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PUBLIC POLICY AND PRIVATE CHARITY:
A TAX POLICY PERSPECTIVE

John K. McNulty*

The tax law of the United States has allowed a deduction from income for charitable contributions since 1917.1 During the 1960's and 70's, when both federal and state governments were more inclined to provide social and economic benefits to the needy, the charitable contribution deduction came under heavy criticism regarding both its form as a deduction, and its policy justifications.2

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1 See War Revenue Act of 1917, ch. 63, § 1201(2), 40 Stat. 330. The Act provided a deduction for

Contributions or gifts actually made . . . to corporations or associations organized and operated exclusively for religious, charitable, scientific or educational purposes, or to societies for the prevention of cruelty to children or animals, no part of the net income of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's taxable net income . . . .

Id. Compare the simplicity of that provision with the complexity of the current charitable contribution provision. See I.R.C. § 170 (percentage limitations, carryovers, distinctions by types of property and charitable organization).

The original purpose of the charitable contribution deduction may have been to protect philanthropy from the high income-tax rates beginning to emerge at the time of World War I. See Break, Charitable Contributions Under the Federal Individual Income Tax: Alternative Policy Options, in 3 Research Papers Sponsored by the Commission of Private Philanthropy and Public Needs, Department of Treasury 1521, 1531, 1538 n.5 (1977) [hereinafter cited as 3 Research Papers].

* See Kahn, Personal Deductions in the Federal Income Tax, National Bureau of Eco-
With the current political inclination to curtail governmental provision of these benefits and to encourage individual and corporate contribution to the social and economic welfare of the poor and other philanthropic beneficiaries, it has become even more appropriate to examine the tax policy justifications for the current form of the allowance for charitable contributions, the deduction.

As with any tax allowance, the deduction for private philanthropy can be analyzed in two ways. One method focuses on the exogenous public policy considerations and economic effects supporting the allowance, such as incentives, subsidies, and price differentials. The other major approach concentrates on matters endogenous to the tax system—horizontal and vertical equity, the allowance's structural characteristics, its utility in defining the tax base, and its relationship to other existing allowances.

Both approaches yield valuable insights. Some blending of approaches occurs, for example, in the "tax expenditure budget" analysis and in the "comprehensive income tax base" debate. Under either approach, unless tax allowances strictly consist of the costs of producing income, they are viewed as tax subsidies—the counterparts of direct government expenditures. Such analysis measures "tax expenditures" against the same standards as direct government grants and presupposes that any expenditure that cannot be justified as a direct grant is equally improper as a tax expenditure.

The first questions posed in examining tax policy toward private
charity include (a) whether the law should grant an allowance for contributions to charity; (b) if so, what form that allowance should take; (c) how the allowance should operate against inclusions in income or the transfer tax base, against the rates of tax, or against the rates and bases of various sub-taxes such as the minimum taxes or the capital gain tax; (d) what should be the allowance's scope—who should be eligible for it, when and upon what events; and (e) what limits or collateral consequences, if any, should attach to the allowance. To answer such questions, the effects of the allowance's exogenous and endogenous policies must be evaluated. However, this paper does not attempt such a complete overview.

Rather, this article focuses solely on the endogenous perspective and addresses this question: What in the internal logic of the tax law argues for or against giving any allowance, or the present form of allowance, for philanthropy? This article examines a number of powerful arguments that support income, estate and gift tax allowances for charitable contributions in a form very close to the existing one and that reject the frequently proposed tax credit alternative.

At the expense of detailed treatment of the section 501 exemption, this article emphasizes the income tax allowance embodied in the donor's deduction provided by section 170 of the Internal Revenue Code. Similarly, in a cursory treatment of transfer taxes, the article briefly contemplates the charitable contribution deductions allowed by section 2055 in the estate tax area and section 2522 in the gift tax area. A summary discussion of the relationship between the deduction and the exemption provisions necessarily be-

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8 Collateral consequences may be adjustments to basis, to corporate earnings and profits accounts, or to the ability of individuals to itemize deductions or take other allowances.

9 The two sections of the Internal Revenue Code dealing especially with income taxation and the "third sector," which generally is defined as charitable organizations, are § 170, allowing a deduction for gifts or contributions to or for the use of qualified charitable recipients, and § 501 and its corollaries, granting an exemption from taxation for some or all of the income of so-called "exempt organizations." See generally I.R.C. §§ 170, 501. The two allowances are not coincident—charitable contributions are deductible only if made to a recipient specified in § 170(c). See id. § 170(a)(1), (c). The organizations specified there do not exhaust the category of tax-exempt organizations and they include organizations some of whose income may be taxable. Compare id. § 170(c) with id. § 501(c)-(f).

The limited deduction available to non-itemizing taxpayers on a trial basis under § 170(i) largely will be ignored for the purposes of this analysis. For a brief reference to the section's effect, see infra note 71 and accompanying text.

10 See I.R.C. §§ 2055, 2522.
gins this paper's analysis.

I. ENDOGENOUS FACTORS

A. Relationship Between Deductions and Exemptions

The examination of deductions in the income and transfer taxes should begin by recognizing that section 501 exempts from income taxation the income of, and contributions received by, charitable organizations. The existence of the exemption should either be taken as a "given" or at least be considered to reveal a strong policy consideration regarding the propriety of continued deductions.

At a minimum, the exemption reflects a policy judgment that income arising in the private sector devoted to designated charitable purposes should not be burdened by an income tax. The underlying rationale may be that the costs of organized charity should not be increased by the income tax. Alternatively, the exemption may indicate a conclusion that such receipts do not constitute "income" in the sense of consumption or saving in an accretion view of the income tax, or in the sense of "consumption" by anyone who views the income tax as a tax on consumption.

Receipts of a charitable organization might properly be viewed as income to the ultimate beneficiaries. But, of course, these beneficiaries very often are not taxed on analogous types of benefits—public goods such as parks and low tuition, and other receipts that are excluded from income under "stated" or "unstated" exclusions. Furthermore, a receipt that is otherwise includible in income may not be taxed because the beneficiary's zero bracket

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11 See id. § 501(a). Charitable organizations are taxed, however, on unrelated business income and some other activities. See id. § 511.
12 See id. § 501(c)-(f).
15 Welfare benefits and free medical treatment are examples of unstated exclusions.
amount, personal and dependency exemptions, and other allowances exceed the amount received.\(^\text{17}\)

If the charity's receipts are not to be taxed as income, perhaps such income also should not be taxed when first received by individuals as income from services, capital investment or even windfalls, before being contributed to charities. If all such private sector income should escape tax, perhaps the income tax law should contain an express *exclusion*. It does not, but it achieves much the same result by allowing a *deduction* for contributions to charity.\(^\text{18}\)

Thus if the deduction allowed the donor is the counterpart of the exemption from income tax enjoyed by the charity itself, the same policy decisions that justify the exemption for the charitable organization support the charitable contribution deduction. Or, the presence of the exemption for charitable organizations may compel a comparable allowance for individual income donated to those organizations. The symmetry is more than aesthetic, for principle suggests that a receipt should be treated identically whether it accrues directly to a charitable organization or is first received by a taxable individual or corporation which then donates it to the organized charity.

Not everyone would agree that the section 170 deduction follows from the section 501 exemption. For example, some might argue that receipt by the taxable individual constitutes income in the von Schanz/Haig/Simons sense\(^\text{19}\) because it increases that person's ability to consume or to save, and hence to pay tax. A consumption-oriented tax analyst\(^\text{20}\) might argue that the taxpayer's donation of the economic resources earned or saved itself constitutes consumption and therefore should be taxed, notwithstanding the charitable organization's section 501 exemption. Nevertheless, the present section 170 deduction can be defended as the private sector counterpart of the section 501 exemption for charities.

**B. Relation Between Tax Rules for Philanthropy and for Private Non-Charitable Gifts**

Illuminating tax parallels also exist between the income tax al-

\(^{17}\text{See I.R.C. §§ 1 (zero bracket amount) and 151 (personal exemption provisions).}\)

\(^{18}\text{See id. § 170(a).}\)

\(^{19}\text{See supra note 13 and accompanying text.}\)

\(^{20}\text{See supra note 14 and accompanying text.}\)
lowance for charitable gifts and the tax treatment of private non-charitable gifts made directly to family members or friends. The present tax law provides no direct allowance to the ordinary taxpayer who earns income and then gives it to a non-charitable recipient. The income is taxed to the donor when earned and not deducted when transferred. The tax system, however, does allow an exclusion to the donee. Thus, the income is taxed only once, and at the donor's rate. It is not taxed again when received by the donee. Perhaps the tax on the donor can or should be viewed as a substitute for a tax on the donee.

Some have advocated that the donee should be taxed as receiving income due to the increased ability to consume or to save. The donee has income in the sense of an accretion to economic well-being or power, and perhaps also in the sense of a consumption-oriented view of the income tax. This view is sometimes coupled with the theory that the donor should be allowed a deduction or exclusion so that the income again would be taxed only once, but in the recipient's rather than the donor's hands and according to the recipient's tax status. Alternatively, one may assert that both the donor and donee have taxable income. Similar to the beneficiaries of charities, however, private gift donees would have no tax liability despite the gift's inclusion in income if the zero-bracket amount, exclusions and other exemptions exceed the gift received.

The income tax law does not permit a donor to deduct a private

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21 See I.R.C. § 102.
22 Similarly, the wealth transfer taxes do not grant an allowance for most non-charitable gifts or bequests. However, many gifts fall under the $10,000 annual present interest exclusion and thus escape the gift tax. See id. § 2503(b). The unified credit in the estate tax performs the same function. See id. § 2010(a).
23 See Department of Treasury, Blueprints for Basic Tax Reform 95, 117 (1977) [hereinafter cited as Blueprints].
26 See Dodge, supra note 24, at 1186-91. The same view can be taken regarding transfer taxes.
27 See supra note 17 and accompanying text.
gift even if the gift is made to an impoverished individual and provides benefits identical to those provided by exempt charitable organizations. In other words, a taxpayer can deduct a contribution to a charity, but may not deduct a gift made directly to the same person to whom the charity would ultimately direct the contribution.\textsuperscript{28}

The presence of the section 501 exemption and the section 170 deduction suggests a rationale for extending a similar deduction to the taxpayer who gives cash or other property directly to a person likely to qualify for benefits from public charity. Why the tax system does not allow such a deduction may not be entirely clear, but may more reflect administrative considerations and concerns about abuse and evasion than any theoretical or policy notions about subsidies and incentives. The Service would have difficulty distinguishing deductible private charitable gifts from nondeductible family support or transfers, sometimes made with the implicit or explicit expectation of some reciprocal benefits.

Odd contrasts appear in the different tax treatments of philanthropic gifts made directly to target beneficiaries and gifts made to charitable organizations that act essentially as conduits between donors and donees. While the private donor who gives “alms to the poor” receives no deduction, a gift to a charitable organization that in turn gives those resources to the poor is deductible. The latter contribution is similarly deductible if made to an organization that, instead of giving alms to the poor, creates what might be called public goods and services—funds for higher education, art collections and displays or musical performances.\textsuperscript{29} Moreover, contributions to “public goods and services” charities are used for more diffuse benefits that usually are not specifically targeted at a limited individual or set of individuals, and which may accrue to

\textsuperscript{28} The denial of any allowance for the donor to a privately identified charitable target has considerable tax planning, incentive, and biasing effects, and also entails significant governmental influence upon the business of philanthropy. Not only is a deduction denied for direct contributions to an individual, but no deduction is allowed for a gift to a charitable organization that does not qualify under the terms of § 501(c)(3) and the administrative interpretation of those terms. See I.R.C. § 170(c)(2)(B), (D); Treas. Reg. §§ 1.170A-1(a)(1), 1.170A-4(b)(3)(ii); see also Rev. Proc. 82-39, 1982-2 C.B. 759 (1982). Thus the different tax treatment of charitable donations and private, non-charitable gifts has injected government control into philanthropy by specifying which contributions will confer the desired tax benefits upon the donor.

\textsuperscript{29} See I.R.C. § 170(c)(2).
many people who do not fit the archetype of a charity recipient, including the wealthy and prosperous and, in some instances, the donors themselves. The irony is that the donor of a direct gift to a needy person may, in the minds of some, be more deserving of a deduction than the donor who contributes to a qualifying organization which provides little or no direct aid to the poor. One is left wondering how this anomaly can be explained.

Possibly, charitable organizations are more efficient than individuals in distributing alms to the poor and more efficient than any alternate means of collecting and organizing resources devoted to universities, religious networks and musical, artistic, and scientific institutions. Yet such organizations may actually be "inefficient," considering the contributions consumed in management, operation and solicitation efforts. Additionally, individually or as a class, donors to these organizations may realize ephemeral benefits such as power or influence over the organization, or personal benefits, as in the case of the donor whose child is admitted to an educational institution that has benefited from the donor's munificence.

One might argue that to the extent donors benefit directly from the contributions, they are capturing some of the external benefits of their contribution or are simply getting something in return, and that this is proper because it alleviates at least some of the "free rider" problems associated with public goods. But this argument applies with equal force to the donor of a private gift to an impoverished recipient. In that case, too, a social good is encouraged if a donor can capture some benefit, such as knowing the ultimate recipient of the donation and seeing the fruits of the good deed.

In sum, the tax law distinguishes between private contributions to eligible charities, deductible under section 170, and private gifts made directly to worthy beneficiaries, which are treated as if made, nondeductibly, to a spouse or child. Yet, the law does not distinguish between charitable organizations that benefit the poor directly and those that provide public goods and services generally.

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80 See 3 Royal Commission Report, supra note 24, at 225. Charitable gifts can result in benefits to donors such as the prestige of making contributions in cash or in kind, the control over an academic institution's admissions process, or more tangible benefits such as the pleasure of attending a concert of a supported symphony orchestra. See id.
81 See supra note 30.
Based on different policies or a different balance between competing policies in the income, gift and estate tax areas, the law seems to treat equally the provision of public goods and the more clearly income-redistributive provision of alms to the poor through charity.\textsuperscript{23} The requirement that the charity generally be among those enumerated in section 501\textsuperscript{23} may ensure that the benefits are sufficiently general or diffuse that the donor is not likely to reap undue personal benefit from his contribution.

C.Comparable Expenditures and Their Tax Treatment

1. Taxes, Casualty Losses and Medical Expenses

Examination of the Code’s internal structure and the relationship of the charitable allowance provisions to other rules may uncover other policies that support sections 170 and 501. Charitable contributions may have characteristics that parallel other acts or events for which an allowance in some form, a deduction in particular, is given. If the latter allowances are to remain, comparable treatment of comparables, or “second best” tax-reform thinking,\textsuperscript{24} suggests that section 170, and its estate and gift counterparts,\textsuperscript{25} should be retained as well.

For example, donations to charity may resemble taxes paid to a state or municipality, for which the Code allows a deduction from income and the gross estate.\textsuperscript{56} The comparison is particularly apt when the contributions involve “tithing,” a practice which historically related closely to compulsory contributions—taxes—to gov-

\textsuperscript{23} Perhaps § 170 approaches such a distinction with the differential limits it places upon the percentage of income a donor may offset by charitable contribution deductions, depending upon whether the contribution is made to a 20\% charity (private foundations and the like) or to a 50\% charity (public charities). See I.R.C. § 170(b)(1)(A), (B).

\textsuperscript{24} See id. § 170(c)(2)(D).

\textsuperscript{25} See Bossons, The Value of a Comprehensive Tax Base as a Tax Reform Goal, 13 J. Law & Econ. 327, 328 (1970). Bossons raises the “second best” problem in questioning the utility of the comprehensive tax base concept in defining the income tax base. He questions whether “[m]aximum feasible comprehensiveness of the tax base is necessarily optimal” when a “truly comprehensive tax base cannot be obtained for administrative or other reasons.” Id. While the comprehensive tax base theory is a pleasing concept, its practical difficulty suggests that a “second best” approach be taken where everything that reasonably can be ascertained is included in income. See id.

\textsuperscript{26} See I.R.C. §§ 2055, 2522.

\textsuperscript{27} See id. §§ 164, 2053.
ernment.\textsuperscript{37} For some donors, charitable contributions may also be somewhat involuntary in much the same way that a casualty or theft loss decreases one's ability to pay taxes, consume or save. Both the income and estate taxes allow deductions to some extent for such losses.\textsuperscript{38} Charitable contributions may also resemble medical expenses which are deductible, subject to the limitations in section 213.\textsuperscript{39}

In other words, charitable contributions for some donors or in some instances may amount to semi-involuntary reductions in taxpaying ability, or loss of "income" of a kind for which the Code generally gives an allowance. Deductions for such expenditures may be necessary to determine taxpaying ability in terms of income (or consumption).\textsuperscript{40} To be sure, some semi-involuntary reductions in taxpaying ability or in income do not receive a tax allowance. Prominent among these are expenditures for education,\textsuperscript{41} most nonbusiness legal expenses,\textsuperscript{42} and other noncasualty, nonbusiness losses.\textsuperscript{43} Thus the principle that draws a line between all deductible and nondeductible costs, losses or expenditures is not readily apparent. However, the parallels that exist help to discern common policy objectives.

2. Services Contributed to Charity

In analysis of charitable contribution policy, an important comparison can be drawn between contributions of cash or property and voluntary contributions of services.\textsuperscript{44} A desire for evenhandedness would dictate that the law be "tax neutral": tax consequences

\textsuperscript{37} Tithing is defined as, among other things, "a payment in kind or money consisting until the middle of the 19th century of one tenth of the yearly profits arising from land, stock or personal industry and traditionally required of the inhabitants of a parish in the United Kingdom for the support of the parish church." Webster's Third New International Dictionary of the English Language Unabridged 2400 (1971).

\textsuperscript{38} See I.R.C. §§ 165(h), 2054.

\textsuperscript{39} See id. § 213.

\textsuperscript{40} See Andrews, supra note 14, at 314; Bittker, Charitable Contributions: Tax Deductions or Matching Grants? 28 Tax L. Rev. 37, 47, 58 (1972). See also infra text accompanying notes 55-65.


\textsuperscript{42} See I.R.C. § 162.

\textsuperscript{43} See id. § 165(c).

should not influence a taxpayer's decision whether to contribute services or cash or property to a charity. Two taxpayers who make contributions of equal value, one of cash, the other of services, should face identical tax consequences. Correspondingly, the donee should be indifferent to the tax consequences of receiving a contribution of services or a contribution of cash or property.

Although a contribution of services to a charitable organization or to a necessitous individual donee is not deductible, some or all of most contributions of cash or property are deductible under section 170. The donee, however, is generally not taxed on the receipt of either contribution. Section 102 excludes from the donee's income the cash or property contribution and an "unstated" exclusion exempts the contribution of services.

Another unstated exclusion allows donors of services to contribute their time without paying tax on the imputed income measured by the market value of that time. Thus a doctor may choose to spend Thursday afternoons practicing in a free clinic or for the United Way or Red Cross and not pay any income tax on the value of this time. On the other hand, a tax lawyer, whose services the charity might not value as highly as those of the doctor, may have nothing to give in the form of services and thus may have to contribute cash or property in order to confer an equivalent value upon the charity. The tax lawyer may spend the same Thursday afternoons working and generating income from private clients. If the tax lawyer then donates, in cash or property, an amount equal to the Thursday afternoon income, should not she be given a tax allowance equal to that given to the donor of services? Once again a taxpayer has deflected income from personal consumption or saving just as does the doctor who contributes services. Should the lawyer not get a deduction, as the symmetrical counterpart of the doctor's unstated exclusion, for the contribution of the market

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40 See id.
41 See Treas. Reg. § 1.170A-1(g).
42 See I.R.C. § 170(a).
43 See id. § 102(a).
44 Services rendered out of donative or philanthropic motives, although perhaps constituting "income" to the donor in the comprehensive sense of the term, and possibly also constituting "consumption," generally, by administrative practice, have not been included in the donor's income. Cf. Rev. Rul. 57-135, 1957-1 C.B. 307 (amounts paid by hospital to religious organization for work performed by volunteers assigned by religious organization are not taxable to volunteers as wages).
value of her Thursday afternoon services?

Indeed, the lawyer's contribution is deducted and the doctor's services are excluded from income. Both taxpayers have foregone leisure on their Thursday afternoons as well as the personal consumption or saving of the market value of their services.

Or have they? Some would say that service donors must gain a greater benefit from donating Thursday afternoon services to charity than from any other competing expenditure, otherwise they would not have made the voluntary contribution. If so, the theoretically correct solution would be to tax the service donors on the market value of the services and to deny a deduction for their contribution to charity.

However, if inclusion and no deduction is the theoretically correct tax treatment of service donors, then symmetry requires that the person who contributes cash or property be denied a deduction for the same reasons. In contrast, if the warm feeling in each donor's heart or the other psychic or imputed benefits are too ephemeral to constitute income, the correct solution would be to tax the donor on the value of the services, allow a deduction for the contribution of that value to charity, and continue to allow a deduction for cash or other property donations since they are presumed, sometimes contrary to fact, to come from previously taxed income.

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50 This argument may be circular unless it is rooted in independent empirical evidence or in an unfamiliar theory. It may also result simply from the factual limits upon the vocabulary or analytical tools of its proponents. If ordinary economics cannot account for altruism, if that term means something other than marginal utility-maximizing behavior, then perhaps an economist must simply admit inability to say anything about the conduct of the doctor and tax lawyer in these examples. Each at least had the opportunity to be a "free rider," and yet each chose to "pay." Is that because each thought that the marginal increment in the ability of the charity to provide services would please the donor more than that provided by any other expenditure of time and energy or money? Or, is it that each anticipated a warm feeling, plus some sense of identification and perhaps even recognition at home or at the club for what he or she has done? If so, this implies that both the donor of services and the donor of property have realized gain or "income" (or utility or pleasure) from their conduct, and thus should be taxed accordingly. Neither should receive a deduction or an exclusion.

51 Absent the percentage limits on the deduction, see I.R.C. § 170(b), the result under this solution would be the same as the present unstated exclusion and nondeduction. Given the limitations, however, the results will not always be the same. As highly paid athletes and performers well know, they often render benefit performances for charity to avoid tax on income they could not otherwise offset because a deduction, together with other contribution deductions, would exceed the percentage limits of § 170.
In any event, the present legal rule that fails to tax the donor of services may account in large part for the rule allowing a deduction for cash or property contributions. This symmetry may not be inevitable. Our rules could be changed to tax the donor of services or to continue the unstated exclusion for the contribution of services but not to allow a deduction for the contribution of cash or property. But again, the present symmetry is more than a matter of aesthetics. It largely equalizes both the relative incentives to contribute services, cash or property and the tax treatment of taxpayers who similarly surrender economic resources only in different forms.\(^2\)

The charitable contribution deduction may thus be desirable to remove any disincentive to contribute cash or property, and thereby to achieve greater neutrality with respect to the choice between a contribution of services on the one hand and cash or property on the other. When viewed as an attempt to eliminate a disincentive in the form of a tax upon desired behavior, the deduction returns us to the exemption of section 501 and the original suggestion for the allowance under section 170.\(^3\) That view might, in the minds of some, justify the tax allowance against the challenges hurled by tax expenditure budget advocates who insist upon viewing the allowance as a subsidy.\(^4\) In other words, it may not be so much an affirmative grant of a subsidy as a carving out of something not to be "penalized" by a negative tax expenditure!

D. Definition of the Tax Base: Income, Gift or Estate

Probably the most important endogenous tax argument for the section 170 deduction is that by making a charitable contribution the taxpayer deflects income to and for the benefit of another. Thus the deflected income should not accrue to the donor.\(^5\) The taxpayer has reduced his ability to pay tax and yet has neither

\(^2\) Perhaps a more attractive comparison than the doctor and the tax lawyer might have been between the doctor and tax lawyer offering valuable services to charity, and the wealthy elderly, incompetent or incapacitated person, whose services simply cannot be sold or contributed to charity at all, but who wishes to make a contribution in some form, and so donates cash or property.

\(^3\) See supra notes 11-20 and accompanying text.

\(^4\) See supra note 7 and accompanying text.

\(^5\) The author takes this view, which has been stated and elegantly elaborated by others. See Andrews, supra note 14, at 344-75; Bittker, supra note 40, at 57-58.
consumed nor saved vis-a-vis the von Schanz/Haig/Simons definition of income. Indeed, since the donor has "shared" the income, perhaps the donee should share the corresponding tax burden.

Comprehensive tax base (C.T.B.) theorists take the opposing view—that the donor does enjoy the benefits of consumption by contributing to charity. Economists assert that this must be the case for why else would the donor part with the gift, pure altruism perhaps being difficult to integrate into classical economic theory. The C.T.B. enthusiast may alternatively say that because the expenditure was not made for the purpose of producing income, by default it must be deemed to be personal consumption, or an otherwise nondeductible expenditure.

To counter the C.T.B. theorists, one who regards the comprehensive tax base as a kind of model for comparison with the present law, but not as a touchstone to law reform, might reply that the benefits to the donor take the form of imputed income which is at best difficult to measure. Imputed income varies indeterminately among various donors and is often excused from taxation for administrative, psychological, societal or other reasons. Like imputed income from home ownership, leisure, clean air, or national defense, the benefit to the donor is too ephemeral or indeterminate to include in the tax base. Furthermore, imputed income does not directly increase the donor's ability to pay tax.

A somewhat more refined approach asserts that not all income is alike—that one must distinguish between various sources and uses of income. Under this approach, income used to make charitable gifts should not be considered taxable income even if it satisfies an

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56 See supra note 13 and accompanying text.
57 See Kelman, Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far From Ideal World, 31 Stan. L. Rev. 831 (1979). Uses of income under Kelman's view of the C.T.B. theory are "irrelevant to tax law." See id. at 835. Once the donor exerts control over resources, regardless of purpose, the resources become part of the tax base. See id.
58 See supra note 50 and accompanying text.
59 See Kelman, supra note 57, at 834.
60 See B. Bittker, C. Galvin, R. Musgrave & J. Pechman, A Comprehensive Income Tax Base? A Debate (1968); Bossons, supra note 34.
61 The nearest the tax law comes to accounting for this element of personal consumption may again be in its distinction between 20% and 50% charities, see I.R.C. § 170(b), the former being thought generally to provide more private benefits to the donors than the latter. See supra note 32 and accompanying text.
These arguments tend to justify both an allowance, and one cast in the form of a deduction. A deduction functions as an exclusion by relieving the taxpayer of exactly the tax liability otherwise pay-able had the income been devoted to the donor's personal eco-
nomic or other benefit. This form of allowance, however, has
drawn cries of outrage. Admittedly, the amount deducted is "in-
come" and "wealth" or, more properly, "tax status" variant—the
amount of tax saved depends upon the taxpayer's composite mar-
ginal rate, which in turn depends on the taxpayer's status and
other taxable income and allowances. Nevertheless, the deduction
simply relieves the taxpayer of whatever tax would otherwise be
payable, just as an exclusion, stated or unstated, treats income as
not received.

E. Tax-Status-Variant Form of Allowance

As noted above, many say that the income-variant section 170
deduction is improper. The critics level this charge because the
deduction form makes contributions by high-bracket taxpayers less
costly than similar contributions by low-bracket taxpayers, and it
provides no relief at all for persons not otherwise required to pay
any tax due to insufficient taxable income or for other reasons.
To the contrary, however, the deduction is defensible not only on
endogenous grounds, but also on exogenous efficiency grounds.

The present income-variant form of benefit may more efficiently
draw charitable contributions out of potential donors and into the
hands of charity than would an income-constant allowance, or even
an allowance that provides disproportionately greater benefit to
lower-bracket donors, such as a double deduction for low-income

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63 Similarly, contributions to charity during life or at death, while constituting donative
transfers of wealth, perhaps should not be taxed since they do not contribute to accumula-
tions of private wealth and family dynasty, but instead take a redistributive direction.

64 These same arguments may go a long way toward supporting a deduction for gifts
made to worthy individual recipients even if they do not qualify under §§ 170 and 501 as
eligible "organizations." The failure to allow such a deduction may, as indicated above, be
attributed to concerns about evasion and abuse rather than to theoretical differentiation.
See supra text following note 28.

65 See generally authorities cited at supra note 2.
66 See, e.g., McDaniel, supra note 2, at 395-96.
67 See supra note 17 and accompanying text.
taxpayers and a 150 percent deduction for medium-income taxpayers. The answer lies in the response at various income levels to tax incentives for charitable contributions.⁶⁸

While early studies seemed to indicate that philanthropic giving is not very price sensitive,⁶⁹ more recent studies show that it is, especially at high income levels.⁷⁰ The results may reflect the fact that, with one temporary exception,⁷¹ taxpayers who do not itemize their deductions cannot deduct charitable contributions, whereas taxpayers who pay deductible interest and taxes on owner-occupied homes or who otherwise have sufficient deductions can separately deduct charitable contributions. If contributions by low-income persons are relatively insensitive to price, then perhaps tax allowances for these donors are unnecessary and would be inefficient.⁷² On the other hand, if contributions by high-income persons are highly price sensitive and perhaps income sensitive, then an income-variant tax deduction may be an efficient form of government subsidy or incentive.⁷³

Tax expenditure budget advocates deprecate the charitable contribution deduction as an "upside down" subsidy of the kind that Congress would never enact in the direct expenditure budget.⁷⁴ Perhaps Congress would not enact an income-variant matching grant program or other direct expenditure system, but that is not to say that such a system might not be efficient. Admittedly, the efficiency issue has yet to be resolved and in any event would have


⁶⁹ See Taussig, Economic Aspects of the Personal Income Tax Treatment of Charitable Contributions, 20 Nat'l Tax J. 1, 6 (1967) ("[T]he results indicate that giving is highly income elastic throughout the whole population, but that it is influenced by the price aspect of deductibility only among the small minority of individuals with very high incomes.").


⁷¹ The exception consists of the very limited deduction allowed on a trial basis until 1987. See I.R.C. § 170(i).


⁷³ See id.

⁷⁴ See, e.g., McDaniel, supra note 2, at 383.
to be weighed against the fairness arguments.

As to fairness, many suggest that the correct form of tax allowance for charitable contributions, if any, is a credit rather than a deduction. Credit enthusiasts sometimes further indicate that a regular credit would be income or tax-status constant. However, that statement is false, misleading or incomplete. Only a credit that is both refundable and taxable would enjoy those qualities.

An income or tax-status constant credit would have to be refundable to benefit a person who has no positive tax liability due either to a lack of income or to other allowances. That is particularly true if other credits must be “stacked” first and if the excess charitable contribution credit cannot be carried forward or back by rule of law or by reason of the taxpayer’s circumstances.

Perhaps it is less obvious that the credit must be taxable to be income or tax-status constant. A credit that is not taxable consists of two things: a governmental grant of money and an exemption from tax on that grant. Thus, for example, if a non-refundable credit were given at a flat rate of twenty percent, both the poor and rich taxpayer who gave $1000 to charity would be entitled to a $200 credit. Assuming that the poor taxpayer can benefit fully from the credit, each taxpayer has $200 of exempt income. The $200, however, is not of equal value to the two taxpayers because of their different tax brackets. Excluding the $200 from income saves the poor or low-bracket taxpayer nothing at all, or perhaps eleven percent—the bottom rate of $200, or twenty-two dollars. The rich or high-bracket taxpayer, however, saves $100, representing the fifty percent tax otherwise payable on the $200 income. In this respect, the exempt uniform rate credit is not income constant. It can be made income constant only by taxing the credit

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76 See W. Vickrey, Agenda for Progressive Taxation 131 (1947); Hochman & Rodgers, The Optimal Tax Treatment of Charitable Contributions, 30 Nat'l Tax J. 1 (1977). See also Feldstein & Taylor, supra note 68, at 1433, 1435-36 (projecting effect of replacing charitable deduction with a credit).

For a provocative exchange on the choice between deductions and credits for dependents' allowances, and the structural characteristics of the form of allowance, see Brannon & Morris, The Tax Allowance for Dependents: Deductions versus Credits, 26 Nat'l Tax J. 599 (1973); Gottschalk, Deductions versus Credits Revisited, 29 Nat'l Tax J. 221 (1976); Pogue, Deductions vs. Credits: A Comment, 27 Nat'l Tax J. 659 (1974).

77 See W. Vickrey, supra note 75, at 130-31, 385; Hochman & Rodgers, supra note 75, at 7.

78 See I.R.C. § 1(a)(3).
itself. The low-bracket taxpayer would have to pay perhaps as much as $22 additional tax in return for the $200 credit, whereas the high-bracket taxpayer would have to pay $100 additional tax. Each taxpayer could then use the $200 credit in full to offset total tax liability on the $1000 income.

A nontaxable credit may be income variant in another respect. By definition a progressive rate schedule is income variant—it demands a higher percentage tax from the taxpayer with more income than it does from a lower-bracket taxpayer. As a consequence, the $200 nontaxable credit above offsets the tax liability on income of $1818 for an eleven percent bracket taxpayer, while only offsetting the tax liability on $400 for the fifty percent bracket taxpayer. Thus the fixed percentage credit seems to have an income or tax-status variant effect, and a very progressive, or perverse, one at that. This result flows merely from the fact that graduated tax rates make the price of realizing $1000 in income higher, at the margin, for high-income taxpayers than for low-income taxpayers. Thus the credit’s marginal utility for paying tax on income is greater for low-income persons as a result of the rate structure (and apart from interpersonal utility comparisons).

A tax planning situation illustrates the nontaxable credit’s apparent upside-down income variance. If both taxpayers in the foregoing example had given $1000 to charity early in the year and both were in a position at the end of the year either to earn more income or to realize gain by sale of property or otherwise, the $200 credit would enable the low-bracket taxpayer to realize and be taxed in that year on additional income of perhaps $1818 or more. The $200 credit would fully offset the additional tax liability resulting from a decision to realize or earn the additional $1818 in income, taxed at eleven percent. If the high-bracket taxpayer, however, earns or realizes another $1000 before year end, the additional tax will be, by hypothesis, $500, or $200 if it is long-term capital gain, and the $200 credit for the charitable contribution will not fully offset the tax except in the case of long-term capital

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79 A $200 tax credit offsets the tax liability on $1818 of income for the 11% bracket taxpayer ($1818 x .11 = $199.98), whereas the same dollar credit offsets the tax liability on only $400 income for the 50% bracket taxpayer ($400 x .50 = $200).
gain.

The credit’s different effects may create different incentives for contributing to charity or realizing income. In any event, it is a form of income variance produced by a supposedly flat and income-constant credit. As seen above, making the credit taxable may actually aggravate rather than remedy this peculiar variance, although it does solve the primary version—the variance the deduction form itself creates.

Whether the income variance of the credit created by applying graduated rates to income will affect behavior may depend on whether the taxpayer is subject to a budget constraint. Absent a budget constraint, since the credit does not change the marginal tax rate facing each person, no bias would be expected from the income variance. But given a budget constraint, charitable giving and discretionary earning by both low- and high-bracket taxpayers may be affected differently even in a regime of a constant percentage credit. Making the credit taxable would accentuate the effect.

In sum, a refundable and taxable credit appears to be the most neutral or fair allowance if the allowance’s purpose is not to perfect the definition of income but rather to subsidize or reward socially desirable behavior. Yet, a deduction would better serve to define income and cannot definitively be viewed as less efficient than a credit nor more inappropriate as an incentive or subsidy.

II. REDISTRIBUTIONAL CONSIDERATIONS AND TAXATION

A. Forms of Redistribution

Any analysis of philanthropy and its related tax allowances must consider that both its purpose and consequence is the redistribution of resources. Indeed, at an elemental level redistribution seems to be what philanthropy is. Philanthropy can consist partly of redistribution from the private sector to charitable organizations. It could involve a redistribution from the public sector to the private sector to the extent of revenue foregone by the allowance. It entails a redistribution from donors to donees, and perhaps even to managers of charitable organizations. The tax allowances could also produce a redistribution of the tax burden, and of income or wealth after tax, among taxpayers by constructing differential

See supra text accompanying notes 76-79.
prices charged to various taxpayers.

The allowance's tax-status variance may also effect a redistribution among possible beneficiaries. If rich contributors tend to favor charities such as education and hospitals, and if their contributions are quite sensitive to price, the presence of any tax allowance, particularly where tax relief increases with income, will tend to shift resources to such charitable organizations. If poor donors tend to favor organized religion, then the relatively lower tax benefit provided to low-bracket donors produces some shift of funds from other uses to organized religious charities, but a smaller shift than other forms of tax subsidy or direct budget matching grants might provide. The choice between the deduction and another form of tax allowance thus may affect which charities and beneficiaries receive the amounts contributed.

Some say that the income tax allowance for charitable contributions is objectionable because it undercuts overall progressivity. That is of no concern to those who regard the allowance as more perfectly defining the income tax base because progressivity must be evaluated against a base determined according to independent principles. If it is not, then any allowance, even one for the cost of producing income, undermines progressivity.

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81 See Feldstein, supra note 72, at 214.
82 See id.
83 The low-bracket taxpayer receives a lower tax benefit from her charitable contribution because the deduction offsets income taxed at a lower rate. See supra notes 63-67 and accompanying text. The lower tax benefit also is attributed to the low-bracket taxpayer not itemizing deductions and therefore obtaining only the § 170(i) charitable contribution deduction. See supra note 71 and accompanying text. Or quite simply, the low-bracket donor may not have taxable income in excess of exemptions and other credits. See supra note 17 and accompanying text.

As to redistribution among taxpayers, the income-variant or tax-status-variant quality of the deduction in its present form may be viewed merely as a consequence, and not an improper one at that, of the graduated tax rates. See generally McDaniel, supra note 2. One adopting the tax expenditure budget view, however, would have more critical things to say about the redistributive effects of the allowance and the redistribution of the tax burden that is accomplished by the presence, and the form, of the allowance. See generally id.

84 See Note, supra note 3, at 696.
85 See McDaniel, supra note 2, at 395.
86 Carrying the logic of a tax expenditure budget to an absurd extreme, one could even contend it implies that we must have a 100% rate of tax on everything von Schanz would consider income, and any departure from that tax rate and base is objectionable as undercutting progressivity and allowing loopholes.
B. Transfer Tax Allowances and Redistribution

Much of what has been said about the base-defining role of income tax allowances suggests a similar role for allowances of various forms in the transfer taxes. However, because evaluating the incidence or burden of the estate, gift and generation-skipping taxes is so hopelessly mired in theoretical and empirical difficulty, conclusions about the redistributive effect of the estate and gift tax deductions are nearly impossible.

Nevertheless, one is led to believe, from anecdotal evidence as well as an intuitive understanding of the law, that the presence of the deductions does increase the amount of charitable giving. It does so at the expense both of revenue and of other beneficiaries who would take an increased inheritance if the donor did not make the contribution to charity. Still, the precise bearer of the burden cannot be determined, and thus little can be said of the incidence or economic effect of the tax allowance.

Certainly if the charitable contribution deduction now allowed by the transfer taxes reduces anyone's tax burden, simple economic intuition would suggest that behavior will in some way be affected and that someone other than the government, and those upon whom it would spend the foregone taxes, will benefit. That "someone" seems to be the charitable organizations receiving the gift or bequest and ultimately their beneficiaries.

Depending upon the wealth elasticity of charitable gifts and bequests, the government may not be the only loser. The donor (before death) or other beneficiaries may bear part of the burden of the contribution. They are denied a benefit just as the government foregoes the transfer tax it would collect absent the deduction. Nevertheless, the amount of revenue the government foregoes is difficult to determine and tax expenditure budget analysis does not enable us to account for the allowance's behavioral or second order effects.

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87 See supra notes 55-65 and accompanying text.

88 As to the estate and gift tax, John Simon has pointed out that "Professors Bittker and Andrews have not worked out a comparable 'estate-refining' rationale." Simon, Charity and Dynasty Under the Federal Tax System, 5 Prob. Law. 1, 22 (1978).

C. Governance of Charitable Organizations

Reasons for the charitable contribution deduction include the desirability of encouraging charitable organizations to bear some of the costs of government, or to bear some costs that government might fail to bear, and to provide, with decentralized control, diverse benefits throughout our society. In this connection, one can compare the control over the tax dollars the government distributes—subject ultimately to the control of voters, who exercise power more or less on a one-person-one-vote basis—with control over a charity’s distributions to its beneficiaries. Objections to the greater power that wealthy contributors obtain, perhaps even disproportionate to their contributions and perhaps enhanced by the income or wealth-variant form of the tax allowance, can be reduced to the notion that the wealthy contributors’ power is not one-person-one-vote but rather one-dollar-one-vote, or more.

An analogous model is the corporate “democracy” in which shareholders vote according to the number of shares owned or dollars invested. What this comparison yields is unclear. It may suggest only that the ultimate charitable beneficiaries should vote to determine the distribution of benefits by charitable organizations, and that their votes should be based upon one-vote-per-person or one-vote-per-unit of need, somehow independently determined. The latter system surely would tend to insure that the most needy received the most benefits!

A related concern is that wealthy contributors have the power to direct contributions through the charities to beneficiaries of their choice and that the form of the present tax allowance enhances that power. In contrast, poorer persons can exert at best “remote control” over distribution of tax-financed government benefits, the “poor man’s charitable foundation.” The poorer philanthropist can of course make direct contributions to nonqualified organizations, but the benefit of controlling one’s own wealth through direct contributions to needy donees lacks the tax allowance as a parallel.

See W. Vickrey, supra note 75, at 130; Hochman & Rodgers, supra note 75, at 2-3; McDaniel, supra note 2, at 390.

See supra notes 66-67 and accompanying text.


See McDaniel, supra note 2, at 391.
D. Forms of, and Limits on, Tax Allowances

The deduction form of allowance affects society by favoring contributions by high-income persons who then can obtain special influence on charitable boards and their policies. The deduction form, however, might be favored to maintain the full level of support that charities now receive and to insure tax neutrality between cash or property and service donations, even though that form of allowance means that the burden of donating a dollar declines as the donor's income rises.

To say that the present tax allowance consists of a deduction is an oversimplification. Section 170 is replete with percentage limits on the amount of charitable contributions deductible in any one year, carryovers for amounts contributed that cannot currently be deducted, differential limits for different charitable recipients and complex rules limiting the deduction for contributions of property with inherent but unrealized and untaxed gain. These rules are the product of many attempts at tax reform and are designed to reduce inequities or "loopholes" in the law. They fall short.

Some would urge that a contribution of appreciated property should never give rise to a deduction in excess of basis unless the untaxed gain were included in income. Section 170(e) provides that treatment only for certain kinds of property contributed and differentiates the result according to the recipient's nature and to whether or not the property is directly related to the tax-exempt purpose of the charitable recipient. Earlier variations on the deduction theme included relief from the percentage ceilings for taxpayers who were so very generous as to give most or all of their income to charity for a great many years. The absence of such relief from the ceiling at present seems odd, but the ceiling appears based on the notion that everyone but the lowest-income taxpayers must bear some portion of the cost of government, even if all in-

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94 See supra text accompanying notes 66-80.
95 See W. Vickrey, supra note 75, at 30-31.
96 See Feldstein, supra note 72, at 214.
97 See I.R.C. § 170(b), (d), (e).
98 See id. § 170(e).
99 See id. § 170(b)(1)(C) (1976). These were said to have been enacted so that a Philadelphia nun or a Texas oil man who gives all of her or his income to charity year after year would not have to bear any tax.
come is donated to charity. This theory treats income received and donated to charity as sufficiently within the taxpayer's power to warrant imposing some tax burden.

III. Conclusion

The present system of tax allowances for philanthropic giving has been much criticized, both by those who favor a repeal of any such tax allowance and by those who wish to increase the allowance in general for certain taxpayers. Much of the tax planning and many of the equity and efficiency objections to the allowance's present form have roots in the legislative choice to use graduated and differentiated rates in the income tax system. A moment of speculation about the extent to which these objections would melt away if the income and transfer taxes used proportional rates, with or without some exemptions or exempt negative-income tax grants to create progressivity, leads to the observation in this area, as elsewhere, that attempts at progressivity by means of high and steeply graduated rates in the system have greatly increased complexity. The complexity is found not only in the statutes, regulations, rulings and cases, but also in the administrative and compliance costs to both the government and the taxpayer, and in the costs of planning to avoid the tax or to maximize the benefits of the allowance. Tax expenditure budget devotees might be more agreeable to the charitable subsidy if the tax rate system were proportional and uniform.

Those who object to the income and tax-status variant quality of the present allowance would be less vehement in the absence of different rates of tax for each different status—single, married, head of household—for different kinds of income—capital gain, al-


101 George Break has masterfully discussed the connection between the various contours that from time to time have outlined the § 170 deduction, or alternatives that have been proposed for adoption, and possible policies, and thus has eliminated any temptation to undertake a similar analysis here. See Break, Charitable Contributions under the Federal Individual Income Tax: Alternative Policy Options, in 3 Research Papers, supra note 1, at 1521.

102 Indeed, such complexity is evident even in the economic and tax law literature when it attempts to engage in a policy analysis of the role of these tax allowances. See, e.g., authorities cited at supra note 68.
ternative or additive tax preference income, ordinary income, earned income—and for different amounts of income—the graduated rate schedules themselves. Under a proportional and uniform tax regime, it might be easier to reconcile the techniques that would use a tax allowance to define income in the income tax, or the appropriate tax base in the estate and gift taxes, and the techniques or forms of allowance suggested by the economists who want to provide an incentive or subsidy for private philanthropy. Existing incentives for high-bracket taxpayers to use the charitable contribution allowance for tax planning would diminish under such a regime. Objections that the allowance undercuts progressivity would weaken.\textsuperscript{103} The tension between equity and efficiency and the differences between direct expenditures and tax expenditures might diminish. It might be easier to decide whether to have an allowance for contributions to charity, and indeed, it might hardly matter whether such a tax system granted such an allowance. Surely the entire policy evaluation of allowances for philanthropic giving would become clearer, probably easier, and maybe even more productive.
