

Wiley Nonprofit Authority



**the tax law of
charitable
giving**

+ website

Fifth Edition

Bruce R. Hopkins

WILEY

The Tax Law of Charitable Giving

Don't Miss Out on Must-Have and Timely New Information!

- Learn about new federal laws surrounding charitable giving.
- Keep up-to-date on relevant changes in IRS forms, requirements, and related tax procedures.
- Stay abreast of complicated legal and tax issues in the realm of charitable giving.

Subscribe now to make sure you have access to the latest information regarding tax regulations pertaining to charitable giving.

Go to

[www.nonprofitcommunity.com/index.php/
nonprofit-accounting-finance/](http://www.nonprofitcommunity.com/index.php/nonprofit-accounting-finance/)

and sign up today!



The Tax Law of Charitable Giving

Fifth Edition

Bruce R. Hopkins

WILEY

Cover image: © iStockphoto.com/Trifonov_Evgeniy

Cover design: Wiley

Copyright © 2014 by Bruce R. Hopkins. All rights reserved.

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

Published simultaneously in Canada.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, (978) 750-8400, fax (978) 646-8600, or on the Web at www.copyright.com. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, or online at <http://www.wiley.com/go/permissions>.

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

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

Wiley publishes in a variety of print and electronic formats and by print-on-demand. Some material included with standard print versions of this book may not be included in e-books or in print-on-demand. If this book refers to media such as a CD or DVD that is not included in the version you purchased, you may download this material at <http://booksupport.wiley.com>. For more information about Wiley products, visit www.wiley.com.

ISBN 978-1-118-76803-7 (cloth)

ISBN 978-1-118-76766-5 (ebk)

ISBN 978-1-118-76772-6 (ebk)

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

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

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

Contents

Preface	xv
Book Citations	xxi

PART ONE

Introduction to the Tax Law of Charitable Giving

1 Charitable Giving Law: Basic Concepts	3
§1.1 Introduction to the Charitable Contribution Deduction	3
§1.2 Defining <i>Tax-Exempt Organizations</i>	5
§1.3 Principles of Charitable Organizations Law Philosophy	8
§1.4 Statistical Profile of Charitable Sector	23
§1.5 Categories of Tax-Exempt Organizations	28
2 The United States Tax System: An Overview	31
§2.1 Concept of Income	33
§2.2 Gross Income	34
§2.3 Exclusions from Income	35
§2.4 Concept of Adjusted Gross Income	36
§2.5 Deductions	37
§2.6 Standard Deduction	39
§2.7 Concept of Taxable Income	39
§2.8 Taxable and Nontaxable Entities	41
§2.9 Annual Accounting Period	42
§2.10 Accounting Methods	43
§2.11 Timing	43
§2.12 Property	44
§2.13 Inventory	46
§2.14 Gain	47
§2.15 Taxation of Income	53
§2.16 Capital Assets, Gains, and Losses	58
§2.17 Carryovers and Carrybacks	60
§2.18 Alternative Minimum Tax	61
§2.19 Depreciation	64
§2.20 Capital Gains and Losses Rates	65
§2.21 Taxation of Corporate Distributions	65
§2.22 Accumulated Earnings and Personal Holding Company Taxes	66
§2.23 Tax Credits	66

CONTENTS

- §2.24 Foreign Tax Credits 67
- §2.25 Federal Tax Law Definition of *Marriage* 67

PART TWO

Basics of Charitable Giving Law

- 3 Fundamental Concepts 71**
 - §3.1 Meaning of *Gift* 71
 - §3.2 Meaning of *Donor* 117
 - §3.3 Meaning of *Charitable Organization* 119
 - §3.4 Public Charities and Private Foundations 131
 - §3.5 Unrelated Business Rules 146
 - §3.6 Factors Affecting Income Tax Deductibility of Charitable Gifts 153
 - §3.7 Charitable Organizations Listing Reliance Rules 155
 - §3.8 Grantor Trust Rules 157

- 4 Gifts of Money and Property 161**
 - §4.1 Gifts of Money 161
 - §4.2 Gifts of Property in General 162
 - §4.3 Gifts of Long-Term Capital Gain Property in General 164
 - §4.4 Gifts of Ordinary Income Property 165
 - §4.5 Certain Gifts of Capital Gain Property 170
 - §4.6 Gifts of Property for Unrelated Use 173
 - §4.7 Variations in Applying Property Rules 177
 - §4.8 Step Transaction Doctrine 178
 - §4.9 Charitable Pledges 184

- 5 Fundamentals of Planned Giving 187**
 - §5.1 Introduction 188
 - §5.2 Appreciated Property Gifts 188
 - §5.3 Planned Gifts: Core Concepts 189
 - §5.4 Charitable Remainder Trusts 191
 - §5.5 Pooled Income Funds 199
 - §5.6 Charitable Gift Annuities 207
 - §5.7 Charitable Lead Trusts 208
 - §5.8 Planned Giving: Other Forms 211
 - §5.9 Planned Giving and Securities Laws 212

PART THREE

Charitable Giving in General

- 6 Timing of Charitable Deductions 217**
 - §6.1 Gifts of Money in General 219
 - §6.2 Gifts of Money by Check 219
 - §6.3 Gifts of Money by Credit Card 222

CONTENTS

§ 6.4	Gifts of Money by Telephone	222	
§ 6.5	Gifts of Securities	223	
§ 6.6	Gifts of Copyright Interest	226	
§ 6.7	Gifts by Means of Notes	226	
§ 6.8	Gifts by Letters of Credit	227	
§ 6.9	Gifts of Property Subject to Option	227	
§ 6.10	Gifts of Stock Options	228	
§ 6.11	Gifts of Credit Card Rebates	230	
§ 6.12	Gifts of Tangible Personal Property	231	
§ 6.13	Gifts of Real Property	231	
§ 6.14	Gifts by C Corporations	232	
§ 6.15	Gifts by S Corporations	233	
§ 6.16	Gifts by Partnerships	234	
§ 6.17	Gifts by Means of Internet	237	
7	Percentage Limitations		239
§ 7.1	Introduction	240	
§ 7.2	Individual's Contribution Base	243	
§ 7.3	Corporation's Taxable Income	243	
§ 7.4	Percentage Limitations: An Overview	243	
§ 7.5	Fifty Percent Limitation	246	
§ 7.6	Thirty Percent Limitation for Gifts of Certain Property	253	
§ 7.7	Electable 50 Percent Limitation	257	
§ 7.8	General 30 Percent Limitation	263	
§ 7.9	Interplay of 50 Percent/Special 30 Percent Limitations	265	
§ 7.10	Interplay of 50 Percent/General 30 Percent Limitations	266	
§ 7.11	Interplay of Special 30 Percent/General 30 Percent Limitations	268	
§ 7.12	Twenty Percent Limitation	268	
§ 7.13	Gifts for the Use of Charity	270	
§ 7.14	Blending Percentage Limitations	270	
§ 7.15	Individuals' Net Operating Loss Carryovers and Carrybacks	271	
§ 7.16	Rules for Spouses	275	
§ 7.17	Information Requirements	279	
§ 7.18	Percentage Limitation for Corporations	280	
§ 7.19	Corporations' Net Operating Loss Carryovers and Carrybacks	283	
8	Estate and Gift Tax Considerations		287
§ 8.1	Introduction	287	
§ 8.2	Federal Gift Tax	289	
§ 8.3	Federal Estate Tax	301	
§ 8.4	Unification of Taxes	315	
§ 8.5	Generation-Skipping Transfer Tax	316	
§ 8.6	Remainder Interests	319	
§ 8.7	Ascertainability	329	

9	Special Gift Situations	333
	§9.1 Works of Art	334
	§9.2 Gems	338
	§9.3 Inventory	340
	§9.4 Scientific Research Property	352
	§9.5 Computer Technology or Equipment	353
	§9.6 License to Use Patent	355
	§9.7 Conservation Property	357
	§9.8 S Corporation Stock	380
	§9.9 Section 306 Stock	389
	§9.10 Retirement Plan Accounts	391
	§9.11 Commodity Futures Contracts	401
	§9.12 Donors' Creations	403
	§9.13 Charity Auctions	404
	§9.14 Services	411
	§9.15 Unreimbursed Expenses	412
	§9.16 Limitation on Deduction for Expenses Due to Pleasure	418
	§9.17 Automobile Expenses	422
	§9.18 Use of Property	422
	§9.19 Bargain Sales	423
	§9.20 Property Subject to Debt	429
	§9.21 Future Interests in Tangible Personal Property	433
	§9.22 Contributions by Trusts	436
	§9.23 Partial Interests	444
	§9.24 Taxidermy	447
	§9.25 Clothing and Household Items	448
	§9.26 Charitable Family Limited Partnerships	448
	§9.27 Motor and Other Vehicles	450
	§9.28 Intellectual Property	457
	§9.29 Foreign Tax Credit	462
	§9.30 Subsistence Whaling Expenses	462
	§9.31 Public Policy Considerations	463
10	Other Aspects of Deductible Giving	471
	§10.1 Valuation of Property	472
	§10.2 Contributions by Means of an Agent	496
	§10.3 Gifts for the Use of Charity	497
	§10.4 Conditional Gifts	499
	§10.5 Earmarking of Gifts for Individuals	505
	§10.6 Alternative Minimum Tax Considerations	508
	§10.7 Interrelationship with Business Expense Deduction	509
	§10.8 Denial of Deduction for Lobbying Activities	510
	§10.9 Deductible Gifts to Noncharitable Organizations	511
	§10.10 Reallocation of Deductions	516

CONTENTS

- § 10.11 Charitable Giving and Funding of Terrorism 517
- § 10.12 Statute of Limitations 518
- § 10.13 Concept of Trust Income 518
- § 10.14 Penalties 521
- § 10.15 Transactions of Interest 532

PART FOUR Planned Giving

- 11 Valuation of Partial Interests 541**
 - § 11.1 Overview of Statutory Law 541
 - § 11.2 Standard Actuarial Factors 542
 - § 11.3 General Actuarial Valuations 544
 - § 11.4 Nonstandard Actuarial Factors 547

- 12 Charitable Remainder Trusts 551**
 - § 12.1 Definitions 552
 - § 12.2 Charitable Remainder Annuity Trust Rules 566
 - § 12.3 Charitable Remainder Unitrust Rules 580
 - § 12.4 Issues 598
 - § 12.5 Tax Treatment of Distributions 615
 - § 12.6 Division of Charitable Remainder Trusts 627
 - § 12.7 Early Terminations of Charitable Remainder Trusts 631
 - § 12.8 Taxation of Charitable Remainder Trusts 633
 - § 12.9 Mandatory Provisions 636
 - § 12.10 Private Foundation Rules 637
 - § 12.11 Wealth Replacement Trusts 639
 - § 12.12 Calculation of Charitable Deduction 646

- 13 Pooled Income Funds 653**
 - § 13.1 Definitions 654
 - § 13.2 Qualifying Pooled Income Funds 655
 - § 13.3 Allocation of Income 661
 - § 13.4 Recognition of Gain or Loss on Transfers 665
 - § 13.5 Mandatory Provisions 666
 - § 13.6 Private Foundation Rules 667
 - § 13.7 Pass-Through of Depreciation 668
 - § 13.8 Tax Status of Fund and Beneficiaries 669
 - § 13.9 Multiorganization Pooled Income Funds 670
 - § 13.10 Comparison with Charitable Remainder Trusts 674
 - § 13.11 Charitable Contribution Deduction 675

- 14 Charitable Gift Annuities 677**
 - § 14.1 Contract as Vehicle Form 677
 - § 14.2 Tax Treatment to Donor 678

CONTENTS

§ 14.3	Deferred Payment Gift Annuities	679	
§ 14.4	Estate and Gift Tax Consequences	681	
§ 14.5	Unrelated Business Income Implications	681	
§ 14.6	Unrelated Debt-Financed Income Implications	682	
§ 14.7	Contrast with Other Planned Gift Methods	683	
§ 14.8	Gift Annuities and Antitrust Laws	684	
§ 14.9	Gift Annuities and Securities Laws	685	
§ 14.10	Charitable Contribution Deduction	685	
15	Other Gifts of Remainder Interests		687
§ 15.1	Overview	687	
§ 15.2	Contributions of Remainder Interests in Personal Residence or Farm	688	
§ 15.3	Undivided Portions of Entire Interests in Property	691	
16	Charitable Lead Trusts		701
§ 16.1	General Rules	701	
§ 16.2	Income Interest	702	
§ 16.3	Income Tax Charitable Deduction	704	
§ 16.4	Tax Treatment of Charitable Lead Trusts	705	
§ 16.5	Testamentary Use of Charitable Lead Trusts	707	
§ 16.6	Percentage Limitation Rules	708	
§ 16.7	Private Foundation Rules	709	
§ 16.8	Anti-Abuse Rule Concerning Income Interests	710	
§ 16.9	Charitable Income Trusts	713	
§ 16.10	Comparison with Charitable Remainder Trusts	713	
§ 16.11	Valuing Charitable Deduction	714	
17	Gifts of and Using Life Insurance		715
§ 17.1	Introduction	715	
§ 17.2	Life Insurance Concepts	716	
§ 17.3	Charitable Giving and Insurance	719	
§ 17.4	Insurable Interest	724	
§ 17.5	Unrelated Debt-Financed Income Considerations	727	
§ 17.6	Charitable Split-Dollar Insurance Plans	728	
§ 17.7	Applicable Insurance Contract Reporting Requirements	735	

PART FIVE International Charitable Giving

18	International Giving by Individuals During Lifetime		739
§ 18.1	Introduction	739	
§ 18.2	Background	740	
§ 18.3	Earmarking and Conduit Restrictions	743	
§ 18.4	Control Over Foreign Donees	747	

CONTENTS

§ 18.5	Summary	749	
§ 18.6	Income Tax Treaties	750	
19	International Giving by Individuals through Estates		753
§ 19.1	Introduction	753	
§ 19.2	Estate Tax Rules	754	
§ 19.3	Gift Tax Rules	760	
§ 19.4	Charitable Giving by Noncitizen Nonresidents	760	
20	International Giving by Corporations		763
§ 20.1	Corporate Gifts to U.S. Charity for Overseas Use	763	
§ 20.2	Gifts of Money from Foreign Affiliate of U.S. Parent to Overseas Charity	764	
§ 20.3	Gift of Goods or Services to Benefit Foreign Charity	765	
§ 20.4	Grants of Funds from U.S. Corporation-Related Foundation to Foreign Charity	766	
PART SIX			
Administration of Charitable Giving Programs			
21	Substantiation and Appraisal Requirements		779
§ 21.1	Introduction	779	
§ 21.2	Substantiation Requirements for Gifts of Money	780	
§ 21.3	Substantiation Requirements for Gifts of \$250 or More	782	
§ 21.4	Substantiation Requirements for Noncash Gifts	792	
§ 21.5	Appraisal Requirements	795	
§ 21.6	Appraisals and Penalties	805	
§ 21.7	Appraisals of Clothing and Household Items	807	
§ 21.8	Burden of Proof Rules	807	
22	Disclosure Requirements		809
§ 22.1	Disclosure by Charitable Organizations in General	809	
§ 22.2	<i>Quid Pro Quo</i> Contribution Rules	814	
§ 22.3	Disclosure by Noncharitable Organizations	818	
23	Special Events, Corporate Sponsorships, and Donor-Advised Funds		823
§ 23.1	IRS Audit Guidelines	824	
§ 23.2	Special Events	828	
§ 23.3	Corporate Sponsorship Rules	830	
§ 23.4	Donor-Advised Funds	833	
24	Reporting Requirements		841
§ 24.1	Gift Reporting by Individuals	841	
§ 24.2	Gift Reporting by C Corporations	842	
§ 24.3	Gift Reporting by S Corporations	842	
§ 24.4	Gift Reporting by Partnerships	842	

CONTENTS

§ 24.5	Gift Reporting by Donees in General	843	
§ 24.6	Gift Reporting in Unrelated Business Context	848	
§ 24.7	Reporting of Noncash Gifts in General	851	
§ 24.8	Reporting of Gifts of Vehicles	868	
§ 24.9	Reporting of Gifts of Intellectual Property	870	
§ 24.10	Reporting on Dispositions of Contributed Property	871	
§ 24.11	Personal Benefit Contract Reporting Requirements	874	
§ 24.12	Split-Interest Trust Filing Requirements	875	
25	State Fundraising Regulation		877
§ 25.1	State Regulation in General	877	
§ 25.2	Historical Perspective	878	
§ 25.3	States' Police Power	880	
§ 25.4	Basic Definitions	881	
§ 25.5	Registration Requirements	882	
§ 25.6	Reporting Requirements	882	
§ 25.7	Exemptions from Regulation	883	
§ 25.8	Fundraising Cost Limitations	884	
§ 25.9	Prohibited Acts	885	
§ 25.10	Contractual Requirements	886	
§ 25.11	Disclosure Requirements	887	
	About the Author		889
	About the Online Resources		891
	Index		893

Preface

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

There is another reason for my wonder, one that is personal. By the early 1990s, this book had been on my mind for a long time. It had been written, in fits and starts, on many occasions over the years, with the manuscript pages ending up accumulating in this storage box and that file. It took some gentle prodding by the wonderful people at John Wiley & Sons—specifically, for the initiation of this project, Jeffrey Brown (long since promoted to Wiley’s higher echelons) and Marla Bobowick (now a consultant in the charitable sector)—to get me going on completion of the book. The first edition appeared in 1993. Martha Cooley skillfully continued in the fashion of her predecessors; the second edition arrived in 1997. Susan McDermott provided the impetus for the third and fourth editions (2005, 2010) of the book. Lia Ottaviano oversaw production of this fifth edition.

It is not that I did not want to write this book; that is certainly not the case. In fact, I long dreamed of—it seems rather immodest to say it—a trilogy. This idea reflects what is now more than 45 years of law practice entirely in the realm of nonprofit organizations. I see the law uniquely affecting these organizations as falling into three general fields: the law of tax-exempt organizations, the law of fundraising, and the law of charitable giving.

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

I have been writing books, published by Wiley, for more than 35 years. (The first book, the third edition of *The Law of Tax-Exempt Organizations*, was published in 1979. The predecessor to *The Law of Fundraising* was published in 1980.) These and other Wiley books I have been involved with entail the

PREFACE

writing of annual supplements. As the 1980s unfolded, I discovered something unusual: I enjoy writing supplements. (There is something perversely challenging about simultaneously correcting prior mistakes while capturing and integrating subsequent developments.)

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

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

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

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

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

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

The two major relevant enactments that were introduced by the American Jobs Creation Act—concerning charitable gifts of intellectual property and motor vehicles—have since been augmented by guidance from the Internal

PREFACE

Revenue Service (IRS). These two provisions, bred of Congress's concern about abuses (read: overvaluations), are complex, discouraging of charitable giving, and otherwise troublesome. While the concept is understandable (given Congress's concerns), this matter of confining the federal income tax charitable contribution deduction to the amount the charity actually receives from holding or disposition of the property is terrible precedent. If that concept were extended to all charitable gifts of property (such as taking into account fundraising costs), the result would be disaster and chaos in the realm of charitable giving. More laws like this may be forthcoming unless something can be done about the underlying problem, which is standards and compliance as to gift property valuation.

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

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

The book also included references to the various provisions of charitable giving tax law that were extended (through 2009) by enactment of the Tax

PREFACE

Extenders and Alternative Minimum Tax Relief Act of 2008, which is Division C of the financial markets stabilization legislation.

As is commonly known, Congress has not been particularly productive recently; its legislative output has been scant. Thus, the only law that is new to this edition is the American Taxpayer Relief Act of 2012. That legislation, as is discussed in the book, extended four relevant tax provisions, altered some of the tax rates, reinstated a form of the personal exemption phaseout and limitation on itemized deductions, and made some changes in the estate tax rules.

The Treasury Department and the IRS are also quite busy in the charitable giving field, promulgating much in the way of regulations, notices, announcements, forms, private letter rulings, and technical advice memoranda. Issues and subjects in the realm of the tax law of charitable giving that the IRS has addressed in recent months include the timing of the charitable deduction in connection with gifts of stock options, gifts where the donor retains the ability to manage the gift property, regulations concerning the charitable remainder trust characterization and ordering rules, a controversial (and withdrawn) proposal concerning the impact of spousal elective share laws on the qualification of charitable remainder trusts, regulations concerning the taxation of charitable remainder trusts with unrelated taxable income, proposed record keeping and substantiation rules imposed in connection with cash and noncash contributions, proposed regulations concerning new rules pertaining to qualified appraisals and appraisers, and guidance issued by the IRS as to the federal tax consequences of division of charitable remainder trusts.

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

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

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

PREFACE

The courts continue to churn out opinions that shape and reshape the law of charitable giving. Certainly in recent years, there has been intense focus on cases concerning gifts of easements. In some instances, a charitable contribution deduction was allowed; in most instances, it was not. The latter instances involved circumstances where the special rules concerning conservation easements were not followed, there was a valuation issue, or the gift substantiation or appraisal requirements were not satisfied. Several recent opinions apply the accuracy-related and overvaluation penalties. These and other charitable giving tax law developments involving the judiciary are summarized in the book.

Overall, then, much more law concerning charitable giving is on the way, keeping this field alive, fascinating, and sometimes confusing. A year or so ago, it appeared that tax “reform” (if that is the right word) had some reasonable chance of advancing. At this writing, however, the efforts have stalled. (From the standpoint of the charitable deduction, that probably is a good thing.)

This book is offered as a vehicle to survey the law and minimize the confusion as to the federal tax law of charitable giving. This time around, I am generally satisfied that nearly everything relevant through 2013 has been captured.

If readers suspect that my using the writing of prefaces to praise the outstanding folks at John Wiley & Sons is simply a routine courtesy, please believe otherwise. These people have been marvelously supportive (and adept at enforcing deadlines). The publisher’s devotion to the production of quality publications in the nonprofit field warrants unstinting praise. The Wiley Nonprofit Law, Finance, and Management Series is an unparalleled collection of books in the area. I am honored to be among those who have been and are contributing to this substantial body of knowledge.

Thus, my sincere thanks go to my development editor, Lia Ottaviano, and to Mary Daniello, production manager, for their assistance and support in connection with this project.

Bruce R. Hopkins

Book Citations

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

1. *The Law of Fundraising, Fifth Edition* (2013): cited as *Fundraising*
2. *The Law of Tax-Exempt Organizations, Tenth Edition* (2011): cited as *Tax-Exempt Organizations*
3. *The New Form 990: Law, Policy, and Preparation* (2009): cited as *New Form 990*
4. *Private Foundations: Tax Law and Compliance, Fourth Edition* (2014): cited as *Private Foundations*

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

P A R T O N E

**Introduction to the Tax Law
of Charitable Giving**

CHAPTER ONE

Charitable Giving Law: Basic Concepts

- | | | | | | |
|-------|---|----|----------------------------|--|----|
| § 1.1 | Introduction to the Charitable Contribution Deduction | 3 | (b) Other Rationales | 19 | |
| § 1.2 | Defining <i>Tax-Exempt Organizations</i> | 5 | (c) Freedom of Association | 21 | |
| § 1.3 | Principles of Charitable Organizations Law Philosophy | 8 | § 1.4 | Statistical Profile of Charitable Sector | 23 |
| | (a) Public Policy and National Heritage | 10 | § 1.5 | Categories of Tax-Exempt Organizations | 28 |

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

§ 1.1 INTRODUCTION TO THE CHARITABLE CONTRIBUTION DEDUCTION

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

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

The principal charitable contribution deduction is the one that is part of the federal income tax system. A charitable contribution paid during a tax year generally is allowable as a deduction in computing taxable income for federal

income tax purposes. This deduction is allowable irrespective of either the method of accounting employed or the date on which the contribution may have been pledged.

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

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

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

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

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

¹ See Part Three.

² See Part Four.

³ See Part Six.

⁴ See, e.g., ch. 25.

⁵ Companion books by the author provide a summary of the law concerning tax-exempt organizations as such (*Tax-Exempt Organizations*), planning considerations for tax-exempt organizations (*Planning Guide*), IRS examinations of tax-exempt organizations (*IRS Audits*), and regulation of the charitable fundraising process (*Fundraising*). Governance of tax-exempt organizations is the subject of Hopkins & Gross, *Nonprofit Governance: Law, Practices, & Trends* (Hoboken, NJ: John Wiley & Sons, 2009). These bodies of law are reviewed in less technical detail in Hopkins, *Starting and Managing a Nonprofit Organization: A Legal Guide*, 6th edition (Hoboken, NJ: John Wiley & Sons, 2013). Coverage of these areas of the law (including the charitable giving rules) in even less technical detail is in these books by the author: *Nonprofit Law Made Easy* (Hoboken, NJ: John Wiley & Sons, 2005), *Charitable Giving Law Made Easy* (Hoboken, NJ: John Wiley & Sons, 2007), and *Fundraising Law Made Easy* (Hoboken, NJ: John Wiley & Sons, 2009). All of these areas of the law (and others) are also covered in the *Bruce R. Hopkins' Nonprofit Law Library*, an e-book published by John Wiley & Sons in 2013.

§ 1.2 DEFINING TAX-EXEMPT ORGANIZATIONS

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

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

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

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

⁶ The term *nonprofit organization* is used throughout, rather than the term *not-for-profit*. However, the latter term is used, such as in the federal tax setting, to describe activities (rather than organizations) whose expenses do not qualify for the business expense deduction. Internal Revenue Code of 1986, as amended, section (IRC §) 183. Throughout this book, the Internal Revenue Code is cited as the “IRC.” The IRC constitutes Title 26 of the United States Code.

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

⁸ See § 3.3(b), text accompanied by note 303.

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

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

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

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

The private inurement doctrine is applicable to many types of tax-exempt organizations. It is, however, most pronounced with respect to charitable organizations.¹² By contrast, in some types of nonprofit (and tax-exempt) organizations, the provision of forms of private benefit is the exempt purpose

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

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

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

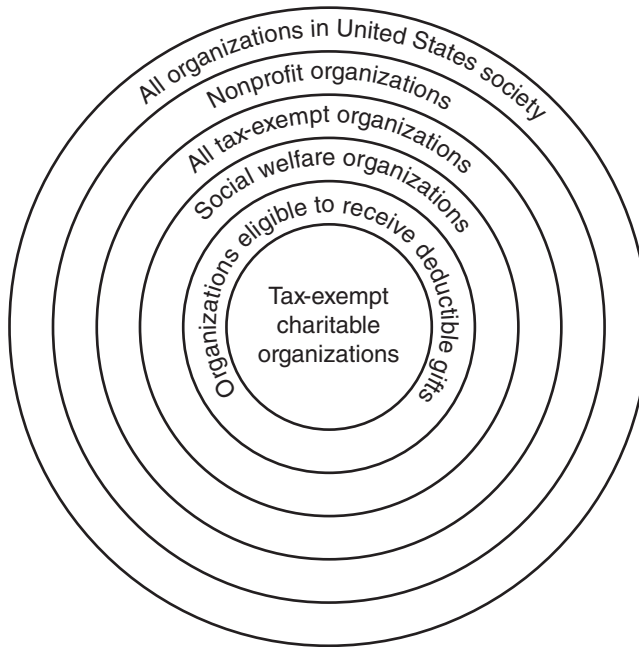
¹² The federal law of tax exemption for charitable organizations requires that each of these entities be organized and operated so that "no part of . . . [its] net earnings . . . inures to the benefit of any private shareholder or individual." IRC § 501(c)(3).

§ 1.2 DEFINING TAX-EXEMPT ORGANIZATIONS

and function. This is the case, for example, with employee benefit trusts, social clubs, and, to an extent, political committees.¹³

As this chapter has indicated thus far, there are subsets and sub-subsets within the nonprofit sector. Tax-exempt organizations are subsets of nonprofit organizations. Charitable organizations (using the broad definition of that term¹⁴) are subsets of tax-exempt organizations. Charitable organizations in the narrow sense are subsets of charitable organizations in the broader sense of that term.¹⁵

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



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

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

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

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

§ 1.3 PRINCIPLES OF CHARITABLE ORGANIZATIONS LAW PHILOSOPHY

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

This is somewhat unusual; most tax laws are based on some form of rationale that is inherent in tax policy. The law of charitable and other tax-exempt organizations, however, has very little to do with any underlying tax policy. Rather, this aspect of the tax law is grounded in a body of thought quite distant from tax policy: political philosophy as to the proper construct of a democratic society.

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

any planned legislative scheme” but were enacted over the decades “by a variety of legislators for a variety of reasons.”¹⁶

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

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

Tax exemption for categories of nonprofit organizations can arise as a by-product of enactment of other legislation. In these instances, tax exemption is granted to facilitate accomplishment of the purpose of another legislative end. Thus, tax-exempt status has been approved for funds underlying employee benefit programs. Other examples include tax exemption for professional football leagues that emanated out of the merger of the National Football League and the American Football League, and for state-sponsored providers of health care to the needy, which was required to accommodate the goals of Congress in creating health care delivery legislation.

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

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

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

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

¹⁹ “Comment,” 27 *Iowa L. Rev.* 128, 151–155 (1941).

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