law should encourage corporations to give property rather than cash to charity because the charitable organization can better determine the goods it needs to carry out its purposes. Cash, of course, gives the organizations more power and discretion to decide that for themselves.").

[313] *See supra* text accompanying notes 109-12.

[314] I.R.C. § 262 (2006). If any deduction other than the charitable deduction were available, such as a business expense deduction or a loss, the taxpayer would be able to take it. *See, e.g.*, I.R.C. §§ 162, 165 (2006).

[315] I.R.C. §§ 102, 501(a) (2006).

[316] I.R.C. § 1015 (2006).

[317] A special basis rule applies to gifts of depreciated property. *Id.*

with property contributions provides an answer. Put simply, the policy of a charitable giving incentive should be to encourage gifts of measureable benefit to the donee, which would then be the base for the tax benefit.

Phrased this way, the primary focus is placed not on the tax treatment of the donor, or even on the type of contribution as cash or property, but rather on serving what should inarguably be the goal of the incentive—to deliver known value to qualified donee organizations. If a type of contribution raises too many questions of donee benefit, then there should be a strong presumption of no deduction. This is not to say that such contributions provide zero, or even low benefit; but that as a matter of policy, the uncertainty regarding the benefit means they should not be tax preferred.

A "measurable benefit to the donee" standard contains two key parts. First is the idea of an objectively verifiable measure. Such a measure generally makes tax administration easier because auditors will be able to verify, based on an objective external measure, the amount of the contribution. Second is the idea that the measurement is of the donee benefit. Measuring donee benefit makes sense because generating a donee benefit is the point of the incentive.[318] Using a measurable donee benefit as the base for the deduction also serves the important function of helping to ensure that the benefit exceeds the cost. Because the value of the tax benefit to the donor (the revenue cost) is based on a percentage of the measurable benefit, there will nearly always be assurance that benefit exceeds cost, thus promising the overall efficiency of the tax incentive.

As an example, cash contributions clearly meet a measurable benefit to the donee standard. As the benchmark for value, cash is easy to measure. In addition, except to the extent of donee fundraising costs, cash also is the measure of donee benefit. In general, with cash, the donee has complete discretion—to save, to purchase property, to pay salaries.[319] In short, a deduction for cash contributions works because cash is a good measure for administrative purposes, and it also (mostly) captures donee benefit. With cash, there is alignment between the base for the tax benefit and the benefit to the donee.

By contrast, in general, property contributions often fail the measurable benefit to the donee test. The generally applicable measure for property contributions—fair market value—is not easy to apply, leaves too much to taxpayer control, and typically is not the measure of actual benefit to the donee.[320] Thus, with property, under current rules, the measure is not objec-

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[318] To a certain extent, measuring donee benefit is the intent behind the current "fair market value" measure for the deduction. Fair market value as the measure has intuitive appeal because it would seem on the surface to be a good proxy for donee benefit. But, as discussed, the fair market value measure has largely failed in this regard.

[319] Cash gifts, however, may be restricted as to use.

[320] *See* Part V.A. As discussed, actual donee benefit depends on a variety of factors, including the timing of the disposition, the use of the property by the donee, and the need by the donee for the property.

tive and there is weak alignment between the base for the tax benefit and the benefit to the donee.

The challenge then in crafting exceptions is to use a measurable benefit to the donee standard to assess the merits of a tax benefit for the different property types. The best case under this standard is for publicly traded securities. In general, as discussed *supra*, the objectively verifiable exchange value is measurable, and as a close equivalent to cash, this measurable value also is a reasonable proxy for donee benefit (assuming the donee has complete control over the property as of the contribution date). Even here, however, the ability to time contributions at market peaks or based on insider information, and the very fact that property, even highly marketable property, is not the same as cash, could lead to the conclusion that the exchange value should automatically be discounted by a percentage to take into account some difference between exchange value and actual donee benefit.[321]

Further, once the measurable benefit to the donee standard generally is satisfied, a secondary question then is cost, namely whether the cost of the incentive is worth it. Costs will vary across property types. For appreciated securities, if the tax benefit is based on a percentage of exchange value, as presumably it must be to secure the contribution, the issue again is squarely raised whether the cost of the incentive (deduction of basis, deduction of (some or all of the) appreciation, value of the gain exclusion, equitable considerations, preferring property to cash) is worth the actual benefit to the donee.

Nonpublicly traded securities and other investments present a different issue. The fair market value measure is not "measurable" here because it is not based on an objectively verifiable standard (such as a public exchange). It does not follow, however, that no appropriate measure exists. For this and other property types, a rule could be developed that allows a deduction (or, for that matter, a credit) based on the donee benefit received upon sale of the contributed property by the donee.[322] Indeed, the deduction could be delayed until such sale.[323]

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[321] The general approach of allowing as a deduction a percentage of the contribution amount is used elsewhere, e.g., to determine the deduction when the donor receives in exchange for the contribution the right to purchase tickets at a collegiate athletic event. I.R.C. § 170(l) (2006). Here, the percentage discount is used to measure, if arbitrarily, the value of the quid pro quo received. The fact that the measure is arbitrary is less important than the policy implied: the bright-line rule acknowledges both that there should be a reduction in value to account for the quid pro quo and administrative realities.

[322] An alternative approach was suggested by the President's Advisory Panel on Tax Reform in 2005. Under this approach, donors would donate the proceeds from sales of property (within 60 days of sale), not the property itself. The donor would be allowed to exclude the gain on the proceeds. *See* PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM, *supra* note 227, at 77.

[323] A difficulty is whether to credit the donor with post-contribution gain or "punish" the donor by taking into account post-contribution loss. To avoid this difficulty, and the related necessity of determining a value as of the contribution date, rough bright line rules would have to be developed. One solution would be to adopt a discount rate based on the amount of time

A model for such an approach exists in both the current rules for vehicles and intellectual property. The deduction for vehicles is tied to sales price of the vehicle.[324] The deduction for intellectual property is based on donee income from the property in subsequent years.[325] Both approaches illustrate an effort to align the measure for the deduction with the benefit to the donee. Clearly, either approach, adapted to cover additional property types, would introduce complexity. But this would be a cost to be weighed in deciding whether the incentive was worth it. Most important is that any effort to provide an incentive for property contributions be made with measuring donee benefit at the forefront. Then, once such benefit is identified, the cost of securing the benefit can be weighed.

A dividing line for how to approach any incentive is whether contributed property is for a related use of the donee in its exempt programs. For property not for a related use, a rule as described above could be invoked, tailored as necessary to the property type. Here, it is important to keep in mind that because the property is not for a related use, the donee benefit generally is based on the disposition amount for the property, an amount that typically will not be known until a date after the contribution date.[326]

Related use property presents different, perhaps more daunting challenges. The measurement challenge is considerable because the donee benefit generally is not based on a disposition amount, but on actual use by the donee. This could be subjective, depending upon the need of the donee organization. In some cases, e.g., of food inventory, if the contributed items would have been purchased and used by the donee, the donee benefit from the donated inventory generally would equal the amount the donee otherwise would have paid to acquire the inventory. In other cases, where the donee does not need the contributed inventory or does not use it, the donee benefit might be zero (or negative). In cases where the contributed property is unique, e.g., artwork, the best measure of donee benefit likely is fair market value (i.e., the appraised value) discounted in some fashion. For related use clothing and household items, the only feasible measure might well be the donor's best estimate of exchange value. For conservation easements, the measure of donee benefit may not be quantifiable.[327]

The problems of measuring the donee benefit from related use property likely mean that in most cases, related use property will fail the measurement test—there simply will not be an objectively verifiable measure available. However, the measurement difficulties might in some cases be outweighed by a policy preference for related use property. In other words,

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between contribution and disposition. Donors would know the rate in advance, and take the risk that the property would decline in value in the hands of the donee.

[324] I.R.C. § 170(f)(12) (2006).

[325] I.R.C. § 170(m) (2006).

[326] *See* Kovach, *supra* note 121, at 99–103 (discussing alternative measures to the "willing buyer willing seller" fair market value standard).

[327] *See* Colinvaux, *supra* note 144, at 26.

if certain property is of such importance to donee organizations for the success of their mission, the measurement concerns might be overcome nevertheless to warrant an incentive.

Artwork, or other cultural property, is perhaps the best example. Museum reliance on the donation market to acquire art is, some argue, essential to building collections. Food might be another example. But if a tax incentive is necessary, in these or other related use property cases, more must be done than under present law to ensure that a substantial donee benefit results from the contributions.

For example, any exception for art should clearly be viewed as a deliberate subsidy to museums, and museums must be held accountable for the contributions that are accepted. Present law already goes to great lengths to recapture part of the tax benefit for putatively related use property (art or otherwise) that is later sold.[328] Present law does not require, however, that the donee be involved in the valuation of the property or bear any burden for accepting property that is overvalued. One option would be to develop a penalty, to be paid by the donee, for accepting substantially overvalued property. The penalty perhaps could be based on valuation misstatement penalties paid by the donor. Reporting obligations also could be imposed to certify the related use of, and distinct need for, the property. In addition, a dollar floor could be established to eliminate low value and hard to verify contributions.[329] In short, if a tax incentive for related use property is called for, the problem of measuring the donee benefit must be compensated for with additional procedural rules and burdens on the donee organization. Again, this additional complexity should be viewed as a cost to providing the subsidy and weighed against the benefit.

The foregoing overview of possible approaches to allow an incentive for property contributions based on a measurable benefit to the donee is not an endorsement of any particular approach. It is beyond the scope of the Article to develop detailed rules for each property type. Rather, the goal here is to provide a framework through which exceptions to a new general rule of no deduction for property contributions could be developed.

VII. Conclusion

On average, nearly $46 billion of property is given to charitable organizations each year,[330] about twenty-five percent of the total charitable deduction.[331] This makes the charitable contribution deduction for property a tax expenditure within a tax expenditure, yet it is rarely analyzed as such. The

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[328] *See* I.R.C. § 170(e)(7) (2006).

[329] For example, the deduction for casualty losses contains a $100 per loss floor. I.R.C. § 165(h)(1) (2006).

[330] *See infra* Table 1 accompanying note 103 (averaging column 1).

[331] *See id.* (averaging column 3).

general rule allowing a deduction based on the fair market value of the property may have some intuitive appeal, but its implementation has yielded numerous exceptions and immense complexity. Property quite simply is not as good as cash and should not be favored. Unlike cash, the value of property is hard to measure, which means that property contributions are difficult and costly to administer. It also means that the amount of the contribution is not well aligned with the benefit to the donee. In many cases, donee benefit is an afterthought, when it should be the driving concern.

This Article has argued that it is time to admit that the extensive historical effort to allow a deduction for property contributions is a failure. Given the substantial direct and indirect costs involved—including to revenue, tax administration, the reputation of the charitable sector, and to tax policy—the uncertain benefit to the donee, and the absence of any affirmative policy to favor property contributions as such, it is time to reverse the general rule and not allow a charitable deduction for property contributions. Reversing the general rule would provide many benefits—increased revenue, improved tax administration, fewer abusive transactions, a simpler and more equitable tax code, and a preference for cash. Exceptions to the general rule of disallowance may be warranted, but any exception should be analyzed and fashioned according to whether it provides a measurable benefit to the donee. By following a measurable benefit to the donee standard, emphasis will be placed on providing a tax benefit that is administrable and that is based on the goal—donee benefit. Any resulting complexity should be viewed as a cost of the incentive, and weighed accordingly in deciding whether it should be provided.