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Non-Itemizers**

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# Charitable Contributions of Services: Charitable Gift Planning for Nonitemizers

HENRY ORDOWER\*

## ABSTRACT

This Article examines the tax treatment of charitable contributions and concludes that contributors who do not itemize their deductions (nonitemizers) should contribute their services to charity whenever possible rather than contributing cash or property. Charitable donees similarly should embrace opportunities to accept and utilize service contributions from their donor bases, give service contributions as much recognition as money or property contributions, and encourage their lower-income donors to render services rather than giving money earned with performance of services. The Article suggests that nonitemizing taxpayers are the donors who have the most “skin in the game” for charitable contributions in terms of sacrifice. Promoting service rather than money or property contributions maximizes the tax subsidy of the charitable contributions. From the perspective of efficient tax planning for low and moderate-income taxpayers, the tradition of volunteerism in the United States is compelling. Yet, despite the ability to get more “bang for the buck” from service contributions, many charitable organizations that used to rely on volunteers for support increasingly have shifted their operations to reliance on paid staff and pushed even the low-income members of their donor base to contribute money rather than volunteer services.

## I. Introduction

This Article recommends renewed emphasis on service contributions to charity for taxpayers who do not itemize their deductions for federal income

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tax purposes.<sup>1</sup> Despite proposals to offer a charitable contribution deduction for certain service contributions, this Article does not argue that any taxpayers, whether physicians or other skilled workers, should receive a contribution deduction for the value of their services unless they include the value of the services in income and claim an offsetting deduction.<sup>2</sup> Service contributions currently provide contributors, especially lower-income contributors who do not itemize their deductions, a more substantial tax benefit than do cash and property contributions by not imputing income from the performance of those volunteer services in the donor's gross income.<sup>3</sup> Promoting service, rather than money or property, contributions helps maximize the tax subsidy accompanying charitable contributions and redirects revenues from governmental to nongovernmental, charitable activities. From the perspective of efficient tax planning for low and moderate-income taxpayers, the tradition of volunteerism in the United States is compelling. Yet, despite the systemic tax advantages of service contributions, many charitable organizations that used to rely on volunteers for operational support have shifted to reliance on paid staff.<sup>4</sup>

Part II of this Article illustrates the basic tax treatment of charitable contributions and distinguishes the charitable contribution deduction from the charitable exclusion of gain and service income. Part III seeks to quantify the combined effect of the charitable deduction and gain exclusion and compares that effect with the services exclusion. Part IV addresses the income splitting or shifting function of charitable contributions and seeks to understand the denial of the charitable contribution deduction to taxpayers who do not itemize deductions. Part V discusses the issue of sacrifice inherent in the context of charitable giving. Part VI looks more closely at imputation of service

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<sup>1</sup>I.R.C. § 63. Section references are to the 1986 Code, as amended, unless otherwise noted. Section 63 allows individual taxpayers to deduct from their adjusted gross incomes, as determined under section 62 (and defined as gross income under section 61 less specified deductions), either a standard deduction amount or the amount of the individual's itemized deductions. Taxable income is adjusted gross income less personal exemptions under section 151 and less the standard deduction or itemized deductions. Section 1 computes an individual's tax liability on the taxable income. Itemizers are those individual taxpayers whose itemized deductions exceed in amount the standard deduction, as well as some taxpayers whom the Code requires to itemize deductions. The charitable contribution deduction under section 170 is one of the itemized deductions.

<sup>2</sup>Charity Care Tax Deduction for Physicians Act of 2012, H.R. 5849, 112th Cong. (proposing a deduction for physicians offering charity care but proposal did not come out of committee); see, e.g., Alice M. Thomas, *Re-Envisioning the Charitable Deduction to Legislate Compassion and Civility: Reclaiming Our Collective and Individual Humanity Through Sustained Volunteerism*, 19 KAN. J.L. & PUB. POL'Y 269 (2010) (proposing an imputed charitable contribution deduction or credit for volunteer services).

<sup>3</sup>This Article refers to nonimputation as a charitable exclusion. See *infra* Part II.B.2.

<sup>4</sup>See MARK A. MUSICK & JOHN WILSON, VOLUNTEERS: A SOCIAL PROFILE 397 (2007) (discussing how volunteering is changing by group and activity—trending towards low-income young adults and elderly volunteering in sporadic affiliations managed by a paid staff, with more tending to volunteer with government agencies).

income and, specifically, the charitable exclusion for contributions of services. Part VII concludes that charitable organizations should revisit their approach to service contributions by returning to volunteerism to capture additional implicit government tax subsidies for charities and their donors.

## II. Charitable Contribution Tax Benefits

### A. *The Charitable Deduction*

Among individual charitable donors of cash or property are (1) some who itemize their deductions for federal income tax purposes<sup>5</sup> and get a federal income tax benefit by deducting their contributions;<sup>6</sup> (2) some taxpayers who itemize their deductions but get only a partial current federal income tax deduction from their contributions because their contributions exceed certain percentages<sup>7</sup> of their adjusted gross income to which deductible contributions are limited;<sup>8</sup> and (3) some taxpayers who do not itemize their deductions for federal income tax purposes and, accordingly, receive no income tax deduction from their contributions at all.<sup>9</sup>

To the extent that the charitable contribution deduction reduces the taxpayer's income, the deduction's impact begins at the taxpayer's greatest marginal rate of tax and works its way down through the taxpayer's marginal brackets as it reduces the taxpayer's taxable income.<sup>10</sup> Similarly, most states that impose a tax on incomes also allow a deduction for gifts to charity that begins at the taxpayer's highest state income tax bracket and works its way

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<sup>5</sup>See *supra* note 1.

<sup>6</sup>I.R.C. § 170 (allowing a deduction for contributions to charity).

<sup>7</sup>§ 170(b) (limiting the current deductibility of charitable contributions to 50% or less of the individual taxpayer's contribution base, defined in section 170(b)(1)(G) as adjusted gross income computed without regard to any net operating loss carryback). For a discussion of these limitations and their function, see Miranda Perry Fleischer, *Generous to a Fault? Fair Shares and Charitable Giving*, 93 MINN. L. REV. 165 (2008).

<sup>8</sup>§ 170(d) (allowing a carryover of contribution amounts exceeding section 170(b) limitations to the next five taxable years).

<sup>9</sup>Under section 63, the standard deduction amount does not vary with the amount, if any, of the taxpayer's charitable gifts. See I.R.C. § 63.

<sup>10</sup>See I.R.C. § 1 (imposing a tax upon the taxable income of each individual or trust taxable at marginal rates ranging from 15% (or zero percent if one includes those whose incomes fall below the first marginal bracket threshold) to 39.6% of the taxpayer's taxable income subject to that marginal bracket). See generally the reform proposals in ROGER COLINVAUX, BRIAN GALLE & EUGENE STEUERLE, URBAN INSTITUTE, *EVALUATING THE CHARITABLE DEDUCTION AND PROPOSED REFORMS* (2012), available at <http://www.urban.org/UploadedPDF/412586-Evaluating-the-Charitable-Deduction-and-Proposed-Reforms.pdf>.

down any marginal brackets the state may have.<sup>11</sup> To illustrate this point, assume an individual taxpayer makes a \$100 deductible contribution. Absent the contribution, \$50 of the taxpayer's income would be subject to the 39.6% federal rate of tax and the maximum state rate of tax of eight percent in a state having marginal brackets matching the federal marginal income tax brackets but using rates of zero, two, four, six, and eight percent. The taxpayer will reduce her federal income tax liability by \$37.80, which is 39.6% of \$50 plus 36% of \$50 since only \$50 of the contribution reduces tax at the maximum rate. The taxpayer will also reduce her tax liability by \$7 at the state level, that is eight percent of the \$50 taxed at the maximum rate and six percent of the remainder taxed at the six percent state rate. Since state taxes are deductible in computing the federal income tax,<sup>12</sup> the taxpayer's state tax savings reduces that deduction by the \$7 state tax savings and increases the federal income tax by \$2.52 (36% of \$7) for a net federal income tax savings of \$35.28 plus the \$7 state tax savings for a total of \$42.28 combined tax savings.<sup>13</sup> As a result of the deduction effect, the value of the charitable contribution deduction increases to the maximum marginal rate of tax as the taxpayer's income increases.<sup>14</sup>

In the example in the previous paragraph, the net cost to the taxpayer of her \$100 charitable contribution is \$57.72, which is \$100 less the federal tax reduction of \$35.28 plus \$7 state tax reduction (\$55.58 under the same assumptions at maximum state and federal rates<sup>15</sup>). For a nonitemizer, the tax

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<sup>11</sup> For example, the author's home state of Missouri uses federal adjusted gross income and federal itemized deductions, both with various adjustments, as its base for tax computations. MO. REV. STAT. § 143.141 (2011) (itemized deductions); MO. REV. STAT. § 143.121 (2011). Nonitemizers in those states get no tax benefit from the charitable deduction unless they qualify for one or more of the targeted tax credits for certain charitable gifts some states like Missouri offer. See *infra* note 55 and accompanying text. Credits generally are a function of the amount of the contribution and do not vary with the donor's marginal rates of tax but may be nonrefundable, so that the credit is of no value once it exceeds in amount the donor's liability for tax.

<sup>12</sup> I.R.C. § 164(a)(3) (allowing a deduction for state income taxes).

<sup>13</sup> The computation may not be quite as straightforward as the example shows. Some states may allow a deduction for federal income taxes in computing state income tax liability. More significantly, the taxpayer may lose some or all the state income tax deduction in computing her federal income tax liability because of the alternative minimum tax under section 55. See I.R.C. § 55. This example and other examples in this Article do not illustrate the effect of the alternative minimum tax. The alternative minimum tax enhances the net value of the charitable contribution deduction because the alternative minimum tax does not allow a deduction for state income taxes but does allow the deduction for charitable contributions. I.R.C. § 56(b)(1).

<sup>14</sup> In the example in the text, if the taxpayer had at least \$100 of income otherwise subject to the maximum federal and state rates, her federal savings would be \$39.60 plus \$8 state savings or \$47.60 (less the state tax deduction effect of \$3.17).

<sup>15</sup> That is if the full amount of the contribution offsets income otherwise taxable at the 39.6% federal and eight percent state rates.

savings from the same charitable contribution is zero and the net cost of the contribution is \$100.<sup>16</sup>

Taxpayers who itemize and make their contributions in the form of appreciated property, rather than cash, enjoy a deduction amount from the contribution of property to charity generally equal to the fair market value of the property on the date of the contribution,<sup>17</sup> rather than the taxpayer's cost of or adjusted tax basis in the property.<sup>18</sup> For example, if a taxpayer contributes a rare coin that she purchased for \$10 and the coin has a value of \$100 at the moment of contribution, the deduction is \$100, not the taxpayer's original investment amount. Compare the rule for losses that limits the loss deduction to the taxpayer's adjusted basis in the loss property even if the property is destroyed.<sup>19</sup> While several provisions limit the deduction amount to the taxpayer's adjusted basis in the contributed property,<sup>20</sup> most appreciated investment property yields a fair market value deduction. Whether cash or appreciated property, the contribution base limits<sup>21</sup> are a function of the donor's adjusted gross income and restrict current deductibility in some instances. Those limits have lower thresholds, however, for appreciated property contributions.<sup>22</sup>

### B. *The Charitable Exclusions*

Supplementing the charitable contribution deduction in the case of contribution of appreciated property is the exclusion of gain on the contributed property from the contributor's gross income. Contribution of appreciated

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<sup>16</sup>There may be unusual circumstances under which a nonitemizer is subject to the alternative minimum tax and is not allowed the standard deduction or personal exemptions in computing that tax. I.R.C. § 56(b)(1)(E) (disallowing the deduction for the standard deduction and personal exemptions in computing the alternative minimum tax). The charitable contribution deduction would be allowable and may result in someone, otherwise a nonitemizer, electing to itemize deductions. I.R.C. § 63(e) (election to itemize deductions).

<sup>17</sup>Section 170(c) defines charitable contribution but does not measure it. Regulation section 1.170-1(c)(1) interprets section 170 with respect to property and uses fair market value as the measure of the amount of a property contribution.

<sup>18</sup>Under section 1012 (defining basis to equal cost), the taxpayer's cost often is the taxpayer's basis in the property. That basis may adjust for allowances such as depreciation under section 1016(a)(2), for example, so that the taxpayer's adjusted basis under section 1011(a) is less than the taxpayer's cost. Gain the taxpayer realizes and recognizes on the sale of the property is the amount realized from the sale less the taxpayer's adjusted basis rather than cost. I.R.C. § 1001 (determining gain from the sale or other disposition of property).

<sup>19</sup>I.R.C. § 165(b) (amount of loss deduction).

<sup>20</sup>For example, section 170(e)(1)(A) limits the deduction to adjusted basis to the extent gain on sale of contributed property would be not be long term capital, and section 170(e)(1)(B) (i) limits the deduction to adjusted basis for gifts of tangible property unrelated to the charity's purpose. I.R.C. § 170(e)(1)(A)-(B).

<sup>21</sup>§ 170(b) (limiting the charitable contribution deduction to specific percentages of the taxpayer's contribution base); *see also supra* text accompanying note 6.

<sup>22</sup>§ 170(b)(1)(C), (D) (contribution base limitations for capital gain property); *see also* Fleischer, *supra* note 7, at 223 (recommending lower contribution base limits for additionally subsidized gifts of appreciated property).

property does not trigger the recognition of the donor's gain on the property despite the donor's disposition of the property.<sup>23</sup> Similarly, rendition of services to a charity does not result in the donor including the value of the services in her income.<sup>24</sup> This Article refers to the failure of the income tax system to impute gain to the contributor of property and the failure to impute income to the contributor of services as the charitable exclusions.

### 1. *Gain*

When the taxpayer contributes appreciated property, she permanently excludes the appreciation from her income.<sup>25</sup> While this outcome resembles the outcome accompanying a noncharitable gift, a noncharitable gift defers the realization and recognition of gain and shifts the burden of the potential gain to the donee. The donee in the case of a noncharitable gift takes the donor's adjusted basis in the gift property.<sup>26</sup> Accordingly, the donee may become taxable on the gain accruing during the donor's ownership (and the ownership of previous donors) when the donee sells the appreciated property. Because the charitable donee is exempt from tax,<sup>27</sup> the donor's potential gain disappears. The charity is not taxable on the historical gain (or gain during the charitable donee's holding period).

The charitable exclusion results from the failure of the income tax to impute taxable gain to the contributing taxpayer from the appreciated property at any time—not upon contribution and not upon sale of the property by the charity.<sup>28</sup> The charitable exclusion applies<sup>29</sup> whether the taxpayer's gain on sale would have been ordinary or capital<sup>30</sup> and even if the property is unrelated

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<sup>23</sup>Section 1001(a) measures realized gain as the excess of the proceeds the taxpayer receives over the taxpayer's adjusted basis in the property. Since the contribution is a gift, there is no exchange of property for consideration so that the statute is inapplicable. I.R.C. § 1001(a).

<sup>24</sup>A donor of services receives nothing in exchange for the services and need not include any amount in her income. *See* I.R.C. § 83 (requiring the receipt of something in exchange for the services in order for an inclusion in income); Reg. § 1.61-2(c) (excluding the value of contributed services from the service provider's gross income, but not services provided to a third party with payment to the charitable organization).

<sup>25</sup>Under section 1001, no realization of gain occurs. *See* I.R.C. § 1001.

<sup>26</sup>I.R.C. § 1015 (requiring that the donee take the donor's basis in the case of a gift, with exceptions for depreciated property).

<sup>27</sup>I.R.C. § 501(a) (establishing that charities are exempt from tax on income, with exceptions).

<sup>28</sup>Compare, for example, section 311(b), imputing a sale at fair market value when a corporation distributes appreciated property to its shareholders. Before 1986, such a distribution would not have been taxable to the corporation under section 311(a). I.R.C. § 311.

<sup>29</sup>I.R.C. § 1245(b)(1) (requiring recapture of depreciation, notwithstanding other Code provisions, and including an internal exception to recapture for gifts); BORIS I. BITTKER ET AL., *FEDERAL INCOME TAXATION OF INDIVIDUALS* ¶ 28.03 (2d ed. 2013) (observing "the assumption that a gift is not a taxable event").

<sup>30</sup>*See* I.R.C. § 170(e)(1)(A) (limiting the deduction to adjusted basis if gain would not be capital on sale).

to the charitable purpose.<sup>31</sup> Even if the charity sells the contributed property immediately following the contribution, neither the contributing taxpayer nor the charity recognizes gain on the contribution or from the contribution<sup>32</sup> unless the taxpayer committed to sell the property and contributed it subject to the obligation to sell.<sup>33</sup> Similarly, the charitable exclusion is not subject to the contribution base limitations. Only if the charity assumes, or takes subject to, indebtedness encumbering the contributed property will the charitable gift become part sale to the extent of the debt and part gift to the extent of the excess of the fair market value of the property over the amount of the debt.<sup>34</sup> In that instance, the donor must allocate her adjusted basis in the property between the sale portion and the gift portion relative to their respective amounts to determine how much gain the taxpayer recognizes on the part sale portion of the transfer of the property to charity.<sup>35</sup>

The charitable exclusion benefit from contributing appreciated property supplements and sometimes exceeds the tax benefit from the charitable deduction. For example, a donor, otherwise taxable at the maximum federal income tax rate chooses to contribute \$100 to charity. If the donor makes the contribution in cash (considering federal income tax only), the net cost of the contribution is \$60.40<sup>36</sup> assuming the donor does not run afoul of any contribution limit and otherwise itemizes deductions. If the donor contributes ordinary gain property to charity with an adjusted basis of \$10 and the fair market value of \$100, the charitable contribution deduction has a value to the donor of \$3.96, that is, 39.6% of the donor's adjusted basis.<sup>37</sup> The charitable exclusion, however, has a value of \$35.64, that is, 39.6% of the avoided \$90 of ordinary income from the sale of the property. In that instance, the value of the exclusion exceeds the value of the deduction, and the overall result is identical to a cash contribution without any concern about contribution limits or itemized deduction limitations. While the gain exclusion is available equally to itemizing and nonitemizing taxpayers, as a class, nonitemizing taxpayers

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<sup>31</sup> § 170(e)(1)(B) (limiting the deduction for tangible personal property unrelated to the charity's charitable purpose).

<sup>32</sup> For vehicle, boat, and airplane contributions, the charity's sale price is the ceiling on the amount of the taxpayer's deduction. § 170(f)(12)(A)(ii). Likewise, if the charity sells property related to its exempt purpose within three years of the contribution of that property, the donor must recapture that portion of the contribution amount exceeding the donor's adjusted basis in the contributed property. § 170(e)(7).

<sup>33</sup> *Palmer v. Commissioner*, 62 T.C. 684 (1974), *acq.* 1978-1 C.B. 83 (holding that the donor of appreciated securities is taxable on the gain from a subsequent redemption only if there was a binding commitment to redeem at the time of the gift).

<sup>34</sup> Reg. § 1.1001-2(a) (treating relief of debt as amount realized).

<sup>35</sup> See I.R.C. § 1011(b) (allocating basis between the sale and gift portions of a bargain sale to charity).

<sup>36</sup> The \$100 charitable contribution deduction yields a tax benefit of \$39.60 tax savings, leaving the net cost at \$60.40.

<sup>37</sup> See I.R.C. § 170(e)(1) (limiting the deduction to the donor's basis).



are far less likely to own appreciated property that they may contribute than are itemizing taxpayers.<sup>38</sup>

## 2. *Performance of Services*

The second type of charitable exclusion upon which this Article focuses is for the performance of services. The income tax does not impute income from the gratuitous performance of services. If a donor contributes her services to a charitable organization, neither the donor nor the charitable recipient includes the value of those services in income.<sup>39</sup> From the perspective of the nonitemizer, the analysis is straightforward. For a donor who receives \$10 per hour for her services and is subject to a 15% rate of income tax and wishes to make a charitable contribution of \$100, a service donation is superior to cash. Taking only the federal income tax into account, if the donor contributes cash, the donor must work for nearly 12 hours to earn enough to have \$100 remaining after tax to contribute the \$100 to charity.<sup>40</sup> On the other hand, if the donor contributes \$100 worth of her services to the charity, she need work only ten hours to fulfill the \$100 gift. The income, net of tax, from the additional nearly two hours of labor remains in the donor's pocket. The charitable recipient should be indifferent to the form of the contribution if it can find a way to substitute the donor's services for services for which it otherwise would pay.

The charitable exclusion for services reaches beyond the federal income tax and into state income taxes and the social security and Medicare taxes as well. A nonitemizer whose wages are less than the social security contribution base ceiling,<sup>41</sup> who is not eligible for the Earned Income Tax Credit (EITC) or has reached the credit maximum,<sup>42</sup> and who has the time and opportunity to earn an additional \$100 in wages but who gives the \$100 worth of services to charity instead of cash, gets a tax benefit from the gift of her tax rate plus the social security and Medicare tax rates. To illustrate: assume a nonitemizer in a 15%

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<sup>38</sup> See *infra* note 58 and accompanying text.

<sup>39</sup> Reg. § 1.61-2(c) (excluding the value of contributed services from the service provider's gross income but not services provided to a third party with payment to the charitable organization).

<sup>40</sup> The donor must earn \$117.65 to have \$100 remaining after paying the 15% income tax.

<sup>41</sup> Under section 3121, the Code imposes the social security tax (or self-employment tax) on income from services to the extent of the social security contribution and benefit base under section 230 of the Social Security Act that increases with inflation. I.R.C. § 3121. In 2013 that amount is \$113,700. Social Security Administration, *Benefits Planner: Maximum Taxable Earnings (1937 - 2014)*, OFFICIAL SOC. SECURITY WEBSITE, last accessed Feb. 22, 2014, <http://www.socialsecurity.gov/planners/maxtax.htm#maxEarnings>.

<sup>42</sup> I.R.C. § 32 (discussing the EITC); see Rev. Proc. 2013-15, 2013-5 I.R.B. 444 (showing inflation adjustments for the EITC among other tax items and the maximum amount of income to which the credit applies as \$13,340 with the phaseout of the EITC beginning in most instances at \$17,530). For taxpayers eligible for the EITC, having one or more qualifying children and incomes less than the maximum credit limit, including the additional income increases the EITC by more than the percentage of income, social security, and Medicare tax.

federal marginal income tax bracket<sup>43</sup> and subject to the six percent Missouri state income<sup>44</sup> tax avoids the tax on the \$100 of income from those services (\$15 federal plus \$6 state). In addition, the taxpayer avoids the \$6.20, 6.2% employee share, of the social security tax and the \$1.45, 1.45%, employee share of the Medicare tax. The employee may bear the burden in the form of lower wages of the employer's share of those taxes as well. If so, the value of the services the employee donates to charity is greater than \$10 per hour since an employer not subject to the wage taxes would pay the employee more than \$10 per hour. The tax savings (or subsidy) is \$28.65 (\$15 federal income tax, \$6 Missouri income tax, plus \$7.65 social security and Medicare tax) or more.

### III. A Closer Look at the Combined Charitable Deduction and Gain Exclusion: Examples

The following examples simplify the analysis of the charitable contribution deduction by ignoring the federal income tax deduction for state taxes and using the 39.6% maximum federal rate and the six percent maximum income tax rate in Missouri<sup>45</sup> rather than the hypothetical, graduated state rates that the previous example uses.<sup>46</sup> If the previous example had used the same assumptions, the tax savings from the \$100 contribution would have been \$45.60 (\$39.60 federal income tax plus \$6 Missouri state income tax).

Assume that, rather than making a contribution of cash, the taxpayer contributes unencumbered, marketable securities the taxpayer has owned for more than one year<sup>47</sup> and in which the taxpayer has an adjusted basis of zero.<sup>48</sup> If the fair market value of the securities on the date of contribution is \$100, the taxpayer may claim a charitable contribution deduction in the amount of \$100. Assuming the taxpayer is taxed at the maximum federal and Missouri state income tax rates, the tax reduction from the contribution is \$45.60.<sup>49</sup> In addition, the taxpayer excludes the potential \$20 tax on the net

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<sup>43</sup>I.R.C. § 1. Rev. Proc. 2013-15, 2013-5 I.R.B. 445, shows a 15% federal income tax bracket for 2013 in the range of \$8,925 to \$48,600, depending on the taxpayer's filing status.

<sup>44</sup>The maximum rate of six percent in Missouri applies to Missouri taxable income in excess of \$9,000. MO. REV. STAT. § 143.011.

<sup>45</sup>MO. REV. STAT. § 143.011 (imposing a six percent tax on income in excess of \$9,000).

<sup>46</sup>See *supra* Part II.A.

<sup>47</sup>See generally § 1(h) (imposing a maximum 20% tax on net capital gain); I.R.C. § 1222(11) (defining net capital gain); § 1222(3) (defining long term capital gain).

<sup>48</sup>The choice of a hypothetical zero adjusted basis simplifies the computations. Rarely would a taxpayer's adjusted basis in securities be zero since, unlike depreciable property which often has a zero adjusted basis after adjustments for depreciation under section 1016(a)(2), a taxpayer's adjusted basis in securities generally would not diminish from purchase price, unless the issuer made nontaxable distributions to the holders of the securities. See, e.g., I.R.C. § 301(a), (c)(2) (nondividend distributions to the extent of the taxpayer's adjusted basis).

<sup>49</sup>Ignoring the federal income tax deduction under section 164 (deduction for taxes, including the state income tax).

capital gain<sup>50</sup> she would have incurred if she sold the securities and the additional \$6 state tax since Missouri, like many other states, does not distinguish capital gain from ordinary income. The total tax savings in this instance may be as much as \$65.60 for a net cost of the contribution of \$34.40.

From the charity's perspective, but for transaction costs, the gift of cash is economically equivalent to the gift of marketable securities. The charity is indifferent to whether it receives \$100 cash or \$100 of marketable securities since it will recognize no taxable gain when it sells the securities because it is exempt from tax.<sup>51</sup> The donor, however, is not indifferent, and the charity is pleased to lend the donor the charity's tax-exempt status in exchange for the gift.

The donor may enhance the tax subsidy of the charitable exclusion further by donating a valuable collectible item rather than a security.<sup>52</sup> If, for example, the donor contributes a rare postage stamp having a value of \$100 and an adjusted basis to the donor of zero to a museum of philately, the avoided federal income tax increases to 28% of the untaxed gain, rather than 20%.<sup>53</sup> The donor chooses a museum of philately because the stamp is related to the charitable organization's charitable purpose so the donor may deduct the full fair market value of the stamp.<sup>54</sup> Assume the same facts as in the previous example. The charitable deduction reduces the donor's tax by \$39.60 federal income tax, \$6 state income tax, and the donor excludes the collectibles gain tax of \$28.00 and a state income tax on the gain of \$6 for a total tax benefit of \$79.60, leaving the donor with a net cost of the \$100 gift of only \$20.40. Viewed another way, of the \$100 donation, \$79.60 is federal and state revenue the donor has redirected to the charity to accompany the \$20.40 from the donor's pocket.

If one takes the securities gift example further into the state tax regime,<sup>55</sup> the donor also might target the gift to a charitable organization that has state-granted 55% tax credits to offer the donor.<sup>56</sup> In that instance, the donor will

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<sup>50</sup>Under section 1001, a sale of the securities (a capital asset under section 1221) at their \$100 value would result in long-term capital gain to the taxpayer. See I.R.C. § 1222(3) (defining long-term capital gain). Absent offsetting capital losses, that gain becomes net capital gain under section 1222(11), subject to a maximum 20% rate of tax under section 1(h)(1)(C).

<sup>51</sup>See I.R.C. § 501(a).

<sup>52</sup>See I.R.C. § 1(h)(5) (defining collectibles).

<sup>53</sup>Net capital gain from collectibles is subject to a maximum rate of 28%. I.R.C. § 1(h)(1)(F), (h)(4)(B), (h)(5).

<sup>54</sup>See I.R.C. § 170(e)(1)(B) (limiting the deduction to basis in the case of tangible property unrelated to the donee's charitable purpose). Less clear is whether a collectible is intangible property because value is a function of its representative character rather than its physical use for its original purpose.

<sup>55</sup>See *supra* text accompanying note 46. The stamp, if tangible personal property for purposes of section 170(e)(1)(B), would not be related in service or use to a charity that immediately sells it to provide affordable housing and only such an organization is likely to be eligible for the existing Missouri tax credits.

<sup>56</sup>Mo. REV. STAT. § 32.115 (2013) (allowing the affordable housing credit under Mo. REV. STAT. § 32.111).

have a tax credit of \$55 for the \$100 gift of marketable securities. The total state and federal charitable gift subsidy becomes greater than the value of the contributed property as follows: \$120.60 is the total tax benefit composed of the above \$59.60 federal income tax subsidy consisting of the \$39.60 deduction benefit and the \$20 exclusion benefit, the \$12 state tax subsidy consisting of \$6 state tax deduction benefit plus the \$6 exclusion benefit, and the \$55 state income tax credit.<sup>57</sup> In this instance, the donor gets to direct \$100 of government revenue to the charity and enhance her personal wealth by as much as \$20.60.<sup>58</sup>

While nonitemizers who contribute appreciated property, like itemizers, do exclude the tax on their unrealized gain on the contributed property, they, as a group, are less likely to own disposable appreciated property than are itemizers.<sup>59</sup> Nonitemizers generally do not own significant portfolios of securities<sup>60</sup> while itemizers, especially those in the group with incomes in excess of \$200,000,<sup>61</sup> may own sizable securities portfolios and often interests in closely held corporations that they may choose to contribute. To level the tax-benefit playing field on charitable gifts somewhat between itemizers and nonitemizers, the nonitemizer would rely on the charitable exclusion for services.<sup>62</sup>

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<sup>57</sup> Even if one were to take the deduction for state income taxes at the federal level into account (\$26.53 composed of 39.6% of (1) the state tax savings of \$12 from the deduction and nontaxation of the gain, and (2) the \$55 state tax reduction from the credit), the net benefit from the contribution would approach the amount of the contribution (\$120.60 less \$26.53 loss of the state tax deduction is still \$94.07).

<sup>58</sup> Note on the federal estate tax—the federal estate tax applies in 2013 to taxable estates exceeding \$5.0 million. I.R.C. § 2001 (imposing the estate tax); I.R.C. § 2010 (providing a credit against the federal estate tax). For high wealth taxpayers whose estates might exceed those estate tax thresholds, the charitable gift removes property that otherwise might be includable in the donor's taxable estate at death and subject to an estate tax on its value. I.R.C. § 2055 (providing an unlimited estate tax deduction for charitable gifts). The estate tax deduction has limited significance for purposes of this Article except to the extent that estate planning opportunities enable a decedent's estate to pass more property free of the estate tax to noncharitable beneficiaries than would pass without the charitable gift. Moreover, in terms of personal sacrifice, the estate tax deduction is of limited significance since the donor would not continue to own the property in any event. The donor could remove the property from his or her estate by throwing it away, destroying it (if legal), or abandoning it although courts might not permit destruction that a decedent directs in his or her will on policy grounds. And if the donor chose to destroy the property or take the property along to his or her grave, it would not become subject to the estate tax in any event. See *N.Y. Trust Co. v. Eisner*, 256 U.S. 345 (1921) (upholding the federal estate tax as an indirect tax on the transfer of property rather than a direct tax on wealth).

<sup>59</sup> Of the 93 million filers with under \$50,000 of income, only 14 million or 15% of that group itemize. Almost all filers with more than \$200,000 income itemize. CONGRESSIONAL BUDGET OFFICE, PUB. NO. 4030, OPTIONS FOR CHANGING THE TAX TREATMENT OF CHARITABLE GIVING 5 (May 2011).

<sup>60</sup> Joseph Campbell, *Household Finance*, 61 J. FIN. 1553, 1563-64 (2006) (noting that most households in the bottom quartile of the wealth distribution hold only liquid assets and vehicles, with a minority participating in real estate through home-ownership).

<sup>61</sup> CONGRESSIONAL BUDGET OFFICE, *supra* note 59.

<sup>62</sup> See Reg. § 1.61-2(c); see also *supra* Part II.B.2.

#### IV. Charitable Tax Benefits As Income Splitting or Shifting: Policy Considerations in Denying the Charitable Contribution Deduction to Nonitemizers

The standard deduction<sup>63</sup> may consist of an assumed average array of expenditures that taxpayers make, including charitable gifts that might be deductible as itemized deductions. Since the amounts of each of those expenditures for nonitemizing taxpayers are small, the standard deduction relieves taxpayers of the need to maintain the records that would be necessary to track and report them. If the standard deduction embeds an imputed amount of charitable contribution within its computation, denying the charitable deduction to nonitemizers makes sense. A better view of the standard deduction, however, would seem to be that it and the personal exemption free a subsistence minimum from the federal income tax. No taxpayer need pay taxes that would reduce his or her income below or further below that subsistence minimum.<sup>64</sup> As a subsistence minimum, the standard deduction has little to do with charitable contributions. Other than concern with the administrative complexity of recordkeeping and accurate reporting of relatively small charitable contributions<sup>65</sup> and, of course, the loss of tax revenue that would result from extending the deduction to nonitemizers, sound tax policy does not compel denial of the charitable contribution deduction to nonitemizers while awarding the deduction to itemizers. From time to time, Congress indeed has considered a charitable contribution deduction for nonitemizers and even included one in the tax law for several years.<sup>66</sup>

Given the origins of charitable giving in the communitarian obligation on the farmer to leave the corners of his field for the poor to harvest,<sup>67</sup> with the tithe growing from this obligation,<sup>68</sup> exclusion of nonitemizers from charitable giving tax benefits is ironic. The tithe obligates all members of

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<sup>63</sup>I.R.C. § 63(c)(3) (defining standard deduction).

<sup>64</sup>Compare Germany where a constitutional mandate defines a subsistence minimum that must remain free from the income tax, but not from the value added tax. For example, see BVERFGE 82, 60 (1990) and BVERFGE 87, 153 (1992) (decisions of the German Constitutional Court holding in part that the income tax may not diminish the taxpayer's income to an amount less than a subsistence minimum). See generally Henry Ordower, *Horizontal and Vertical Equity in Taxation as Constitutional Principles: Germany and the United States Contrasted*, 7 FLA. TAX REV. 259, 302 (2006).

<sup>65</sup>See Ellen Aprill, *Reforming the Charitable Contribution Substantiation Rules*, 14 FLA. TAX REV. 275, 279-86 (2013) (discussing the problems with overvaluation and the substantiation rules).

<sup>66</sup>From 1981 to 1986. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 121(a), 95 Stat. 172, 196 (extending the deduction to include nonitemizers). The Tax Reform Act of 1986 removed the nonitemizer deduction. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085.

<sup>67</sup>See Adam S. Chodorow, *Maaser Kesafim and the Development of Tax Law*, 8 FLA. TAX REV. 153, 160-61 (2007) (discussing the concept of tithing and its relationship to the un-harvested corners).

<sup>68</sup>See *id.* at 162-68.

the community to devote a portion of their incomes, not their wealth, to relieve poverty. The church stepped in to administer collection of the tithe and distribution of the proceeds of the tithe for the good of the community. At its origins, charity was a form of income splitting so that early tax collection would have reached the income of the individual net of the tithe. In the contemporary Mormon Church,<sup>69</sup> tithing remains an obligation of church adherents and is ten percent of gross income, including recognized gains from the sale or exchange of property.<sup>70</sup>

The current tax law treatment of charitable contributions creates an imperfect form of income splitting or shifting to the charitable organization. Income shifting is perfect in that all contributions of appreciated property enable the donor to shift the recognition of unrealized gain to the donee organization.<sup>71</sup> The donee organization is exempt from tax so that the donee's share of any unrealized gain from the contributed property never becomes subject to the income tax. This ability to shift unrealized gain applies equally to ordinary income producing and capital gain property.<sup>72</sup>

Similarly, both itemizers and nonitemizers may split their incomes from services with the charitable organization by performing services for or on behalf of the organization. A donor who performs services for a charitable organization is not taxable on imputed income from the value of the services,<sup>73</sup> and the organization gets the value of the services. If as a volunteer the donor performs services on behalf of the charitable organization, and the organization resells those services to others, the donor may be taxable,<sup>74</sup> and the organization may be engaging in an unrelated trade or business and become subject to the unrelated business income tax on the activity in which the donor is engaged.<sup>75</sup> The nature of the services and the manner in which the charitable donee resells them becomes critical to the charitable exclusion and the unrelated business income classification. If, for example, a retired nurse contributed some time to a hospital, and the hospital did not adjust its billing to take into account that it did not pay the nurse, the resale of the nurse's services to the hospital patients is sufficiently general as not to cause the nurse to have imputed income from services. The hospital, of course, would not have unrelated business income. On the other hand, if the hospital used the contributed services of an auto mechanic to repair cars for which it charged customers, imputation of income to the mechanic and unrelated business income to the hospital might follow. However, if the hospital only

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<sup>69</sup>The Church of Jesus Christ of Latter-day Saints.

<sup>70</sup>*Malachi* 3:10 (requiring tithing).

<sup>71</sup>See *supra* text accompanying note 28.

<sup>72</sup>*Id.*

<sup>73</sup>Reg. § 1.61-2(c); see *supra* text accompanying note 39.

<sup>74</sup>Reg. § 1.61-2(c).

<sup>75</sup>I.R.C. § 511 (imposing an income tax at the maximum rate that would be applicable to the type of business organization the charity resembles—corporation or trust—on its unrelated taxable income under section 512). Section 512 defines unrelated business taxable income.

provided the services to doctors on staff to help them to travel to the hospital without incident, the issue would be a much closer call.

Certain charitable contributions from a donor's tax-deferred individual retirement account (IRA) more closely approximate a true form of income splitting than do other charitable gifts of money or property.<sup>76</sup> The charitable gift from the donor's IRA diminishes the donor's gross income.<sup>77</sup> Donations from individual retirement plans resemble gifts of services, but the donor has provided no services for or on behalf of the donee. Unless retired, the donee continues to perform services in her own trade or business, ultimately shifting the deferred income through the retirement arrangement to the charitable donee. Donors who benefit from the income exclusion by directing tax-deferred retirement savings to charitable donees tend to be at the higher income levels of society rather than the moderate to low-income group that makes up the bulk of the nonitemizer class.<sup>78</sup> Unlike true income splitting, however, the gift from the retirement arrangement may have been subject to the social security or self-employment tax and the Medicare tax when the donor funded the retirement arrangement.<sup>79</sup>

On the donee's end, the gift carries no imputation of source as it would with direct income splitting or income splitting through a partnership.<sup>80</sup> Despite the donor's deferral of income inclusion and accompanying permanent exclusion through the charitable gift, the character of the donee's receipt is a charitable contribution. The donee will not have unrelated business income from the contribution even if the donor received the income she deferred through the retirement arrangement from the conduct of a trade or business that would have been an unrelated trade or business to the donee if the donee had received the income from its source.<sup>81</sup>

The policy underlying the exclusion of IRA charitable contributions from the donor's gross income seems inconsistent with the general tax treatment of charitable gifts. If the donor tries to split her income from services with a charity, the assignment of income doctrine causes her to be taxed on the

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<sup>76</sup>Section 408(d)(8) permits the owner of an IRA who is at least 70 and one half years old to contribute up to \$100,000 per year to charity from the IRA without including the distribution in the donor's income. The provision terminated at the end of 2013. I.R.C. § 408(d)(8) (F). The social security tax or the self-employment tax, whichever applies, and the Medicare tax reach the deductible contributions to an IRA although the income tax does not.

<sup>77</sup>See I.R.C. § 61(a) (defining gross income).

<sup>78</sup>THOMAS L. HUNGERFORD & JANE G. GRAVELLE, CONG. RESEARCH SERV., RL30255, INDIVIDUAL RETIREMENT ACCOUNTS (IRAs): ISSUES AND PROPOSED EXPANSION 13 (2012) (observing that high income individuals are the primary users of individual retirement accounts even though Congress targeted that deferral benefit to moderate income taxpayers).

<sup>79</sup>*Cf.* I.R.C. § 3121(a)(5) (excluding employer contributions to certain qualified retirement arrangement from the social security wage base but not employee contributions).

<sup>80</sup>*Cf.* I.R.C. § 702(b) (extending to partners deemed to be engaged in the trade or business of the partnership); I.R.C. § 512(c)(1).

<sup>81</sup>IRA charitable gifts are contributions, so that the donor's income source is not imputed to the charity.

income.<sup>82</sup> Similarly, if the donor provides services on behalf of a charitable organization to a third party in exchange for a payment to the charitable organization, she is taxable on the income<sup>83</sup> and may claim a charitable contribution deduction for the amount of the gift.<sup>84</sup> Yet, contribution of the income from services that the taxpayer has deferred through an IRA<sup>85</sup> receives more favorable treatment as it reduces what otherwise would be the donor's gross income or the gross income of the beneficiary who receives the rights to the donor's IRA after the donor's death.<sup>86</sup>

While the charitable exclusion permitting the shifting of gain from appreciated property and income from services to the charitable donee is available to all taxpayers without regard to filing status or the aggregate amount of their itemized deductions, the charitable deduction itself is available only to itemizing taxpayers. Unlike the charitable exclusion, the deduction is imperfect as a means of income splitting. The deduction splits income in that it diminishes the amount of the donor's taxable income. Imperfection in splitting arises because, for individuals, (1) the deduction is itemized, that is, deductible only to the extent itemized deductions exceed the standard deduction;<sup>87</sup> (2) the deduction is subject to contribution base limitations;<sup>88</sup> (3) to the extent that the donor gives some of the donor's income from her services to the charity, the donor still must pay the social security and Medicare taxes to which the service income is subject, even if the gift otherwise is deductible, as there is no deduction for charitable contributions in the social security and Medicare bases;<sup>89</sup> and (4) as an itemized deduction, other tax items that are a function of adjusted gross income—for example, medical expense deduc-

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<sup>82</sup> See *Lucas v. Earl*, 281 U.S. 111, 114-15 (1930).

<sup>83</sup> Reg. § 1.61-2(c); see *supra* text accompanying note 38.

<sup>84</sup> I.R.C. § 170(a).

<sup>85</sup> Cf. I.R.C. § 408(d)(8)(A) (excluding the charitable distribution from the donor's IRA from the donor's gross income); § 408(d)(8)(E) (denying a charitable contribution deduction to the donor for the amount paid from the donor's IRA).

<sup>86</sup> Distributions to a beneficiary from a decedent's IRA are income in respect of a decedent under section 691 and not property that receives a new fair market value basis as it passes through the donor's estate. See I.R.C. § 691(a).

<sup>87</sup> See I.R.C. § 63.

<sup>88</sup> See I.R.C. § 170(b); see *supra* text accompanying note 6. Until 2010, the charitable contribution deduction was also subject to the itemized deduction limitation in section 68.

<sup>89</sup> Both the social security and Medicare taxes under section 3101 permit no deductions in the computation of the tax base, and the self-employment tax under section 1401 allows ordinary and necessary business deductions in its computations but not items that fall within the definition of itemized deductions. I.R.C. §§ 3101, 1401. The social security tax generally will not impact the higher wage donors because their incomes will exceed the social security and self-employment tax wage base. See §§ 3101(b)(2), 1401(b)(2)(A).



tions<sup>90</sup> or limitations on the miscellaneous itemized deductions<sup>91</sup>—remain unaffected by the charitable contribution deduction. The charitable deduction's unequal treatment of taxpayers seems inconsistent with the charitable exclusion's equal treatment of taxpayers. Administrative convenience, record-keeping burdens, opportunities to cheat, and personal sacrifice all may help to explain the distinction between the exclusion and the deduction, but none of those reasons explains it compellingly.

## V. Charitable Contributions and the False Notion of Sacrifice

Most people probably would agree that sacrifice of some kind should be an essential condition to the charitable contribution deduction,<sup>92</sup> and that the size of the tax benefit should grow in relation to the amount of the donor's sacrifice. The more of one's wealth one contributes, the greater the charitable deduction benefit should be. While that argument seems sensible, earlier examples illustrate that, in some charitable contribution instances, the charitable tax benefits equal or even exceed the donor's economic sacrifice.<sup>93</sup> That same argument also misses the relative sacrifice element of charitable contributions. Many taxpayers whose relative sacrifice is greatest get little or no tax benefit. Nonitemizers make the greatest relative sacrifice when they make charitable gifts because \$1 of contribution costs them \$1,<sup>94</sup> while itemizers, especially those who are subject to no contribution base limitations,<sup>95</sup> make a smaller relative sacrifice since the tax benefit causes each dollar of contribution to cost them less than \$1.<sup>96</sup>

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<sup>90</sup> See I.R.C. § 213(a) (allowing a deduction for medical expenses only to the extent they exceed ten percent of the taxpayer's adjusted gross income under section 62, and, for the next three years, only to the extent they exceed 7.5% of the taxpayer's adjusted gross income if the taxpayer is 65 or older).

<sup>91</sup> See I.R.C. § 67(a) (limiting the deduction for miscellaneous itemized deductions to the amount by which they exceed two percent of the taxpayer's adjusted gross income).

<sup>92</sup> The donor should get no deduction without giving up something, having some "skin in the game." The concept "skin in the game," often attributed probably erroneously to Warren Buffet, see William Safire, *On Language: Skin in the Game*, N.Y. TIMES MAGAZINE, Sept. 17, 2006, to refer to corporate and investment managers who have a material stake in the businesses they manage, refers to the stake that the donor must have as a condition to claiming the charitable contribution deduction.

<sup>93</sup> See *supra* Part III.

<sup>94</sup> Note that this is not a marginal utility argument that a dollar is worth more to a poor person than to a rich one.

<sup>95</sup> See I.R.C. § 170(b); *supra* text accompanying note 6.

<sup>96</sup> See examples *supra* Part III.

Unless nonitemizers believe they get a charitable contribution deduction when they do not,<sup>97</sup> the charitable contribution deduction must not drive nonitemizers' decisions to contribute or not to contribute to charity.<sup>98</sup> While altruism and sensitivity to the plight of others probably accounts for much charitable giving, explicit and implicit pressure from employers and peers may account for a significant share of nonitemizers' contributions to charity in the absence of any tax benefit. Employers, perhaps unintentionally, may influence employees when they cooperate with charitable organizations<sup>99</sup> by facilitating employees' contributions to the organization through a payroll deduction plan. Some, possibly many, employees who do not itemize deductions may feel uncomfortable not participating when they receive plan notices at work and announcements of participation rates even though they otherwise would not contribute. In the workplace, colleagues and supervisors frequently solicit contributions on behalf of their favorite charities. Such solicitations exert pressure on employees to contribute. Employees who can ill afford to contribute feel themselves obligated because of the public nature of the collection or their specific relationship with the person soliciting the donation. More compelling still is the combination of the public nature of the collection plate or solicitation in a place of worship.<sup>100</sup>

While similar factors may motivate charitable giving among those who do get a tax benefit from their contributions, additional elements may play a role as well. For those able to make significant contributions, nonmonetary benefits including recognition, power, control, and the ability to redirect government revenues to favored causes<sup>101</sup> may motivate the donor. Donors often

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<sup>97</sup> See Lilian V. Faulhaber, *The Hidden Limits of the Charitable Deduction: An Introduction to Hypersalience*, 92 B.U. L. REV. 1307, 1309-10 (2012) (arguing that many taxpayers think they benefit from the deduction who do not). For a discussion of taxpayers arguing against their personal interest with respect to tax law proposals, see Henry Ordower, *The Culture of Tax Avoidance*, 55 ST. LOUIS U. L.J. 47, 117-18 (2010) (arguing that many opponents of the estate tax would never become subject to that tax and misunderstand its context and reach).

<sup>98</sup> Of the 93 million filers with under \$50,000 of income in 2008, the 14 million who itemized (15%) accounted for roughly half of that bracket's charitable donations (\$20.0 billion of the \$37.0 billion). CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 5. The remaining \$17.0 billion of charitable contributions generated no tax benefit to their donors because these donors took the standard deduction. *See id.* at 7. There was an additional \$9.0 billion unclaimed in the \$50,000-\$200,000 brackets, with 58% of filers in the \$50,000-\$100,000 bracket itemizing and 85.7% of filers in the \$100,000-\$200,000 bracket itemizing. *Id.* at 5. Almost all filers with more than \$200,000 of income itemize. *See id.*

<sup>99</sup> The United Way, for example.

<sup>100</sup> *See* Eric Zolt, *Tax Deductions for Charitable Contributions: Domestic Activities, Foreign Activities, or None of the Above*, 63 HASTINGS L.J. 361, 368-69, 407 (2012) (arguing that there is no reason to favor some organizations aiding foreign activities over others as the Code now does for technical reasons, and showing statistics that nonitemizers make proportionally more of their charitable contributions to churches than do itemizers).

<sup>101</sup> *See id.* at 365 (making the observation about directing government revenues to charitable organizations). For a good discussion of the distributive justice aspect of this ability to direct governmental revenues, see also Miranda Perry Fleischer, *Theorizing the Charitable Tax Subsidies: The Role of Distributive Justice*, 87 WASH. U. L. REV. 505, 537 (2010).

get recognition in the form of naming rights when they make significant gifts. The donee organization may name a building, room, or fund after the donor. Moreover, donors get recognition from both professional and peer volunteer solicitors who frequently court significant donors to secure major gifts. Power and control come to donors in the form of organization board memberships and offices that enable the donors to assert some control over the organization's decision-making with respect to both programs and the acquisition of facilities.<sup>102</sup> And donors who may not believe that the government spends tax revenues wisely may redirect money they otherwise might pay in taxes to organizations that share the donor's views.<sup>103</sup>

For very wealthy donors, their charitable contributions are perhaps unlikely to diminish their standard of living insofar as their contributions may be surplus wealth, wealth the donors will not consume. Surplus wealth, however, is a relative concept. Although people's notions of what constitutes surplus differ, there probably is some point at which most people would view additional wealth to be surplus. In their canonical treatment of progressive taxation,<sup>104</sup> for example, Professors Blum and Kalven conclude that marginal utility of wealth is not a sufficient argument for progressivity in taxation because it is so difficult to measure. Short of a Scrooge McDuck-like obsession with simple possession of wealth,<sup>105</sup> however, transfer to others of part of one's wealth is not a sacrifice, as long as one reserves adequate wealth to fuel one's own, unlimited consumption.

Even in the absence of any diminution of one's own consumption, people continue to have an interest in the use of the wealth they have accumulated. Most people do not wish to share their wealth with people or causes they do not like or consider unworthy. Frequently, people try to retain control over expenditure of their wealth although they have no personal use for it. Control, not continuing ownership, is important. The grantor trust rules of the Code, for example, recognize the importance of continuing control.<sup>106</sup> Donors regularly use trusts, restrictive co-ownership arrangements, and pri-

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<sup>102</sup> See Peter Buffett, Op-Ed., *The Charitable-Industrial Complex*, N.Y. TIMES, July 26, 2013, at A19.

<sup>103</sup> *Id.*

<sup>104</sup> WALTER BLUM & HARRY KALVEN, *THE UNEASY CASE FOR PROGRESSIVE TAXATION* 56-63 (1953).

<sup>105</sup> Scrooge McDuck was Donald Duck's uncle in the Donald Duck comic book series. Scrooge was, as his name suggests, wealthy and stingy. He kept his money in a vault and spent countless hours counting it. Each amount of money was critically important to him, so that relinquishing even a small sum was painful.

<sup>106</sup> See I.R.C. §§ 671, 674 (treating the grantor as the owner of the trust and taxable on its income if the grantor retains powers over the income or principal of the trust short of the power to spend for the grantor's consumption). Similarly, see the retained interest rules of the estate tax. See I.R.C. §§ 2036(a)(2), 2038.

vate foundations in order to retain some direct or indirect control over wealth while relinquishing ownership.<sup>107</sup>

Where one has little personal use for the wealth, the wealth may provide the donor with the power and pleasure of giving. Whether for the relief of human suffering or to support artistic endeavors, eleemosynary organizations—churches, political campaigns, and a variety of other organizations that rely on donations employ vast numbers of both paid professional staff and volunteers to help the organizations—capture a share of the public's discretionary spending.<sup>108</sup> In exchange, fundraisers may offer significant donors a variety of tangible gifts and intangible benefits—in addition to the warm feelings one gets from helping an important cause or activity—in exchange for their generosity.

For donors with large amounts of surplus wealth, charitable giving also may offer an opportunity to cleanse their names. While over time we may forget that some corporations dealt in worker exploitation, monopolization, price gouging, and discrimination, we now only associate their names with significant positive charitable giving. In addition, living donors often continue to exert significant direct or indirect control over their donated wealth.<sup>109</sup> Even when the donor retains no power to determine the use of the charitable gift, management of an organization that has received a significant gift may hope to woo the donor to make further gifts. In such cases, management is likely to remain sensitive to the interests and goals of the donor. Even if the donor retains no direct control over the donated funds, major charitable donors customarily define the mission of the charitable funds they establish and, in that manner, continue to influence decisions as to the distribution of funds to donees often long after the donor's death. The donors have made minimal, if any, sacrifice. The wealth they relinquished was surplus, and they retain the only incident of ownership of that wealth about which they really care; they continue to exert some control over what they give away. The reward of a charitable subsidy in those instances seems unnecessary and, perhaps, unwarranted.

Yet, those wealthy donors are likely to be able to direct the expenditure of some governmental resources of both the United States and the state in which they reside alongside the direct expenditure of their own wealth. Through

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<sup>107</sup>Emily Barman, *With Strings Attached: Nonprofits and the Adoption of Donor Choice*, 37 *NONPROFIT & VOLUNTARY SECTOR Q.* 39, 44 (2008) (stating that young individuals and educated professionals drive a current shift in charitable giving toward donor choice and professionalization of nonprofits, requesting donor designation being accustomed to choice in the market and demanding control).

<sup>108</sup>Many might argue that frequently churches capture a share of the nondiscretionary spending that the donor might use better to provide for his or her family's basic needs. See *CONGRESSIONAL BUDGET OFFICE*, *supra* note 59, at 21 (showing a strong inverse correlation between income and percent donation to religious organizations). That discussion is perhaps better suited to an article that argues for differing amounts of charitable contribution deduction that depend on the nature of the recipient organization.

<sup>109</sup>Charitable gift funds and private foundations, for examples.

federal and state income tax deductions and credits, the governments subsidize the donors' charitable gifts.<sup>110</sup> The subsidies are meaningful tax expenditures that one may characterize equally as subsidy to the donor or subsidy to the donee organization.<sup>111</sup>

The preceding paragraphs do not suggest that major donors to organizations are other than genuinely charitable. Their gifts have great value and are critical to the continued existence of many important organizations. Nevertheless, their generosity often comes with little or no "skin in the game."<sup>112</sup>

For other charitable donors, gifts involve varying degrees of sacrifice. Many moderate-income individuals make charitable gifts even though they lack surplus wealth. They donate wealth that they otherwise might consume to maintain or improve their and their families' own standard of living. Whatever one's view of such sacrifice, there can be no doubt that nonitemizers bear a proportionally larger share of each dollar they contribute than do itemizers.

Perhaps the underlying justification for the unequal treatment of itemizers and nonitemizers in the charitable contribution deduction does not lie in relative personal sacrifice but in some collective perception that decisions the group of taxpayers getting the greatest aggregate benefit from both the exclusion and the deduction make are better than decisions the group of nonitemizers might make. Perhaps wealthy people do a better job of redirecting governmental resources to charities than less wealthy taxpayers do. A strong proponent of the separation of church and state might even favor that unequal treatment since nonitemizers tend to give to religious organizations, while itemizers support a broader range of causes, including cultural institutions.<sup>113</sup> Were that the reason for the difference in treatment, it might make better sense to deny the deduction and the exclusion to religious organizations. Such a radical change in the treatment of charitable gifts is unlikely, but nonitemizers and their charitable donees could capture a larger share of the charitable contribution tax benefits by refocusing the form of their gifts and substituting, whenever possible, services for cash.

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<sup>110</sup>See Part II of this Article for the financial analysis of the governmental subsidies.

<sup>111</sup>Ilan Benshalom, *The Dual Subsidy Theory of Charitable Deductions*, 84 IND. L.J. 1047, 1047-48 (2009) (arguing that the ability to direct government revenue with charitable contributions is undemocratic).

<sup>112</sup>Emily Barman, *An Institutional Approach to Donor Control: From Dyadic Ties to a Field-Level Analysis*, 112 AM. J. SOC. 1416, 1421 (2007). Those donating motivated by economic factors expect material, emotional, or prestige-based benefit; those donating for other reasons are still motivated by social rational calculation of individuals—giving not motivated by tangible benefits for individual, but instead by societal norms and obligations. "Charitable giving does not derive from the exchange of material goods but instead from the social relationships that it engenders. Reciprocity involves social or moral obligations between givers and recipients, either between two actors who exchange gifts or between the whole collectivity." *Id.*

<sup>113</sup>See CONGRESSIONAL BUDGET OFFICE, *supra* note 59; Zolt, *supra* note 100 and accompanying text.

## VI. The Charitable Gift Exclusion for the Unwealthy: Contributions of Services

As preceding sections of this Article demonstrate, tax benefits from cash contributions to charity elude taxpayers who do not itemize their deductions. Since those nonitemizers as a class tend to have lower incomes than the class of taxpayers who itemize deductions, the class of nonitemizers also is far less likely than itemizers to own appreciated properties that they might contribute to charity and receive the benefit of the charitable exclusion of gain. If low to moderate-income individuals have appreciated property at all, that property often is their personal residence that they cannot contribute to charity without undermining their own quality of life.<sup>114</sup> Even if they did contribute their personal residences, the charitable gain exclusion in most instances would be no greater than the general exclusion of gain on the sale of one's personal residence.<sup>115</sup> Since nonitemizers capture neither the charitable contribution deduction nor the charitable exclusion for appreciated property, nonitemizers' charitable contributions of money and property do not redirect government revenues to their favored charitable causes. In that respect, those contributions are less tax efficient than the contributions of itemizers. Nevertheless, statistics on charitable giving disclose that nonitemizers regularly make cash gifts to charities, especially religious organizations.<sup>116</sup> For nonitemizing taxpayers, the charitable contribution of their services would be a far more efficient tax choice than cash contributions are. Service contributions would enable nonitemizers to redirect governmental revenues through the charitable services exclusion as itemizers are able to do with cash and property contributions.

From time to time, some legislators<sup>117</sup> and commentators<sup>118</sup> have proposed a deduction or credit for the contribution of services to charity. A deduction or credit for service contributions is not supportable because the donor never took the income from the contributed services into account. Fundamental tax principles require that the taxpayer include an item in income as

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<sup>114</sup>Campbell, *supra* note 60 (noting that most households in the bottom quartile of the wealth distribution hold only liquid assets and vehicles, with only a minority participating in real estate through home-ownership).

<sup>115</sup>See I.R.C. § 121 (excluding up to \$500,000 of gain on the sale of one's principal residence for certain joint returns and up to \$250,000 for other returns).

<sup>116</sup>See CONGRESSIONAL BUDGET OFFICE, *supra* note 59; see Zolt, *supra* note 100 and accompanying text.

<sup>117</sup>See, e.g., Charity Care Tax Deduction for Physicians Act of 2012, *supra* note 2 (proposing a deduction for physicians offering charity care).

<sup>118</sup>See, e.g., Thomas, *supra* note 2 (proposing an imputed charitable contribution deduction or credit for volunteer services).

a condition of the deduction.<sup>119</sup> Allowing a deduction to taxpayers for the value of their donated services, while not imputing income from the services to the donor taxpayers, would double the benefit to the donor and further diminish essential governmental revenues. The fact that a donor gets a deduction for the full value of contributed property but need not include the gain in income is inconsistent with the fundamental concept that underlies the charitable contribution since the donor has not taken the item producing the deduction into account to the extent of the untaxed appreciation in value.<sup>120</sup>

The following example illustrates the observations in the preceding paragraph and the tax efficiency of the service contribution for a highly-compensated individual.<sup>121</sup> Assume that a medical doctor bills her time for patient care at \$300 per hour. The doctor contributes the equivalent in money of five hours of her time to a free clinic for the needy—\$1,500 in cash.<sup>122</sup> The charity pays another doctor to provide services to patients. The payment to the paid doctor is taxable to the doctor. If the paid doctor is an employee of the clinic, the clinic must pay a Medicare tax on the doctor's salary (1.45% of the \$1,500 or \$21.75) and a social security tax up to the social security wage ceiling for the year (possibly as much as 6.2% or \$93). The paid doctor must include the payment in his income subject to the income tax (maximum rate of 39.6% of the \$1,500 or \$594), and the paid doctor pays his share of the Medicare and social security taxes. While the income tax on that inclusion in income for income tax purposes may be substantially equivalent to the reduction in income tax from the deduction the donor doctor receives, it is not

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<sup>119</sup>Basic Federal Income Taxation includes the case of *Haverly v. United States*, 513 F.2d 224 (7th Cir. 1975), *cert. denied*, 423 U.S. 912 (1975). WILLIAM D. ANDREWS & PETER J. WIEDENBECK, *BASIC FEDERAL INCOME TAXATION* 46-47, 179-89 (6th ed. 2009). While not a services decision, the principle in *Haverly* is analogous. There the taxpayer claimed and was denied a deduction for the value of textbooks he received without charge from the publisher as samples. He did not include the value of the textbooks in income when he received them. The Service could have asserted, but it did not, that the value of the textbooks was income to him when he received them. *Haverly's* receipt of the books did not meet the objective donative intent standard of *Duberstein v. Commissioner*, necessary to exclusion of a gift from income under section 102. I.R.C. § 102; *Duberstein v. Commissioner*, 363 U.S. 278 (1960). But *Haverly* could not claim a deduction for the textbooks because he had not taken them into account for tax purposes by purchasing them or including their value in his income. Taking into account, of course, is not the same as having paid tax on the item. One may contribute property that one has received by gift, for example, and still claim a deduction. The donee of property received by gift takes her donor's adjusted basis in the property. That adjusted basis is from the original owner (or his predecessor in interest) having acquired the property in a taxable transaction using funds on which the tax was paid (unless exempt from tax) to acquire the property.

<sup>120</sup>Limiting the deduction to the donor's adjusted basis in this context, as the statute limits the deduction in the case of ordinary income producing property, would make sound tax policy in this context. See Fleischer, *supra* note 7 (recommending lower contribution base limitations for appreciated property).

<sup>121</sup>Federal taxes only. See *supra* note 40 and accompanying text.

<sup>122</sup>The \$1,500 may entail transaction costs that diminish the value of the donation: credit card fees, bank fees for collecting the check, and payments to fundraisers.

identical. The donor doctor and her employer (or the doctor if self-employed) paid the Medicare tax (\$21.75 as above) when she earned the income (and possibly a social security tax of \$93) and may lose part of the benefit of her own deductions because of floors on deductibility or phase-outs of other benefits that relate to her amount of adjusted gross income.<sup>123</sup> To avoid too much counting of tax benefits, we recognize that the paid doctor is likely to fill his available work time in any event, so his inclusion is the substitution of hours for the clinic for hours in another paid practice.

On the other hand, if the donor doctor contributes five hours of her medical services, rather than money, the clinic receives \$1,500 of service value. The donor doctor includes nothing in income from those five hours. Instead of an itemized deduction of \$1,500, the donor simply excludes \$1,500 from her gross income. Her adjusted gross income base for other computations declines in an equal amount. Further, the nonimputation of income from the charitable services also prevents the value of the services from being classified as wages or self-employment income subject to social security or self-employment tax and Medicare tax. The charitable clinic pays no wages to the donor doctor and, accordingly, pays no employer's share of the social security or Medicare tax. The combined net tax savings in this example ranges from 2.9% (Medicare tax only) to upwards of 15.3% depending on the adjusted-gross-income-affected items even in the instance that the donor would get a charitable deduction tax benefit from the contribution.<sup>124</sup> If, contrary to current law, the doctor also were to receive a charitable contribution deduction for the value of her services, the tax benefit of the income exclusion almost would double.

In those cases in which the donor does not itemize deductions, the tax savings from the exclusion is even greater since a cash contribution would yield no income tax benefit either.<sup>125</sup> In addition, for low-income employed individuals who make charitable contributions but have reached the phase-out threshold for the EITC, contributions of services may protect their EITC when additional compensated hours might cause the credit to phase out.<sup>126</sup> For example, a taxpayer having two or more qualifying children and currently receiving the maximum earned income credit must reduce the amount of credit by 20.22 cents for each additional dollar of compensation (or other income) the taxpayer receives.<sup>127</sup> Accordingly, if that taxpayer works additional hours and receives \$100 that she gives to charity, the \$100 of com-

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<sup>123</sup> See I.R.C. § 67 (miscellaneous itemized deductions); I.R.C. § 213 (medical expense deductions).

<sup>124</sup> See *supra* Part II.B.2 (state income tax example).

<sup>125</sup> Of course, this is not a realistic option for those low income taxpayers who may not have the flexibility to substitute labor for cash. Employers may demand that the employee devote all her available working hours to the employer's business.

<sup>126</sup> See I.R.C. § 32(b)(2) (showing the amount of income at which the EITC phases out); see *supra* note 41.

<sup>127</sup> See § 32(b)(2).



pensation costs the taxpayer an additional \$20.22 in reduced earned income credit as well as being subject to social security tax, Medicare tax, and income tax. The total tax cost that the taxpayer could avoid by performing the \$100 of services gratuitously for charity is as much as \$42.87, that is, \$15 at a 15% income tax rate, \$7.65 social security and Medicare tax, plus \$20.22 phase-out of the earned income credit.

In addition, the donor has greater flexibility in her choice of recipients for contributions of her services than an itemizer has for contributions of cash or property. Restrictions on the class of permissible charitable donees of cash and property<sup>128</sup> do not limit service donors' choices of recipients of the donors' benevolence. The charitable donee that receives the services may be a domestic or foreign charity. In the case of a foreign charity, the organization need not rely on a domestic feeder organization for the contribution to qualify for deductibility in the United States.<sup>129</sup> In fact, the donor may contribute services on the same basis to any organization, even one that is not charitable at all, if it serves a political purpose, or is simply a for-profit entity.<sup>130</sup>

The U.S. income tax system fails to impute income from services in many contexts. Absent a market exchange where the donor has an expectation of tangible reciprocity, as opposed to intangible benefits like recognition, blessings, and like benefits, the tax system does not reach imputed income from personal services whether the gift of services is charitable or noncharitable. Even in the presence of reciprocal expectations, the Code does not require inclusion of imputed income from one's services if the other party to the reciprocal arrangement bears certain relationships to the service provider, including spousal, co-habitant, and possibly even communal.<sup>131</sup> Vast numbers of unpaid household and child care workers perform services in their own home and the value of those services never becomes imputed income.<sup>132</sup>

Similarly, some religious organizations rely exclusively, or nearly so, on volunteer workers rather than paid staff to execute the principal religious func-

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<sup>128</sup> See I.R.C. § 501(c)(3).

<sup>129</sup> The service donor's out-of-pocket expenses will not be deductible, however, as they would be in the case of services donated to a section 501(c)(3) donee.

<sup>130</sup> One might expect that a donor would be reluctant to donate services to a profit-seeking venture, yet scores of university students do just that each year in the form of unpaid internships. See Dylan Matthews, *Are Unpaid Internships Illegal?*, WASH. POST, June 13, 2013, <http://www.washingtonpost.com/blogs/wonkblog/wp/2013/06/13/are-unpaid-internships-illegal/> (describing the opinion of the Court of Appeals for the Second Circuit holding that unpaid internships in media production violate wage and hours laws); *infra* note 132. See generally Ross Perlin, Op-Ed, *Unpaid Interns, Complicit Colleges*, N.Y. TIMES, Apr. 2, 2011, [http://www.nytimes.com/2011/04/03/opinion/03perlin.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2011/04/03/opinion/03perlin.html?pagewanted=all&_r=0) (providing a recent critique of unpaid internships and colleges' role in supporting them).

<sup>131</sup> Cf. I.R.C. § 61.

<sup>132</sup> Cf. Nancy C. Staudt, *Taxing Housework*, 84 GEO. L.J. 1571, 1606-10 (1996) (arguing in a cutting-edge article that taxing housework would both define the value of the services that most often women perform in their homes and enable those women to participate directly in the social security retirement system and other benefits that tie into compensated service income).

tions of the church. The Catholic Church, for example, has depended for its basic functions on unpaid workers.<sup>133</sup> Both priests and nuns take vows of poverty and provide services on behalf of the Church to parishioners.<sup>134</sup> Similarly, the Church of Jesus Christ of Latter-day Saints reaches deeply into its membership to provide services in its many missions by expecting each adherent to spend some period doing uncompensated service.<sup>135</sup> And the tax system often fails to reach the considerable amount of value of personal services even when there is a market exchange, such as in unpaid internships.<sup>136</sup> Those internships appear to be reciprocal service arrangements. The intern receives training that, the intern hopes, will lead to employment with the organization for which he is interning or another organization needing someone with that training. In those instances, both the donor and donee should be taxable on the value of the services, as the arrangement is a market exchange for value, a taxable event. Often, failure to impute income from a market exchange is a matter of the administrative difficulty of identifying and determining the value of the exchanged services.<sup>137</sup> Occasionally, however, when the Service seeks to determine the value of and tax reciprocal service arrangements, Congress bars it from doing so.<sup>138</sup>

If, for example, A, an auto mechanic, repairs her own car, she is not taxable on the value of those services that substitute for what otherwise would require a taxable market exchange. If A agrees to repair B's car if B cleans A's kitchen, there is a true, observable market exchange.<sup>139</sup> Both A and B should be taxable on the value of the services exchanged unless A and B are spouses, co-habitants, or, possibly, members of some sort of cohesive unit, a commune perhaps, where members of the commune share responsibili-

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<sup>133</sup> See 1983 CODE OF CANON LAW c.668, §§ 1-5 (describing the vows of poverty taken by nuns); *id.* at c.1008 (describing the duties of priests).

<sup>134</sup> *Id.*

<sup>135</sup> The official website of the Church of Jesus Christ of Latter-day Saints outlines many missionary opportunities for church members. *Missionary Work*, THE CHURCH OF JESUS CHRIST OF LATTER-DAY SAINTS, last accessed Jan. 18, 2014, <http://mormon.org/missionary-work/>.

<sup>136</sup> See *supra* text accompanying note 128.

<sup>137</sup> Consider the debate concerning carried interests in private equity funds that Victor Fleischer recently brought to national attention. See generally Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1 (2008) (analyzing various arguments for taxing a profits interest but concluding that the private equity fund managers should have ordinary income from their profits interests in the private equity funds). On the issue of service partnerships, see generally Henry Ordower, *Taxing Service Partners to Achieve Horizontal Equity*, 46 TAX LAW. 19 (1992) (arguing that the profits interests should be taxable as open transactions).

<sup>138</sup> See I.R.C. § 132(a)(1) (no additional cost service); Act of Oct. 7, 1978, Pub. L. No. 95-427, § 1, 92 Stat. 996, 996 (moratorium on fringe benefit regulations preceding enactment of section 132).

<sup>139</sup> I.R.C. § 6045(c)(1)(B), (c)(3) (including barter exchanges in information reporting for brokers). The information reporting obligation does not apply to informal exchanges of similar services under noncommercial arrangements like baby-sitting exchanges. Reg. § 1.6045-1(a)(4).

ties for various services necessary to the operation of the commune.<sup>140</sup> As to the value of the services, the exchange equivalency doctrine requires that only the value of A's or B's services become determinable because the arm's length nature of the exchange renders the reciprocal services equal in value in a market exchange.<sup>141</sup> Nevertheless, uncertainties about value may inhere unless either A or B renders substantially identical services to third parties for compensation at a constant rate. Exchanges of property are easier to value than exchanges of services.

Some arguments for not imputing income from the gratuitous performance of services are that (1) one need not charge for one's services and (2) the value of the services is indeterminate because the services are expenditures of time that the donor otherwise would not devote to paid employment, making it particularly difficult to value. As to the first of these arguments, judicial decisions historically determined that a taxpayer need not charge interest for the use of her money.<sup>142</sup> As interest rates climbed through the 1970s, Congress imputed interest income into low and no-interest loans both in commercial and gift contexts with no exception even for inter-spousal interest-free loans.<sup>143</sup> Services, like the use of money, have value. As to indeterminacy of value, interest-free loans are an easier issue than uncompensated services insofar as external standards exist against which one might peg an imputed interest rate. While those imputed rates bear little relationship to the rate the lender might charge to the borrower having the characteristics of the borrower in the low or interest-free loan, an arguably objective standard does determine the imputed rates. Similarly, several European countries impute a use value that taxpayers must include in their incomes when they occupy homes they own.<sup>144</sup> The imputation amount tends to be low relative to market rentals for comparable properties, so the inclusion, like the low interest loan imputation in the United States,<sup>145</sup> understates the use value. Objective standards for gratuitous services are more elusive although one might be able to develop a national average to provide the minimum imputed wage standard for the type of services the donor performs.

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<sup>140</sup> Reg. § 1.61-2(d)(1).

<sup>141</sup> See *Phila. Park Amusement Co. v. United States*, 126 F. Supp. 184, 189 (Ct. Cl. 1954) (holding that an exchange at arm's length means that the values of the exchanged property interests must be equal).

<sup>142</sup> See *Dean v. Commissioner*, 35 T.C. 1083, 1090 (1961) (holding that noninterest bearing loans from a corporation did not generate income taxable to the borrower because the interest, if paid, would have been deductible).

<sup>143</sup> Section 172(a) of the Deficit Reduction Act of 1984, Pub. L. 98-369, 98 Stat. 699 (July 18, 1984) added Code section 7872 (imputing interest income into low and no interest loans).

<sup>144</sup> The Netherlands, for example, imputes a 0.6% of value rate. See M. Peter van der Hoek & Sarah E. Radloff, *Taxing Owner-Occupied Housing: Comparing the Netherlands to Other European Union Countries*, 7 PUB. FIN. & MGMT. 393 (2007).

<sup>145</sup> Cf. I.R.C. § 7872(b).

## VII. Charities Should Seize the Exclusion Benefit

Imputation of income to charitable donors of services is unlikely to find its way into the tax law. Even in the presence of reciprocal arrangements like volunteer theater ushers who the theater then allows to stay and watch the show, the government is unlikely to seek to tax the benefit to the service donor. The charitable community should exploit this opportunity that the tax system offers more extensively and effectively than it now does. The exclusion of income benefit for charitable donors who give their services, rather than their money, to charity affords an attractive opportunity for charities to capture government revenue in conjunction with the contributions of even their low-income donors. At the same time, charitable recipients who otherwise would be subject to payroll taxes derive a benefit from using volunteers rather than paid employees. Yet, discussion in the literature has focused on debating whether or not there should be some special deduction for individuals who contribute their services other than treating the donor's out of pocket expenditures as cash contributions.<sup>146</sup>

In part, the problem lies in recognizing the value of services to the charitable organization.<sup>147</sup> When one gives money or property to charity, almost invariably, one gets a written note of thanks from someone affiliated with the charitable organization.<sup>148</sup> Many organizations continue to suggest a value for contributions of property.<sup>149</sup> Those acknowledgements facilitate the donor's claim for a charitable contribution deduction although many donors who receive acknowledgements do not itemize and, therefore, do not claim the deduction. Frequently, the acknowledgement of contribution includes language that identifies limitations on the deduction and seeks to separate the deductible portion of a gift from that part of the payment for which the donor receives something in exchange.

The gift acknowledgement, however, serves more than a tax function. Charitable organizations often recognize and honor their donors, identifying them by size of donation categories, often accompanied by a donor category membership—century clubs and similar, but higher, categories.<sup>150</sup> A donor may achieve a donee level with gifts of money or property or even by designating the organization as the beneficiary on some low-cost life insurance policy but rarely, if ever, with a gift of services. Failure to acknowledge the value of the service gifts misses an opportunity. Even if acknowledging would

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<sup>146</sup> See, e.g., Thomas, *supra* note 2.

<sup>147</sup> MUSTICK & WILSON, *supra* note 4, at 116 (unrecognized volunteers most likely to discontinue the volunteer activity).

<sup>148</sup> Given current substantiation requirements for larger charitable gifts, one now almost invariably receives an acknowledgment. See I.R.C. § 170(f)(8) (contemporaneous acknowledgment for gifts of \$250 or more).

<sup>149</sup> Thrift shops, for example. I.R.C. § 170(f)(16).

<sup>150</sup> Most organizations, universities, and cultural institutions identify donor categories in their publicity and list donors by donation size in their programs or annual reports to their community.

mean that the organization would have to include in the acknowledgment a caution that the gift is not deductible for federal tax purposes, the organization quite possibly would gain the donor's identification with the organization, much as it does with monetary gifts. Giving levels encourage donors to continue to give and to increase their gifts over time.

Valuation of services is complicated but perhaps no more so than valuing clothing and household goods that one contributes to a thrift shop. Unlike valuations of property, there are no tax risks associated with erroneous valuation of services. Absent tax reporting of the value to support a deduction, an incorrect value has no external consequences. The arguments that contributions of services have little market value because the donor relinquishes leisure time, rather than work time, are specious. Even if the donation of services were of one's leisure time, the measure of value for the donor would be subjective as Henry Simon's paradigmatic Flugeladjutant who hates opera emphasizes.<sup>151</sup> Perhaps leisure is far more valuable to the individual than work hours, so that the donor's value is greater than for the donor's work hours. Some donors, on the other hand, enjoy working far more than they enjoy leisure, so an opportunity to work more, albeit without compensation, is particularly beneficial to them. Others have the opportunity to fill all their hours with compensated work so that the charitable contribution diminishes their incomes by a measurable amount. For others who do not need or do not want income, charitable service is a career. There are many "professional" volunteers. In any event, whatever services one performs for a charity as a donor substitute for services for which the charity otherwise might pay. Just as one values goods at their resale value, charities could value services at their market substitute value. No one would seriously argue that the services a doctor performs as a volunteer seeing patients in a charitable clinic without compensation are less valuable or of no value because of the absence of compensation. Services are rarely if ever without value.

Some may argue that monetizing service contributions diminishes them. Service donors wish recognition for their service not the money value of their service. Monetizing, however, is consistent with current practice for cash and property donations and might enhance, rather than diminish, the perception of the services' importance to the organization. We measure value in money. The other donative participants in the charitable process, the monetary donors, tend to trivialize volunteer services of those who are not major decision makers, especially those at the lower end of the work spectrum. Monetary donors might not trivialize those service donations quite so much if the organization did monetize the service donations and give them equal status with monetary donations. But to avoid diminution, charitable organizations

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<sup>151</sup> See HENRY C. SIMONS, *PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY* 53 (1938) (a work establishing the most commonly cited comprehensive income definition emphasizing the difficulty of valuing leisure with the example of the Flugeladjutant who gets opera tickets but hates opera).

could establish separate (but equally valid) contribution categories based upon time commitments and significant recognition opportunities alongside their monetary contribution categories.

### VIII. Conclusion

As a class, service donors, especially those who spend much of their time as charitable volunteers, historically have demonstrated strong commitment to the organizations they serve.<sup>152</sup> They have literal as well as figurative “skin in the game.” Development professionals for charitable organizations actively ought to recruit committed volunteers who might need just a little periodic encouragement to continue to serve rather than fickle financial donors who the organization must constantly woo. Experience also reveals that individuals who commit substantial time and energy to an organization tend to remember the organization in their wills.<sup>153</sup> While job opportunities and career paths within the charitable sector are appealing, the professionalization of charitable occupation regrettably must alter—possibly de-radicalize—the commitment to the charitable cause. Recognition of the value of service contributions might stem this trend and reinvigorate the American traditions of volunteerism and service while it affords less wealthy individuals opportunities to redirect government revenues to their favored charitable causes just as more wealthy individuals do currently with their gifts of some of their surplus money and appreciated property.

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<sup>152</sup> See Ram A. Cnaan & Toni Cascio, *Performance and Commitment: Issues in Management of Volunteers in Human Service Organizations*, 24 J. SOC. SERVICE RES. 1, 9 (1998) (volunteers who are committed to an organization's cause are more likely to remain actively involved with the organization).

<sup>153</sup> See Paul G. Schervish et al., *Charitable Giving: How Much, By Whom, To What, and How?* in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 545, 550 (Walter Powell et al. eds., 2006) (observing that important predictor of charitable giving is continued participation in an organization).

