

GIFTS AND THE INCOME TAX—AN ENDURING PUZZLE

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I

INTRODUCTION

Amounts received by gratuitous transfer—either as gifts given during the life of the donor or by will or intestate succession following the transferor's death—are broadly excluded from the base of the U.S. federal income tax.¹ Because this has been true since the inception of the modern income tax in 1913, it may well not strike the reader as at all puzzling that this would be so. The rule is nevertheless at odds with the usual understandings of the nature of gross income in our tax system.

Consider Henry Simons's classic definition of the income-tax base: "Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question."² The value conferred by gift would ordinarily be either consumed or saved, and would thus fall within either the first or second clause of the income definition. Similarly, the most recent definition of the income-tax base offered by the Supreme Court (in which one detects the long shadow of Simons's definition)

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1. I.R.C. § 102(a) (2006) ("Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.") Although the language has varied slightly over the years, this is essentially the rule as it was enacted in the Revenue Act of 1913, which included the first modern income tax, following ratification of the Sixteenth Amendment in the same year.

2. HENRY C. SIMONS, *PERSONAL INCOME TAXATION* 50 (1938). This essay is considered by many the foundational statement of the modern American income tax (somewhat anachronistically, in light of its publication twenty-five years following the introduction of that tax). It is often referred to as the "Haig-Simons" definition of the tax base, largely because Simons credits earlier work by Robert M. Haig in the latter's "The Concept of Income—Economic and Legal Aspects" in ROBERT M. HAIG, *THE FEDERAL INCOME TAX* (1921), cited in the Simons work at the appropriately numbered page 61 (which would later become the Internal Revenue Code (I.R.C.) section containing the basic statutory definition of income). Simons also noted that an earlier definition offered by German economist Georg Schanz in *Der Einkommenbegriff und die Einkommensteuergesetze*, 13 *FINANZ ARCHIV* 23 (1896), "coincide[s] substantially with that presented [by Simons himself]." SIMONS, *supra*, at 60.

was contained in the following passage from *Commissioner v. Glenshaw Glass Co.*: “[We have in this case] undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.”³ Again, amounts received gratuitously initially represent accessions to wealth, which the donee can either continue to hold as additional wealth or devote to consumption. Finally, in the debate over the “comprehensive tax base” (CTB) that followed shortly after *Glenshaw*, a wide variety of possible definitions of income was considered, though in the end most would probably agree with Joseph Pechman’s assessment that “[e]ven a cursory examination of the literature discloses that the basic concept used or implied in discussions of comprehensive income taxation is the Haig–Simons definition.”⁴ To the extent that the various CTB definitions were true to their origins as Pechman saw them, they would thus have included gifts received in the tax base, though not every contributor to this debate opined on this point specifically.

The puzzle of gifts may thus be stated, Why is it that the federal tax system departed so quickly, and with so little evident debate, from the Haig–Simons income definition on this issue? And further, why is it that this departure is so comfortable, so deeply ingrained, that it is not generally described as a “loophole,” nor even mentioned in most accounts of “tax expenditures” or similar expressions of the ways in which the actual tax rules have strayed from the ideal?

There are other puzzles as well. Though it appears, despite the deviation from Haig–Simons principles, that there is broad satisfaction with the basic background rules regarding the income-tax treatment of gifts, certain ancillary rules regarding gifts of appreciated property are among the most unsatisfactory in our income tax. The defects embodied in these rules are neither technically difficult to remedy nor practically troublesome to correct; the puzzle is thus simply that they persist.

Unlike several of the other contributions to this issue, this is not a story in which a Rubicon was consciously and momentously crossed. There was no gathering of wise men in Philadelphia, no forced surrender of royal prerogatives at Runnymede. The background rules simply happened, without fanfare or explanation, when our income-tax rules were originally drafted. As the Supreme Court explained when faced with interpreting the successor provision derived from the original 1913 version of the income tax, “[t]he meaning of the term ‘gift’ as applied to particular transactions has always been a matter of contention. Specific and illuminating legislative history does not appear to

3. 348 U.S. 426, 431 (1955). Note that this definition adds the concept of realization to the Simons definition. Though the realization concept is strongly embedded in our tax law, it could be viewed as either part of the definition of income itself, or, more properly, as an exception from the definition of income, justified largely by administrative convenience.

4. Joseph A. Pechman, *Comprehensive Income Taxation: A Comment*, 81 HARV. L. REV. 63, 64 (1967).

exist.”⁵ There may be a bit more drama in the story of the defects in the treatment of appreciated-property transfers, but in the end, the tale is simply one of the triumph of lobbyists.

The central argument of this article is that the answer to the gift riddle buried in the background rules lies in what might be described as a paradox: although it is intuitively appealing to regard value received by gift as an element of the income of the individual receiving it, it is completely *unappealing* to regard value received by gift as an increment to income in the aggregate. If one imagines, for example, that every taxpayer were to transfer all of his income in some year to the person next in alphabetical order on a roster of taxpayers, and if one further imagines that a single change—repeal of section 102 of the Internal Revenue Code (relating to the exclusion of gifts from gross income)—were to be made, would one conclude that aggregate income had doubled?

Such a conclusion would be unwarranted. The insight that a donee seems to have income under a Haig–Simons income-tax definition is based on the sense that she has achieved a positive increase in wealth in the amount or value of the gift. But the other side of the same insight is that the donor has suffered an equal and offsetting decrement to wealth in the amount or value of the gift. It thus appears that a full view of the income-production aspects of gifts must include analysis of the situation of both the donee and donor.

This article will begin with a description and analysis of the several possible donor- and donee-linked rules regarding income-tax treatment of gifts. Following that will be discussions of the background rules of the U.S. tax system regarding gifts, as well as two areas at the edges of gift doctrine that have received, ironically, more attention from Congress and the courts than the core puzzle of gifts has received: first, the treatment of gratuitous transfers that have been determined to fall outside the protection of section 102, which, after considerable bumbling, has come to what appear to be the correct conclusions; and second, the treatment of gifts made in the form of appreciated property, which has created a variety of conundrums in the contexts of both charitable and noncharitable gifts, and which has not achieved so successful an outcome. Finally, a brief concluding section will include recommendations for changes in some of the more troublesome areas discussed.

II

MODELING A LINKED DONOR–DONEE VIEW: THE FOUR BASIC OPTIONS

As to each party to a gratuitous transfer, a choice of two rules exists: As to donors, a deduction of the amount or value transferred might or might not be allowed. As to donees, exclusion of the amount or value received might or might not be allowed. Theoretically, either choice as to one party could be combined with either choice as to the other, producing four possible

5. *Comm'r v. Duberstein*, 363 U.S. 278, 284 (1960).

combinations of rules. Some combinations might seem self-evidently superior to others. For example, if one believes that aggregate income is not affected by gratuitous transfers, one should prefer either a donor deduction coupled with donee inclusion, or a donee exclusion coupled with denial of a donor deduction, since either of those rules would leave aggregate income unaffected by the transfer. These might be referred to as the “symmetrical” options, since a favorable rule as to either party is perfectly offset by an unfavorable rule as to the other.

The other combinations result either in adding the amount or value of the transfer to aggregate income (if the donee must include, but the donor may not deduct) or in subtracting the amount or value of the transfer from aggregate income (if the donor may deduct, but the donee need not include). It is nevertheless the case, somewhat surprisingly, that each of the four combinations, including the two nonsymmetrical ones, has had its defenders, in at least some contexts.

Before analyzing each option, a few background observations are in order. The following analysis is heavily influenced by the two primary contexts in which gifts arise: intrafamily transfers and transfers to charitable entities. Other types of gifts can and do occur, but they are exceptions and will in most cases end up being considered as “faux gifts.”

Each of the two main types of gifts comes with practical difficulties that have policy implications. In the case of family gifts, there are often verification problems of a number of kinds. A transfer to a minor child, for example, involves a legal transfer, but it is one under which the donor ordinarily maintains custody of the corpus of the gift as the child’s guardian.⁶ Thus, the parent would continue to exercise the voting rights as to any stock and continue to exercise control over the use of any real property that might be the subject of a gift. Because the obligation of support of minor children is a legal concept that is not crisply defined, it is entirely possible that the proceeds of or income from a gift may be used to defray costs that otherwise would have been paid by the donor–parent in the form of obligatory support.⁷

Transfers to adult children (or grandchildren, nieces, nephews, et cetera) may be no less fraught with ambiguity. There may be undisclosed consideration provided by the putative donee, either of a sort that the tax system would ordinarily not recognize (such as an agreement to refrain from profanity),⁸ or of a sort that the tax system quite possibly would, ideally, account for, if the

6. UNIF. GIFTS TO MINORS ACT § 2 (2007).

7. See Jean T. Adams, *Reconciling Family Law with Tax Policy: Untangling the Tax Treatment of Parental Trusts*, 46 TAX L. REV. 107, 107 (1990).

8. *Hamer v. Sidway*, 27 N.E. 256 (1891); see also *Smith v. Comm’r*, 14 T.C.M. (CCH) 706 (1955) (concerning a tract of land given to a son in exchange for his promise to give up aspirations to play professional baseball and to finish school).

transaction were properly reported (such as an agreement to provide care to an elderly relative).⁹

In at least some situations, there may not truly be any transfer at all, even though the parties may report one. For example, a high-bracket taxpayer might claim to transfer to a lower-bracket relative property that produces periodic income just before the income is received, so that it would be taxed to the lower-bracket donee instead of the higher-bracket donor. If the transfer is real, this strategy would effectively—and perhaps legitimately—reduce the family's aggregate tax burden.¹⁰ But if the transfer in truth is more like a loan, with an unwritten but well-understood obligation to repay, or to provide some other suitable quid pro quo,¹¹ then it would of course not effectively transfer the income-tax liability to the donee, the contrary reporting of the parties notwithstanding.

Transfers to charitable entities raise an entirely different set of problems. Because the donee entities cannot in any meaningful sense consume or otherwise enjoy the benefits of the transfer as those terms are usually understood, it is appropriate to view them instead as intermediaries that transfer the resources to ultimate beneficiaries of the organization's charitable programs. If the ultimate beneficiaries can be identified, then it would presumably be sensible to substitute those individuals for the organization in evaluating the appropriate tax treatment of the donee. In a few cases, identification of specific individuals may be possible;¹² in others, it may be possible to identify beneficiaries as a class in a way that elucidates the analysis of the appropriate tax treatment. In many cases, however, the precise identity of the beneficiary may prove to be quite elusive.¹³

With these background realities in mind, the four combinations of donor and donee income-tax treatment of gifts can be examined.

9. See *Cotnam v. Comm'r*, 263 F.2d 119, 120 (5th Cir. 1959) (involving an oral agreement for provision of care services in exchange for the bequest of one-fifth of his estate); *Braddock v. United States*, 434 F.2d 631, 632 (9th Cir. 1970) (resolving the dispute of an agreement to cook, clean, and help with farm work in exchange for room and board and the eventual bequest of the entire estate).

10. See *Blair v. Comm'r*, 300 U.S. 5, 12–13 (1937) (holding that the income from donated property is attributable to the donee and not the donor).

11. Jonathan G. Blattmachr & Mitchell M. Gans, *Wealth Transfer Tax Repeal: Some Thoughts on Policy and Planning*, TR. & EST., Feb. 2001, at 49, 56–60.

12. Even in some of those cases, there may be intractable timing problems. For example, it is possible to observe the date at which transfers were made to fund a college-scholarship program, and possible as well to identify particular individuals who later received scholarships. But the lapse of time between the two events may make it difficult to develop a unified view of the appropriate donor–donee tax treatment.

13. See RICHARD SCHMALBECK & LAWRENCE ZELENAK, *FEDERAL INCOME TAXATION* 417–18 (2d ed. 2007), for an extensive analysis of an opera performance in which none of the parties can appropriately be described as receiving a subsidy, even though a charitable contribution is deducted, resulting in an unambiguous tax expenditure. The analysis is based on the argument discussed in the text *infra* at note 43.

A. Option 1: No Donor Deduction; Inclusion by Donee

This is, of course, the most revenue-favorable approach to this problem; it has the potential to create taxable income even for cases in which no increment to national income would ever be recognized. It is easy to defend the inclusion treatment on the part of the donee: he has enjoyed an unambiguous increment to wealth, fully realized, so inclusion under the Haig–Simons, *Glenshaw Glass*, or CTB theories seems entirely reasonable.

In fact, one of the more interesting bits of historical data on the treatment of gifts is that the ill-fated predecessor of our modern income tax, the income tax of 1894, did include a rule modeled along the lines of option 1. That law specifically called for the inclusion in income of all “money and the value of all personal property acquired by gift or inheritance.”¹⁴ That provision was never tested for its constitutionality because the entire Act was quickly found unconstitutional on other grounds.¹⁵ But it is noteworthy that Congress found the inclusion position persuasive when it first considered what should be in the income-tax base.

It is somewhat more difficult to justify denying a deduction to the donor, since she has experienced a decrement to wealth in an amount that precisely equals the amount that the donee would be required to include under this option. Indeed, the defect in this option inheres not primarily in its inclusion rule, but rather in a sort of inconsistency between the inclusion rule and the deduction rule, which leads to the proliferation of increments to the income-tax bases that do not seem to accord with ordinary notions of aggregate income, as will be explained further below.

Arguably, this inconsistency could be resolved if, in looking at the accounts of the donor, the gift could be considered a form of consumption. It is, after all, a voluntary disposition of resources that the donor has chosen to make in lieu of some other form of consumption, or in favor of retaining the assets that are the subject of the gift for possible future consumption. This argument, or some form of it, was in fact persuasive to Henry Simons himself, who wrote in his essay that “gifts are consumption to the donor and therefore not properly deductible.”¹⁶ He went on to say, “Broadly, [gifts] represent merely personal expenditure.”¹⁷

14. Act of August 27, 1894, ch. 349, 28 Stat. 509, 553, *invalidated by* *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, *modified on reh'g*, 158 U.S. 601 (1895). The value of real property was excluded because of concerns about the possibility that the tax would, if applied to real property, be considered a “direct tax,” in contravention of the constitutional rules requiring that such taxes be apportioned among the states in proportion to population as stated in U.S. CONST. art. I, § 9, cl. 4.

15. *Pollock*, 157 U.S. 429.

16. SIMONS, *supra* note 2, at 139. This quotation is used here somewhat disingenuously in an important respect, however, because a preceding clause has been omitted. Simons begins the sentence in which the quotation in the text appears by saying, “One may persevere stubbornly in the contention that, as a matter of principle,” signaling his own unease or even disagreement with this argument. He ultimately argues, however, that gifts should be included in the income of the donee, and that they

But this is an odd form of consumption. As the author noted elsewhere, the gift uses up no resources and a failure to make the gift would conserve no resources for alternative uses:

[The] argument on this point can perhaps be best summarized by asking if A and B are, taken together, any better off when A makes a gift to B. They probably are better off in a psychological sense: B is gratified to receive the gift, and A must take pleasure in benefiting B, or the gift would not have been made. However, psychic benefits are not usually accounted for by tax rules; A and B might also be better off if they kissed or embraced, but that is not something with which we want the tax system to deal. . . . [G]ifts are a mere transfer of consumption opportunities, not consumption in itself.¹⁸

If the psychic benefits to A are ignored, as this quotation argued they should be, then no acts constituting “rights exercised in consumption” have taken place; one is left with only the decrement to wealth in the donor’s accounts.

A practical argument favors ignoring this decrement (which will be detailed in the discussion of option (4), which also involves denial of deduction. But the argument for denying the donor’s deduction is blunted in the case of this first option by the fact that the income inhering in the transferred consumption opportunity will be taxed by its inclusion in the donee’s income under this option. The combination of denying donor deductions and mandating donee inclusion thus creates double-counting (or more) of the same consumption opportunities. As Bittker and Lokken note in their income tax treatise,

[I]f (1) Smith inherits \$100 from his parents, (2) he gives the legacy to his wife for Christmas, (3) she uses the funds to purchase a bicycle as a birthday gift for one of their children, and (4) the donee gives the bicycle to a younger brother or sister, an outside observer might doubt that this chain of events should be treated as creating \$400 of income, even though each of the four participants experienced an accession to his or her wealth [totaling that sum].¹⁹

Surely the inside observers—the Smiths—doubt it as well, and would likely not report these income amounts even if the income-tax rules unambiguously called for the inclusion of gifts. But even in the case of much larger intrafamily transfers of assets, in which nonreporting could not so casually be tolerated, the problem of multiple counting makes clear that the combination of inclusion by the donee and denial of deduction by the donor is untenable.

It has also been suggested that gratuitous transfers could be included in the income of the donee, but not deductible by the donor, with the tax on the additional income generated thereby being used as a substitute for the federal

should not be deductible by the donor; so one must conclude that it was more a question of unease than disagreement. The willingness to ignore the decrement to the wealth of the donor can be explained only by noting an offsetting increase in consumption of the donor.

17. *Id.* at 139–40. In this case, Simons’s sentence has been presented in its entirety.

18. Richard Schmalbeck, *Race and the Federal Income Tax: Has a Disparate Impact Case Been Made?*, 76 N.C. L. REV. 1817, 1828 (1998).

19. BORIS I. BITTKER & LAWRENCE LOKKEN, *FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS* ¶ 10.1, at 10-3 (3d ed. 1999).

wealth-transfer taxes.²⁰ This argument may have much to recommend it as a practical legislative strategy, but it is not an argument for option 1 per se. In effect, it admits that option 1 overtaxes income and simply uses that element of overtaxation to offset the revenue loss occasioned by the proposal to forgo taxation of another tax base.

B. Option 2: Donor Deduction; Inclusion by Donee

If the critical shortcoming of option 1 is that denying the donor the deduction while requiring inclusion by the donee results in the proliferation of phantom taxable income, it might seem that allowing the donor a deduction would, by remedying that shortcoming, provide an acceptable solution. There would be only one incidence of tax on each accession to wealth, and it would be placed on the donee who enjoys the benefits of that accession. This option has a good deal of coherence and conceptual appeal. It does, after all, follow most closely the dictates of the Haig–Simons income definition: the donee really does have the goods, and the wherewithal to pay tax on them—why not tax him? The donor no longer has the goods, and if the idea that transferring assets is the equivalent of consuming them is unpersuasive, then allowing the donor a deduction seems appropriate. Strictly in terms of conformity with the Haig–Simons income definition, and ability-to-pay principles, this is in fact the most conceptually appealing approach.²¹

But this approach suffers from intractable practical problems. First of all, it is in the nature of large gifts in general that they take the form of a transfer from a relatively high-wealth, high-income individual to someone of lesser wealth. (This puts aside smaller gifts—those exchanged by friends at Christmas, for example—that are reciprocal in nature, but also of trivial interest to the tax system because of their modest size and offsetting nature.) The donor wishes to make the donee better off than the donee has been, but presumably not better off than the donor is.²² An obvious implication of this is that in a tax system with a series of graduated rates, gifts will typically involve transfers from a donor in a

20. See Joseph M. Dodge, *Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income*, 91 HARV. L. REV. 1177 (1978). The federal wealth-transfer taxes consist of the estate, gift, and generation-skipping transfer taxes in subtitle B of the Internal Revenue Code, §§ 2000–2704.

21. A reader may object that in light of Henry Simons's own insistence that donors should not be allowed a deduction, it is wrong to refer to this approach as consistent with the Haig–Simons income definition. However, as noted, Simons appears to have been less than wholly persuaded by the idea that making gifts constitutes consumption. See *supra* discussion in note 16. He endorsed the denial of the donor's deduction in part on practical grounds along the lines described here. It seems entirely possible that even Simons would have granted that this second combination—donor deduction and donee inclusion—was indeed the most consistent conceptually with the consumption-plus-change-in-wealth definition.

22. The idea of a donor deduction generally presumes that the donor continues to exist and have an interest in being allowed a deduction. It is thus primarily germane to inter vivos gifts, not to testamentary gifts. If such a rule were adopted, however, it is imaginable that a deduction could be allowed to the donor even in the case of testamentary gifts, either on his final income tax return, or on his estate tax return.

relatively high tax bracket to a donee in a bracket that is very rarely higher, and usually lower, than the donor's.

The ability to move tax liabilities around within a family, which would be the inevitable effect of allowing donors to pass tax liabilities to donees in the way that option 2 more or less explicitly permits, would create numerous tax-avoidance opportunities for high-income taxpayers.²³ And, as noted earlier, the possibility that the true nature of the transaction could be cloaked by taxpayers who were willing to avoid documentation of the full details of the transaction is very problematic in the family context. For example, shares of stock could be transferred within a family with the unwritten understanding that the putative donor could continue indefinitely to determine how those shares would be voted.

Even in a nonabusive situation, a practical difficulty of the rules effectuating option 2 is that any transfer of property would have to be valued, requiring an appraisal that might not otherwise be necessary if the transfer did not have immediate income-tax consequences.²⁴ Nevertheless, the appeal of option 2 in terms of its superior assessment of Haig-Simons income, and ability-to-pay principles, is such that it should not be abandoned too readily. The income-shifting possibilities have traditionally been thought to be definitively fatal to this approach, but that view is based to some degree on the traditionally broad range of marginal tax rates. In 1954, there were twenty-four rate brackets in the tax system, ranging from 14% to 91%. Further, those rates ascended with income to a far greater degree than is true under today's rates. The top rate was not reached until income had reached \$200,000. Roughly eight-fold inflation since 1954 means that an income of \$200,000 in 1954 had a purchasing power equivalent to an income of \$1,600,000 in 2008.²⁵ But in 2008, rates stopped ascending once an income of \$357,700 was reached.

To illustrate the difference in income-shifting possibilities under the 1954 and 2008 rate brackets, respectively, imagine a single taxpayer in 2008 who has a taxable income of \$2,000,000. The tax associated with that income would be \$678,596.75. If she could keep only \$400,000, and make gifts of \$160,000 each to ten other single individuals within her family, and if the tax regime of option 2

23. In 2001, when the possibility of repealing the estate tax was much on the minds of Congress, simultaneous repeal of the gift tax was initially appealing as well. However, explanations of the income-tax-avoidance possibilities that would be created by the absence of a gift tax discouraged Congress from taking that route. *See, e.g.,* Blattmachr & Gans, *supra* note 11, at 56–60. The idea that gifts would shift taxability from one taxpayer to another would permit even more-egregious avoidance devices.

24. This factor is muted, however, by the fact that many gifts require valuations in any event, either for gift-tax purposes, or for purposes of applying the alternate-basis rules of I.R.C. section 1015 in the case of property whose value may be less than the donor's basis at the time of the gratuitous transfer.

25. According to the Bureau of Labor Statistics, the annual consumer price index (in terms that have been restated to permit comparisons with today's scale) was 26.9 in 1954. The annual index for 2008 was 215.303, which is 8.004 times as large as the 1954 number. *See* BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, CONSUMER PRICE INDEX, ALL URBAN CONSUMERS—(CPI-U), U.S. CITY AVERAGE, ALL ITEMS (August 14, 2009), available at <ftp://ftp.bls.gov/pub/special.requests/cpi/cpiiai.txt>.

were in place, she would pay tax on only \$400,000 (which would be a tax of \$118,597.75), while the ten donees would each have incomes of \$160,000 each (on which the tax would be \$38,778.25). The total tax under this rather extreme scheme would thus be only \$506,380.25, a savings of about 25.4%.

A person with an economically equivalent income in 1954 of \$250,000 (that is, one-eighth of the 2008 dollar amount) who pursued the same strategy would have found that that strategy was much more effective. The tax on a taxable income of \$250,000 would have been \$202,320 in 1954. If, instead of keeping that income and paying that tax, the 1954 taxpayer had, as his 2008 counterpart had done, kept only 20% of the total, he would have paid a tax of \$26,800 on his income of \$50,000; and the ten other individuals who had incomes of \$20,000 each would have paid a tax on those incomes of \$7260 each. Thus, the total tax paid by the eleven coconspirators would have been only \$99,400, a savings of over 50%.²⁶

One may object that, even though the tax-avoidance potential in the modern version of the income-shifting game is less than it might have been two generations ago, it nevertheless continues to be significant. But that misses the larger point here: Income-shifting is a game indulged in largely by very high-income and high-wealth families. Under the current rate structure, the donees are likely to find themselves, rather early in the game, in the same top marginal-rate bracket as the donor, at which point the game stops being fun. Even in the illustration shown, much of the income-shifting consists of moving income from a return in the 35% bracket to one in the 28% bracket, which does not generate powerful tax savings. When rates were higher, and brackets spread more widely, income-shifting was a huge concern of the tax system, which is why the government brought so many income-shifting cases in the early-to-middle years of our tax history.²⁷ Current bracket structures offer much less rich opportunities; in many cases, every adult member of a wealthy family is likely to be in the same top bracket. And although Congress may tinker with the current bracket structures at the edges, it seems very unlikely, in the light of current knowledge about the unfortunate incentive effects of high tax rates and concerns about international competitiveness, that the U.S. will ever again see a bracket structure that goes much above a 40% rate, or sets the income threshold for that rate very high.

26. These examples ignore the impact of personal exemptions, standard deductions, and the like, but can be repaired in that regard by further imagining that the donor's gross income exceeded the number supposed in the example by precisely the amount of his or her allowable deductions, and that the ten other individuals had, independently of whatever they received from the donor, incomes equal to the maximum amount that they could have received before any tax was due.

27. The significance of the change can be measured in some ways by the shape of income-tax casebooks published before and after the flattening of the rate brackets, which culminated in the Tax Reform Act of 1986. When the author began teaching federal income taxation, the book he used devoted 110 pages to income-attribution cases (WILLIAM D. ANDREWS, *BASIC FEDERAL INCOME TAXATION* 699–809 (2d ed. 1979)). The book he uses currently devotes only about twenty-five pages to this topic (SCHMALBECK & ZELENAK, *supra* note 13, at 801–24).

All this makes option 2 seem less outrageously impractical. Nevertheless, though the avoidance opportunities it presents have diminished greatly, those opportunities still exist, and in an environment in which revenue concerns loom large, it is probably not a reasonable option even under the current bracket structures that offer minimal rewards to income-shifting. But it may be useful to keep in mind that the option has considerable conceptual appeal, for there are some situations in which resort to options that resemble this one may be desirable.

C. Option 3: Donor Deduction; No Inclusion by Donee

This option may seem so patently unreasonable as to suggest that its inclusion in the analysis stems solely from some misbegotten need for comprehensiveness. But this is not so: there is one type of gift for which exactly this option has been chosen, and it is instructive to consider why. That type of gift, of course, is one to a recognized charity. I.R.C. section 170(a) permits deduction of the amount of cash or the value of property given to charities that have been granted that status under I.R.C. section 501(c)(3).²⁸ The exclusion from income for the donee is provided by I.R.C. section 102(a), which does not limit the exclusion to individuals or any other particular category of legal persons, though of course the broader exclusion from taxability provided by section 501(a) itself would presumably allow exclusion of these gifts even if section 102(a) did not.

As was the case in option 1, there is an asymmetry in this option, but of the opposite sort. Instead of leading to the proliferation of income in the tax base, this option leads to its disappearance. Accordingly, the rules governing this option must, and do, constrain the avoidance opportunities in a variety of ways. There are rules limiting the percentage of a taxpayer's income that can be offset by the charitable-contributions deduction.²⁹ There are rules, and a well-developed set of administrative procedures, for ascertaining the eligibility of particular organizations to be the recipients of deductible contributions.³⁰ There are important, albeit loophole-ridden, limitations on deductions of the value of contributions in kind.³¹

28. Technically, the scope of eligible recipients of deductible gifts is contained in I.R.C. section 170(c)(2), but the language of that section closely resembles the language of section 501(c)(3), and the latter designation is the more widely known and accepted description of the recipient organizations. Deductions for charitable gifts are also allowed against the bases of the estate and gift taxes conveyed by section 2055 and 2522, respectively. However, testamentary charitable gifts confer no income-tax advantages for the decedent's last income tax return or for his estate.

29. I.R.C. § 170(b). Generally, the limit is 50% of adjusted gross income for individual taxpayers and 10% of taxable income for corporate donors, but a variety of lesser percentages applies in other cases, such as gifts to private foundations. *See* I.R.C. § 170(b)(1)(B).

30. The statutory requirements are largely contained in I.R.C. section 501(c)(3); the Treasury has added considerable detail to the certification process in Treas. Reg. section 501(c)(3)-1 (2008).

31. I.R.C. § 170(e).

Notwithstanding these constraints, nearly \$200 billion of charitable gifts are deducted each year,³² resulting in a revenue loss of almost \$50 billion each year.³³ From an income-definition perspective, allowing these nontrivial deductions is noticeably contrary to the idea that a gift represents consumption by the donor. In his famous essay, Henry Simons notes the “consumption incidents to charity,”³⁴ and later voices his objection to the generally favorable tax treatment of charitable giving by noting, in effect, that even if one views charitable gifts as transfers of consumption opportunities rather than consumption itself, the ability of the donor to choose the objects of his bounty nevertheless reflects nettlesome elements of personal choice that weaken the case for deduction.³⁵

Of course, one could accept the idea that charitable giving does contain substantial consumption elements and still favor a deduction for such giving on grounds that the tax rules may permissibly be used to provide incentives for behavior that Congress wishes to encourage.³⁶ This sense, as well as a sense that the government is indirectly compensated for at least some of the revenue loss associated with the charitable-contributions deduction by being relieved of some obligations that government might otherwise bear, were it not for the operations of private charity, might be enough to explain the deduction in terms other than the income definition.³⁷

But if one rejects the argument that gifts of any sort are consumption, except perhaps to the negligible degree that there is a consumption element in the ability to choose the direction in which consumption opportunity is transferred, then one must conclude that the decrement to wealth represented by a gift should be reflected in the accounting of the donor’s income. Though the tax rules do not generally permit such a deduction in the case of noncharitable gifts, that policy is, arguably, a concession to the practical problems of allowing deductions for gifts generally. But where those practical

32. The preliminary numbers from the IRS’s Statistics of Income Division indicate that individuals deducted about \$175 billion in 2007 for charitable gifts. INTERNAL REVENUE SERVICE STATISTICS OF INCOME (SOI) BULLETIN, INDIVIDUAL TAX RETURNS, PRELIMINARY DATA 2007, fig.A, 112 (Spring 2009). Corporate giving probably added \$15–20 billion to this number. INTERNAL REVENUE SERVICE STATISTICS OF INCOME, 2006 CORPORATION INCOME TAX RETURNS, tbl.2, 39 (2009).

33. The tax-expenditure estimate for charitable deductions for both business and individuals in 2009 was \$48 billion. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT, FISCAL YEAR 2010, tbl.19-1, 301 (2009), available at <http://www.gpoaccess.gov/USbudget/fy10/pdf/spec.pdf>.

34. SIMONS, *supra* note 2, at 140.

35. As Simons puts it: “If a man devotes practically all of his million-dollar income to the support of the most worthy causes, the question remains of whether anyone should be permitted so much power.” *Id.* at 141.

36. This appears to have been the primary original justification of the deduction in 1917, when Congress first raised income-tax rates above the relatively trivial early levels. The War Revenue Act of 1917, 65 Pub. L. No. 50, §1201(2)(a), 40 Stat. 300, 330 (codified as amended in scattered sections of 26 U.S.C.).

37. On the contrary, Congress was not willing to extend the deduction to foreign institutions on the theory that the U.S. did not derive any benefit in the form of domestic services. H.R. REP. NO. 1860 (1938), *reprinted in* 1939-1 C.B. (pt. 2) 728, 742.

problems of creating tax-avoidance opportunities do not dominate, and where the transfer of consumption opportunities is to achieve some altruistic purpose, then the rules may reflect, and do reflect, a sense that recognition of the wealth decrement of the donor is appropriate. This income-defining property of charitable gifts, first explained in detail by William Andrews,³⁸ is important evidence of the deep intuition that giving away money or property really is something that should be reflected in the accounting of the donor's income, at least in circumstances where tax avoidance opportunities do not make such an approach hopelessly impractical.

Even in the special situation of charitable gifts, it is worth considering the role of the donee. Because the donee in such a case is an organization, it makes no sense to look at its opportunities for consumption, as consumption is something only individuals partake of. But the organization is, in an important sense, an intermediary, receiving contributions (largely) from individuals, and using the proceeds to provide services to other individuals. The latter individuals are not taxed on the receipt of those services, even though those services may unambiguously represent consumption activities. In the most obvious cases, the soup served by a soup kitchen, or the lodging provided by a homeless shelter, are prototypical personal-consumption items. What is the justification for exclusion of these elements of value from the income of those who consume these items?

That question is answered easily enough: The ultimate beneficiaries of the services of a soup kitchen or homeless shelter would ordinarily be too poor to have any net taxable income, after allowing for personal exemptions and the standard deduction. It would not invariably be the case, however, that inclusion would have no tax effects. The personal exemption amount for 2009 is \$3650 per person, and the standard deduction for an unmarried taxpayer is \$5700.³⁹ A single individual who had a full-time but minimum-wage job would earn more than the sum of those amounts, but probably less than the minimum amount needed to rent an apartment in many urban areas. The inclusion of several thousand dollars of benefits from meals and lodging provided without charge or at a nominal charge could, if included at market value, result in net additional tax liabilities.

It may nevertheless be sensible to allow such an exclusion on administrative grounds. The record-keeping necessitated by imposing an obligation to provide, for example, a Form 1099 of some sort to everyone who spent any nights over the course of a tax year in the shelter provided by a charitable organization would be quite burdensome, for both the organization and the individual, particularly in light of the fact that most of the recipients would have no fixed address. If most of the recipients of the services are likely to be beneath the

38. William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 344–48 (1972).

39. See Rev. Proc. 208-66, 2008-45 I.R.B. 1107, 1112, and 1111–12, respectively.

threshold of taxability, there may be little justification in imposing these documentation burdens generally.

Other nonprofit organizations may also be able to justify a failure to pass taxable income through to the beneficiaries. For example, a private school might meet its budget by recovering 80% of its costs through tuition charges and the remaining 20% through gifts to its annual fund. In such a case, it could be argued that the 20% received in the form of gifts represents the value of services provided in excess of the tuition charge, which ought therefore to be included in income. The private schooling is a consumption benefit provided to the parents (because they have an obligation to provide schooling to their school-age children). But in this case, one could argue that the payment of the tuition and gifts toward the annual fund operate to relieve the burdens of a governmental unit, namely the school district that would otherwise bear the responsibility for providing schooling to the private-school student in question. So the governmental sector has already recouped the benefits of the private schooling.

Hospitals and medical-care facilities could justify exclusion not only on grounds that they relieve burdens that might otherwise be met by government, but also on grounds that medical expenses are generally treated favorably under our tax rules, being deductible from income (to the extent that they exceed certain floors),⁴⁰ and excludible when they are covered by employer-provided insurance.⁴¹ Thus, even if the value of subsidized services were included, they might well be subject to offsetting deductions.

The difficult cases for exclusion are presented by organizations like churches, or by arts organizations. The benefits provided by these organizations are enjoyed largely by the group of contributors who are not systematically likely to be below the threshold of taxability. Andrews has defended allowing the deduction even in such cases because the contributions in question create what he calls “common goods.”⁴² This is a less-than-satisfying account, however. It may be true that, at the margin, a church member who gives \$100 to a church with 100 members expects to get only one percent of the benefits. This possibility may be enough to justify allowing the deduction in spite of the rules against deduction of contributions that come with quid pro quo benefits to the donor, since the individual value of the quid pro quo benefit is *de minimis*. But the other \$99 of benefits, while not inuring to the donor, are nevertheless received by people who are, or at least might be, within the range of taxability. Much the same could be said respecting people who make contributions to symphony orchestras or art museums.

A better argument for exclusion of the benefits received might be the difficulty of valuing the benefits and, in particular, in valuing the subsidy that

40. I.R.C. § 213.

41. I.R.C. § 105.

42. Andrews, *supra* note 38, at 357.

each recipient might be said to have received. It is natural to suppose that if there are 500 seats available for a symphony performance, and if the performance costs \$50,000, or \$100 per seat, then a ticket sold for, say, \$60 involves a subsidy of \$40. But if a person buying the seat would not have paid any more than \$60 for the ticket, is it reasonable to say that that person has benefited from a subsidy? This argument raises some questions about whether, in a case of this sort, the deduction for the contribution should have been allowed in the first place, because of the doubts about the delivery of social benefits in equal measure to the costs. But from a Haig–Simons–accounting viewpoint, it remains true in this example that the donor has made a transfer and thus suffered a decrement to wealth, while the buyer of the symphony ticket has received no net benefit, having consumed a concert ticket worth \$60 to him, but only at the expense of the \$60 ticket price. Whether or not value has disappeared (and it quite likely has in this example) as a result of this transaction, it remains true that the income accounting seems right if contributions are not regarded as consumption, and income is included only if the taxpayer in question has received a net benefit.⁴³

D. Option 4: No Deduction for Donor; No Inclusion for Donee

The final option of the four combinations of linked donor–donee treatment is of course the one that the U.S. tax system has adopted. Because it represents the actual practice of the U.S. income tax, and is not merely a theoretical option, it seems appropriate to discuss this option in the following separate section of this article.

III

THE BACKGROUND INCOME-TAX RULES REGARDING GIFTS

Because it has been part of the tax rules since the beginning of the modern tax system in 1913, and because Congress did not offer explanations of its reasoning in this case (as was true of many of the basic tax rules), little is known definitively about the reasons for adoption of the background tax rules denying donors deductions for their gratuitous transfers, but also allowing exclusions for donees. Perhaps Congress was concerned that, because gifts would initially be made largely from stores of capital accumulated before passage of the Sixteenth Amendment, that any attempt to tax the receipt of gifts would be impermissible.⁴⁴

43. *See supra* note 13 (providing example of opera subsidies).

44. Congress took some care to avoid taxing amounts that could be traced to earnings accruing before passage of the Sixteenth Amendment (which permitted the imposition of the income tax). For example, corporate dividends are taxable to the shareholders who receive them only to the extent that they are distributed out of earnings accumulated after February 28, 1913. *See* I.R.C. § 316(a)(1).

As noted in the discussion of option 2,⁴⁵ that option appears to provide the most accurate assessment of Haig–Simons income because it respects both the decrement to wealth suffered by the donor and the increment to wealth enjoyed by the donee in any gratuitous transfer. It follows that option 4, the precise inverse of option 2, is the least satisfactory from that perspective. It does have the advantage, however, of counting the aggregate income correctly, presuming that making gifts does not constitute consumption for purposes of the Haig–Simons definition.

It has two huge practical advantages as well. First, because gifts tend to be given by donors who are in marginal-rate brackets that are at least as high, and usually higher, than the rate brackets of the donees, preserving the aggregate amount of taxable income, but exposing it to those higher rates by keeping the income on the donor's return, yields substantially more revenue than option 2. It also preserves the tax base in the manner approved in some of the early Supreme Court cases that insist that income should be taxed to the person responsible for producing it.⁴⁶

Second, option 4 has the advantage of making the actual existence of a gift largely irrelevant for income-tax purposes. Gifts become, under this option, nonevents for income-tax purposes, generating neither deductions nor inclusions. In light of the ambiguities in many intrafamily transfers—which is to say, the vast majority of noncharitable transfers—there are significant advantages to rules that resolve ambiguities *de facto* by obviating the need to resolve them.

The combination of the exclusion under I.R.C. section 102, and the absence of any rule authorizing a deduction for the donor for the gifts she makes, can be seen as an example of surrogate taxation: even though the income creates a wealth increment to the donee, the system ignores that increment, but ignores as well the wealth decrement of the donor. This not only has administrative advantages, but is also reasonably fair, as long as these rules are well understood and durable. Donors can determine the amount of the gift that they wish to give on the basis of its net cost to them, which of course will be the gross cost, undiminished by any tax reduction associated with a deduction. (If gifts were deductible, as they in fact are if made for charitable purposes, the tax-cognizant donor must, in order to properly assess his actual sacrifice, compute a net cost of the gift after accounting for the tax benefit.)⁴⁷ Similarly, if a gift must achieve a net benefit to the donee (to make a particular down payment on a house purchase, for example), the donor knows that the net is exactly the gross.⁴⁸

45. *See supra* text in note 21.

46. *See, e.g.*, *Lucas v. Earl*, 281 U.S. 111 (1930).

47. Martin Feldstein & Charles Clotfelter, *Tax Incentives and Charitable Contributions in the United States*, 5 J. PUB. ECON. 1 (1976).

48. Of course, if the gift is large enough to be subject to a gift tax, this may not be so, since there is the question of who will take responsibility for any gift tax that might be occasioned by the gift. The

It could thus be argued that the choice of option 4 may reflect a congressional sense that option 2 produced superior results conceptually, but that its outcomes could be reasonably approximated by the administratively sounder surrogate approach embodied in option 4. Because Congress did not expressly declare or deny that surrogate taxation was its intent, this cannot be either verified or contradicted. It can, however, be said that this option adheres to what might be called a symmetry principle, in that its linkage of donee exclusion and donor nondeductibility leaves the aggregate pre-transfer taxable income neither augmented nor diminished.

IV

GRATUITOUS TRANSFERS THAT ARE NOT GIFTS

Section 102 permits exclusion of the value of property acquired by “gift, bequest, devise or inheritance” but does not further define those terms.⁴⁹ The regulations provide rules for “marriage settlements,”⁵⁰ gifts of income interests,⁵¹ and, in proposed regulations, transfers from employers to employees.⁵² However, they add no useful detail on the central concept of a gift.

This is unfortunate, because the boundaries of the gift concept are not entirely self-evident. Obviously, the concept embraces only transfers made gratuitously.⁵³ But many transfers may be entirely voluntary, but not appropriately within the rationale of the exclusion. For example, tips paid to a waiter, bellman, concierge, or the like should be—and are—regarded as compensation for services, not as gifts.⁵⁴ The fact that the arrangements are such that no explicit contract compels payment should not be allowed to obscure the basic nature of the transaction. Any other rule with respect to such transactions would have the effect of making much compensation income untaxable:

consequences of so-called “net gifts,” in which the donee contractually assumed responsibility for payment of the gift tax, were in some doubt until resolved relatively recently by the Supreme Court in *Diedrich v. Comm’r*, 457 U.S. 191 (1992). *Diedrich* made clear that the assumption of the gift-tax liability reduced the amount of the gift, and amounted to the discharge of a liability of the donor by the donee, generating income to the donor, albeit only in an amount equal to the amount by which the value of the gift exceeded the donor’s basis in the property given. *Id.* at 199. Until that time, the parties did not enjoy the benefits of predictability of the net outcome of such gifts.

49. I.R.C. § 102(a).

50. Treas. Reg. § 1.102-1(a).

51. Treas. Reg. § 1.102-1(b) and (c).

52. Prop. Treas. Reg. § 1.102-1(f), 54 Fed. Reg. 627 (Jan. 9, 1989).

53. Actually, even this is a slight overstatement. Property passing by intestate succession cannot always be assumed to reflect a conscious voluntary disposition by the decedent. And property that passes to a surviving spouse pursuant to state forced-share laws may do so contrary to the explicit wishes of the decedent.

54. Direct authority for even so obvious a principle as the one in this sentence is surprisingly elusive. It is not specifically stated in either the I.R.C. or the Regulations, but is for the most part simply assumed. For example, the Conference Report to the Tax Equity and Fiscal Responsibility Act of 1982, which reformed the tip-reporting system under I.R.C. section 6053, says flatly and without citation, “Because tips are includible in income, employees must keep records of all tips received . . .” H.R. REP. NO. 97-760, at 556 (1982) (Conf. Rep.), reprinted in 1982 U.S.C.C.A.N. 1190, 1328.

providers of services could offer mere suggestions as to the compensation level, which most beneficiaries of those services would in fact pay. Not every transaction would proceed on this basis, of course, because in some cases the provision of services would be too extensive for the provider merely to hope that the beneficiary would respond in the expected way. But many providers—especially those who engage in a number of relatively small, discreet transactions with repeat players as the counterparties—could live with a situation in which a few beneficiaries disappoint them, while those who do not, provide tax-free income.

So the basic rule must be that voluntary transfers can only be gifts if they are not intended as compensation. But determining what gratuitous transactions are properly considered to be compensation has proved to be surprisingly difficult. The issue has a prominent place in the history of American tax litigation. Indeed, the very first case decided by the Board of Tax Appeals (the predecessor of the Tax Court) involved a purported gift that was made in the context of an employment relationship. In *Parrot v. Commissioner*,⁵⁵ the taxpayer was the “general superintendent” of a corporation that, having apparently succeeded beyond its directors’ hopes, adopted a board resolution authorizing a series of payments to its senior executives, including one of \$35,000 to Mr. Parrot.

The Board of Tax Appeals got off to a promising start in dealing with this problem, noting first that the record was insufficient to prove that the payment to Mr. Parrot was, together with the admitted compensation, in excess of what might have been appropriate for the services rendered.⁵⁶ The Board also noted in describing the facts of the case that the corporation had deducted the payment,⁵⁷ although less was made than might have been of the likely loss of aggregate taxable income presented by this fact. Still, in its conclusions, the Board offered views on corporate behavior that have been echoed in later cases: they concluded in effect that corporations ordinarily cannot form the state of mind necessary for true gifts—that because the residual value of the corporation belongs to its shareholders, it cannot responsibly be depleted for a purpose other than advancement of the interests of the enterprise. As the Board of Tax Appeals put it, “Corporate action is presumed regular until shown to be otherwise. The payment of a bonus would be regular, the making of a gift would be irregular.”⁵⁸

The Supreme Court got off to a similarly good start, deciding in *Old Colony Trust Co. v. Commissioner*,⁵⁹ on the authority of *Parrot*, that the voluntary payment by a corporation of the income tax of its president was income to the president, notwithstanding the lack of a contractual obligation to make the

55. 1 B.T.A. 1 (1924), *aff'd*, Noel v. Parrot, 15 F.2d 669 (4th Cir. 1926).

56. *Id.* at 3.

57. *Id.* at 2.

58. *Id.* at 4.

59. 279 U.S. 716, 729 (1929).

payment. It was, the Court found, compensation, whether voluntarily paid or not.⁶⁰

But eight years later, a closely divided Court decided in *Bogardus v. Commissioner*⁶¹ that a payment from an acquiring corporation to an executive of an acquired corporation was excludible, overruling both the Board of Tax Appeals (the finder of fact) and a well-reasoned opinion by Judge Learned Hand for the Court of Appeals below.⁶² The five-member majority seemed to be swayed to a considerable extent by the fact that the manager was not employed by the corporation making the payment, though the opinion refers to no evidence that a continuing business relationship was impossible or even unlikely. Nevertheless, the Court found that “[t]here is entirely lacking [in this case] the constraining force of any moral or legal duty as well as the incentive of anticipated benefit of any kind beyond the satisfaction which flows from the performance of a generous act.”⁶³

Two decades later, the Court got back on track, or at least found its way to the vicinity of the track, in *Commissioner v. LoBue*,⁶⁴ a case that involved stock options awarded to a manager by the employer corporation. Finding that the arrangements there revealed “not the slightest indication of the kind of detached and disinterested generosity which might evidence a ‘gift’ in the statutory sense,”⁶⁵ the Court reached the clearly correct outcome. However, rather than reconsider *Bogardus*, the Court casually distinguished it, noting that in *LoBue*, “[t]he company was not giving away something for nothing.”⁶⁶ *Bogardus* was cited at this point, suggesting that the Court viewed both the outcome and reasoning of that case as still sound. The standard thus seemed to be that if no possibility of a post-transfer quid pro quo could be identified, then the gratuitous transfer could be a gift.

Thus the stage was set for the famous case of *Commissioner v. Duberstein*,⁶⁷ doubtless the most important Supreme Court pronouncement on the range of the gift exclusion under I.R.C section 102. The decision actually involved a pair of unrelated cases, one involving Duberstein himself, and the other involving a substantially different sort of transaction relating to a taxpayer named Stanton. In brief, Duberstein, an Ohio metal fabricator, suggested that one of his suppliers, the Mohawk Metal Company of New York, contact other specified Ohio firms that might be interested in buying Mohawk’s products. These tips produced substantial additional sales for Mohawk, and Mohawk’s president decided to present Duberstein with a new Cadillac in appreciation. Mohawk

60. *Id.*

61. 302 U.S. 34, 44 (1937).

62. *Bogardus v. Helvering*, 88 F.2d 646 (2d Cir. 1937).

63. *Bogardus v. Comm’r*, 302 U.S. at 41.

64. 351 U.S. 243 (1956).

65. *Id.* at 246.

66. *Id.* at 247.

67. 363 U.S. 278 (1960).

deducted the cost of the car as a “finder’s fee,”⁶⁸ but Duberstein excluded it from his income on grounds that it was a gift. The IRS thought not, and its view was sustained by the Tax Court.⁶⁹ The Sixth Circuit, however, reversed.⁷⁰

In the companion case, *Stanton v. United States*, the taxpayer had been for about ten years the comptroller of a church in New York City and president of a company established by the church to oversee its substantial real-estate holdings. When Stanton resigned from these positions in 1942,⁷¹ the directors of the real-estate company awarded him a “gratuity” of \$20,000, an amount that approximated his annual salary. Stanton excluded the amount received as a gift, but the IRS insisted on inclusion. Stanton paid the tax, but sued for a refund in the Eastern District of New York,⁷² which found that the gratuity was indeed an excludable gift. The Court of Appeals reversed.⁷³

This created, plausibly, a conflict between the Sixth and Second Circuits because the cases both involved gratuitous payments from parties for whom services had been provided, made to the parties who had provided those services, and the Circuits reached opposite results on the exclusion issue. However, there were, as is evident from even the brief statement of the facts of the two cases, a number of distinctions between the cases that could have justified denial of certiorari. *Stanton* involved an employment situation, where the only basis for the transfer was recognition of employee duties well discharged; *Duberstein* involved a supplier–customer relationship, in which the gratitude expressed was sparked by an incidental service not directly related to that relationship. Stanton’s “gift” was a series of cash payments, which in the case of a departing executive certainly resembled severance pay; Duberstein’s transaction took a more traditional gift-like form—a lavish item of personal property, that may or may not have had a value to the donee equal to the cost of the item.⁷⁴ One might even have noted that a church, as a tax-exempt organization subject to explicit prohibitions on providing noncharitable private benefits,⁷⁵ had no business making gratuitous transfers to anyone except on grounds of indigence, which Stanton manifestly could not have demonstrated. One might then have concluded that the transfer to Stanton *must* have been compensation. The Court could well have concluded on those bases that the decision of the Sixth Circuit that Duberstein’s Cadillac was a gift was easily reconciled with the decision of the Second Circuit that the termination payment to Stanton was not.

68. *Duberstein v. Comm’r*, 265 F.2d 28, 29 (6th Cir. 1959).

69. *Duberstein v. Comm’r*, 17 T.C.M. (CCH) 16 (1958).

70. *Duberstein v. Comm’r*, 265 F.2d at 31.

71. Notably, more than eighteen years passed between the events giving rise to the tax dispute and its final resolution.

72. *Id.*

73. *Id.* at 729.

74. In the actual case, the record indicated that Duberstein at first tried to decline the proffered gift, and that he already owned a Cadillac, as well as an Oldsmobile. *Duberstein*, 363 U.S. at 280–81.

75. I.R.C § 501(c)(3).

In fact, the willingness of the Court to decide these cases was not primarily due to the conflict between the two circuits involved. In his concurring opinion, Justice Frankfurter noted, although the “claimed difference in the approaches between two Courts of Appeals” may have had some influence, certiorari was granted “primarily on the Government’s urging that . . . clarification was desirable for determining when a transfer of property constitute[d] a ‘gift’”⁷⁶

And the government knew precisely what clarification it hoped the Court would adopt, having proposed an elegant test: “Gifts should be defined as transfers of property made for personal as distinguished from business reasons.”⁷⁷ Although this proposed rule does not expressly insist on the symmetry that was the principal attraction of options two and four in the analysis of the preceding section, this test would generally have produced that effect. If a particular transfer was motivated by personal reasons, it could be excluded under section 102, but there would generally be no basis on which the value of the transfer could be deducted—an option 4 outcome. It would thus have no effect on aggregate income. On the other hand, if the transfer was made for business reasons, a deduction as a business expense would be available, but the value transferred in that case could not be excluded from the income of the transferee, who would thus be taxed on the increment to wealth she had enjoyed—an option 2 outcome. In either case, the outcomes would conform to the symmetry principle described above.

But the Supreme Court would not bite. Justice Brennan explained that, were the Court to adopt the government’s test, it would be “painting on a large canvas with indeed a broad brush.”⁷⁸ Coming from the brush of Justice Brennan, this seems comically disingenuous, since he was hardly the most reluctant member of the famously activist Warren Court to slap paint on a large canvas. Be that as it may, his opinion mandated a more cautious approach that in many ways left the problem in the same state as he found it. In an opinion filled with homilies such as, “Decision of the issue . . . must be based ultimately on the . . . fact-finding tribunal’s experience with the mainsprings of human conduct . . .”⁷⁹ and, “Life in all its fullness must supply the answer to the riddle,”⁸⁰ Brennan adopted, in effect, a case-by-case approach in which the role of the trial court as fact-finder was supreme because it was in the best position to discern “the dominant reason that explains [the transferor’s] action in making the transfer,” which Brennan adopted as the touchstone in determining whether section 102 applied to exclude a transfer as a gift.⁸¹ Unfortunately, the opinion offered little

76. *Duberstein*, 363 U.S. at 294 (Frankfurter, J., concurring).

77. *Id.* at 284, n.6.

78. *Id.* at 287.

79. *Id.* at 289.

80. *Id.* at 288, n.9. The quotation in the text is from Justice Cardozo’s equally unsatisfying opinion in *Welch v. Helvering*, 290 U.S. 111, 115 (1933).

81. *Duberstein*, 363 U.S. at 286.

guidance about precisely how trial courts were to make that determination, or what factors were most salient in deciding whether to come down on one side or the other of the section 102 exclusion line.

In fairness to Justice Brennan, it must be conceded that he was charged with writing an opinion for a Court that was completely fractured over the question of the appropriate dimensions of the section 102 exclusion. In *Duberstein*, the Court found that the Cadillac could not be excluded as a gift; in *Stanton*, the Court found that the evidence as to the “dominant reason that explains [the transferor’s] action” could not be conclusively determined from the record, so the case required remand to the District Court for further proceedings. But only three other Justices signed this combined opinion. Justice Whittaker, by concurring only in the two results (while explicitly declining to endorse the plurality opinion’s explanation), allowed the Court to dispose of the cases.⁸² But the absence of any majority opinion meant that even Brennan’s watered-down approach was barely vague enough to attract the votes needed to resolve the cases.

The government did not go away from the case completely empty-handed. In parsing through the six concurring, dissenting, or concurring and dissenting opinions,⁸³ it is clear that every Justice but Justice Douglas viewed *Duberstein*’s Cadillac as outside the ambit of the section 102 gift exclusion,⁸⁴ and that is a result that considerably assists the Internal Revenue Service in holding to the view that payments in recognition of past services provided do not stem from “detached and interested generosity,” and hence cannot be excluded as gifts.⁸⁵ And it was certainly important that the Court clarified that “donative intent” under common law, which meant simply that there was a bona fide intention to transfer the property, was not enough to sustain an exclusion under section 102(a). But the split on the remand of *Stanton* revealed the full measure of the Court’s fissure on this issue: four Justices, including Brennan himself, of course, signed the plurality opinion, and Whittaker concurred in the result, But four Justices dissented to the remand—two because it was clear to them without further proceedings that the transfer qualified as a gift (Douglas and Black), and the two others because it was clear to them without further proceedings that the transfer could not qualify as a gift (Harlan and Frankfurter).⁸⁶ Predictably, upon remand, the District Court found, in language suitably

82. *Id.* at 293 (Whittaker, J., concurring).

83. Three of the opinions—those of Brennan, Black, and Frankfurter, were full opinions. The other three—by Harlan, Whittaker, and Douglas—were simply third-person statements of each Justice’s preferred outcomes in the two cases. The opinions other than the plurality opinion are at 363 U.S. at 293–98.

84. Justice Douglas was, of course, famous for his loyalty to the taxpayer’s side of any tax controversy that reached the Court, at least after 1950. See Bernard Wolfman et al., *The Behavior of Justice Douglas in Federal Tax Cases*, 122 U. PA. L. REV. 235, 237 (1973).

85. See, e.g., *Olk v. U.S.*, 536 F.2d 876, 879 (9th Cir. 1976) (involving the payment of “tokens” from a successful gambler to a casino dealer, which were held to not constitute gifts).

86. *Duberstein*, 363 U.S. at 293 (Harlan, J., concurring), 294–98 (Frankfurter, J., concurring).

mirroring Justice Brennan's prescription, that the payment to Stanton was indeed motivated by detached and disinterested generosity, and it therefore reinstated its conclusion that the payment was excludable as a gift.⁸⁷

A third case involving the scope of the section 102(a) exclusion was also decided by the Court the same day, and it too reached a questionable outcome. In *United States v. Kaiser*, the Court was faced with the question whether benefits paid by a union to a worker who was not a member, but who was nevertheless participating in a strike called by the union, could be excluded as gifts.⁸⁸ The Court, sustaining the conclusion of the jury in the original District Court trial below, found that they could, by a six-to-three vote, once again writing multiple opinions (four this time) to explain its reasoning. The Court appeared to be impressed by the fact that the payments were made only after some verification of financial need, with Justice Douglas in particular equating this with an exercise of a "charitable" impulse on the part of the union.⁸⁹ Of course, while neediness was apparently a necessary condition for assistance from the union, it was not sufficient in itself; the financial need also had to be directly caused by participation in a strike called by the union. Obviously, the union was not an all-purpose dispenser of welfare benefits, but was advancing its economic interests by supporting those who supported it, whether or not they were members.

Summing up, one must conclude that June 13, 1960, (the day on which these opinions were announced) was a dismal day for the Supreme Court jurisprudence on the subject of gifts. By a fourteen-to-thirteen margin, the votes in these three cases actually favored gift status in the respective transactions, even though none of the three seems to have reflected much in the way of "detached and disinterested generosity."⁹⁰ Further, none of the ten opinions written to dispose of those three cases made any real effort to come to grips with the policy principles underlying the gift exemption. This reticence could be justified on grounds that Congress had given the Court virtually no grist on which it could base such a discussion. But the absence of legislative history would presumably not have stopped the Court had it been able to form a coherent policy rationale of its own. It apparently could not do so.

This left the law regarding this important exclusion in a state of some uncertainty. Fortunately, the other branches of government moved to fill in the

87. *Stanton v. United States*, 186 F. Supp. 393, 396–97 (E.D.N.Y. 1960).

88. 363 U.S. 299, 299–301 (1960).

89. *Id.* at 326. Douglas also noted that "my idea of a 'gift' within the meaning of the Internal Revenue Code is a much broader concept than that of my Brethren." *Id.* He did not explain what his idea of a gift was, but it appears from context to have included all or most gratuitous transfers, whether or not motivated by any "detached and disinterested generosity."

90. The count proceeds as follows: In *Duberstein*, the vote was eight to one against gift status; in *Stanton*, the vote was seven to two in favor of gift status, if one counts the five votes to remand as reflecting a concession that the transfer in that case at least *might* have been a gift (and perhaps a recognition that the district court to which the case was remanded was highly likely to reiterate its original findings); and in *Kaiser*, the vote was six to three in favor of gift status.

vacuum shortly thereafter. The Treasury proposed measures in 1962 that affected a number of business-expense deductions in situations in which substantial personal-consumption benefits appeared to be present, including business meals and entertainment, and—of greatest relevance here—business gifts. The business-gift provisions were contained in what became section 274(b) of the I.R.C., which allows a token deduction of \$25 per donee per year, but no deduction for business gifts beyond that point.⁹¹ Thus, a sales manager can now give a bottle of decent wine to a customer, or a woolen scarf as a holiday present to a secretary, and still deduct it. But payments of the magnitude involved in the three 1960 Supreme Court cases would not qualify for a deduction if characterized by the transferor as “gifts.” This would, but for the small-gift exception, substantially assure that outcomes would fall within the second or fourth options described above, which are the two options that satisfy the symmetry principle. The rule of section 274(b) preserves the possibility of some option 1 outcomes, as in the case that a transferor eschewed the deduction by declaring the transfer a gift, but the IRS successfully contested the section 102 exclusion by the donee. No such cases could be found, however. If they exist at all, they must be quite rare.⁹²

Option 3 outcomes might not be so rare. After all, the amounts in the *Stanton* case were presumably paid out of funds derived from deductible gifts to the church. Similarly, payments from the union were presumably paid out of funds derived from deductible union dues or assessments. And because both the church and the union are generally exempt from income taxation,⁹³ they may not have been much concerned with the loss of a deduction that they had no use for anyway.

Changes in the law after the addition of section 274(b), however, lessen this concern. With respect to business managers like Mr. Stanton, charitable organizations heavily engaged in profit-making activities might be concerned about deductions that would be available to offset unrelated business income.⁹⁴ And the penalties now imposed on both the organization and its managers in the case of so-called “excess benefit transactions”⁹⁵ make it very unlikely that a charitable organization’s board would authorize a substantial gratuitous payment to an individual who had not demonstrated financial need. Payments of the sort Mr. Stanton received are now also barred by section 102(c), which precludes exclusion as a gift in all cases of payments based on the existence of an employment relationship.

91. The \$25 limitation has not been indexed or otherwise adjusted since it was added to the I.R.C. in 1962. It was therefore not quite a *de minimis* exception when enacted, but it has certainly become so due to the approximately six-fold inflation in the years since.

92. It is imaginable that denial of a section 102 exclusion could have been made administratively, and not contested by the taxpayer. No public record of such an outcome would be created, so the possibility that cases of this sort exist cannot be conclusively disproved.

93. Unions are exempt under I.R.C. section 501(c)(8).

94. I.R.C. § 511.

95. I.R.C. § 4958.

None of these changes quite reaches the situation in *Kaiser*, though the less-generous treatment of union dues under current law may make this less readily categorized as an option 3 situation.⁹⁶ Thus, with but a few largely inconsequential exceptions, the law may now assure that outcomes will be categorized within options 2 or 4, and will therefore be consistent with the symmetry principle.

V

GRATUITOUS TRANSFERS OF APPRECIATED PROPERTY

The tax rules have achieved less consistency with the symmetry principle in cases involving gratuitous transfers of appreciated property.⁹⁷ There are three primary types of gratuitous transfers of appreciated property: transfers during the life of the donor (usually to a close relative); transfers at the death of a decedent (also usually to a close relative) and transfers either during life or at death to a charitable organization. All three types are problematic, though to widely differing degrees.

Beginning with the most acceptable outcome, gifts of appreciated property made during the donor's lifetime are generally treated as other such gifts—there is no deduction by the donor and no inclusion by the donee. However, because the tax basis of such property in the hands of the donee is a transferred basis derived from the donor's basis, there is some shifting of tax liabilities from donor to donee.⁹⁸ It is in a sense a blend of the option 2 and option 4 approaches: up to the adjusted basis of the property, it is an option 4 approach; beyond that, it more closely resembles option 2, in the sense that any gain on the property realized upon a subsequent sale by the donee will be taxed to her and excluded (effectively achieving the same result as a deduction would have) from the donor's income.

96. Though union dues remain deductible, the more generous standard deduction and the limitations on deduction of "miscellaneous itemized deductions" presumably means that union members obtain significantly less benefit from deductions of union dues and assessments than was the case in the tax years involved in *Kaiser*.

97. The term "appreciated property" is used here to refer to property whose value at the time of the transfer is greater than its adjusted tax basis, so that sale of the same property would usually produce taxable gain. The spread between value and adjusted basis could occur either because of genuine market appreciation or because adjustments to basis to reflect such items as depreciation allowances have lowered the basis more than market factors have lowered the value. In fact, in the case of investments in real estate, it is common for both to occur with respect to the same item of property: as its market value rises, its tax basis may be falling due to depreciation allowances.

98. The basis rule is in I.R.C. section 1015. There is one exception to the transferred-basis rule: If the property has a value below its adjusted basis at the date of the gift, then for purposes of determining the donee's loss on the property on a subsequent sale, the basis is set at the fair market value at the date of the gift. This is to prevent taxpayers from transferring their losses to related taxpayers, a result that seems satisfactory, but leaves one wondering why Congress was not similarly concerned with the possibility explained in the text following this note that taxpayers may be able to move their gains around within the family in whatever way suits them. The Supreme Court approved this rule as entirely consistent with the Constitution in *Taft v. Bowers*, 278 U.S. 470, 482 (1929).

This of course makes it possible for high-bracket taxpayers to arrange for their gains to be taxed at the rates that may apply to their lower-bracket relatives, by the simple device of transferring appreciated assets to them. Revenue is almost surely lost due to this rule, though perhaps not in large amounts.⁹⁹ The reasons for the hybrid rule are, like the basic rules of option 4 that the U.S. tax system has adopted, largely practical. If the gains on appreciated property given to another were to be taxed to the donor, the gift would presumably have to be a realization event. If it were not, there is a risk that the donor might die or otherwise escape tax jurisdiction prior to the donee's decision to realize the gains. Making a gift a disposition that constituted a realization event is neither distasteful nor unreasonable; but it may be unwise, at least in the light of other tax rules that will be discussed below. Making gifts taxable events would surely discourage the gifts that would be subject to that rule, which would both diminish utility generally (since the transaction is voluntary on both sides, it must be presumed to increase utility or the parties would not go to the trouble of engaging in it), and cause more property to be transferred at death, which would bring the transaction into a territory in which the relevant income-tax rules *are* distasteful and unreasonable.

The rule governing the basis of property transferred at death is simply that the property in question is given a basis in the hands of the transferee equal to the value of the property at the date of death.¹⁰⁰ This means, of course, that the gains a decedent enjoyed while holding her assets over her lifetime simply disappear for tax purposes when she dies. Well-advised taxpayers—a group that presumably includes most of the wealthy individuals who own most of the financial assets extant in this country—are well aware of this rule, and undertake considerable efforts not to realize gains if they are elderly or if death seems reasonably proximate for health reasons.

This rule is not easily defended, but those who try, including Congress itself, do so by reference to the supposed difficulties of establishing the transferor's basis when the transferor is no longer on the scene to provide any sort of help. This is, of course, not exclusively a problem associated with transfers at death. Even with respect to inter vivos transfers, the donor may not timely disclose his basis to the donee, who upon a later sale may need to reconstruct an estimated basis without the donor's help for any of a number of reasons. It is also true that

99. There are two reasons to doubt that much revenue is lost due to this rule. First, it may be that donees are more likely than donors to realize the gains built into the gifted property in the years immediately following the gift. The donees do, typically, have less liquidity than the donors, and may need the cash that can be realized from a sale. So the taxable event may be accelerated for gifted property compared with comparable property that remains in the hands of the party who bought it. Second, some amount of appreciated property that is *not* given away in this manner may still be held by the original owner at the time of her death, in which case the gains that accrued on that property during the decedent's lifetime will never be taxed at all, as explained in the next section of this article.

100. I.R.C. § 1014. The rule actually allows the executor to choose to value the property transferred as of the "alternate valuation date" which is exactly six months after the date of death. The alternate valuation date makes it easier to arrange for the appraisal of hard-to-value property, and in a rising market yields even more-favorable bases of assets.

most major forms of wealth holding are associated with substantial data-retention practices. Real-estate transfer records have long been adequate to establish purchase prices of real estate; brokerage firms keep reasonably good records with respect to securities purchases, and could readily be required to keep more. So the most problematic types of holdings—coin collections, personal effects, and the like—are also the ones that are relatively unimportant for income-tax purposes.

But if the absent-donor argument in favor of a market-value-at-date-of-death rule has any persuasive power, it also has a resolution: it suggests that a transferred-basis rule should be phased in over time—that Congress should implement changes as of a date certain, putting everyone on notice that preservation of basis information for her estate was now expected. Any long-time observer of the tax scene (or any newcomer with a knowledge of history) will know that this is precisely what Congress did in the Tax Reform Act of 1976. That Act imposed a rule that would, in the long run, give heirs a basis in property received from a decedent that was equal to the decedent's basis. But as a phase-in measure, Congress set December 31, 1976, as a date before which it would not tread on the decedent's basis; that is, any property held by the decedent as of that date would have a basis, for purposes of transfers at death, equal to its value on that day.

This enactment appeared to catch the financial world by surprise. Banks and trust companies had not geared up much opposition while this Act was being drafted and considered, apparently because they did not take it seriously. But, playing catch-up after enactment, the banking industry, expressing the interests of its institutional executors and administrators of estates, argued fiercely that the new rules imposed insuperable practical difficulties. The rule was suspended in the Revenue Act of 1978, and retroactively repealed in 1980, after a blistering tour de force by the banking lobbyists. One suspects that they were simply trying, on behalf of their wealthy clientele, to preserve an excessively generous and largely unjustified tax break, rather than expressing genuine concerns about the administrability of the new rules. But ulterior motives are hard to prove.

The third piece of the gifts-of-appreciated-property story—gifts of such property to charity—is even more convoluted, and just as unsatisfactory. The basic rule with respect to such gifts is that the donor is allowed to deduct the value of the donated property.¹⁰¹ The first opinion of the IRS had been to the contrary—that only the donor's basis in donated appreciated property could be deducted.¹⁰² But the Service quickly relented, and agreed, mistakenly, that the appropriate deduction amount was the value of such property.¹⁰³

That this rule is a clear error in accounting is not immediately obvious to everyone, as anyone who has taught a federal income-tax course knows. The

101. Treas. Reg. § 1.170A-1(c)(1) (as amended in 2008).

102. O. 979, 2 C.B. 148 (1920).

103. L.O. 1118, 2-2 C.B. 148 (1923).

error is essentially one of double-counting—counting the gain element of the gift as an item to be subtracted from income due to the deduction, while excluding the gain element from any computation of positive income. It can be illustrated by the following extended example: Suppose that three doctors, whose practices involve the provision of very expensive services, each earn \$500,000 in a particular year,¹⁰⁴ and suppose further that each puts aside \$100,000 of that amount in an investment fund of some sort. In the succeeding year, their paths diverge: Doctor A continues his full-time practice, again earns \$500,000, and in this year, he donates \$100,000 in cash to his preferred charity. Doctor B decides to devote one day each week to volunteer work in a local AIDS clinic. She receives only \$400,000 of income from her four-days-per-week practice. She might like to take a deduction for the value of the time or professional services she contributes to the clinic, but the regulations are clear in barring such a deduction.¹⁰⁵ And they are correct in doing so: the value of the services has already been excluded from her income for the simple reason that she did not receive compensation for them. Were she allowed to deduct that value as well, it would double-count the donated value. Her income after such a deduction would appear to be only \$300,000, when in fact she clearly has the full \$400,000 of income from her paid services at her command.

Dr. C continues to work a five-day week and earns \$500,000 for his services. But unlike Drs. A and B, whose investment funds have produced no net gains, Dr. C finds that his assets have appreciated over the course of the year to a value of \$200,000. He decides to donate these assets to his favorite charity. If he is allowed to deduct the value of those assets, he will be left after the deduction with a taxable income of only \$300,000. The same double-counting error can be seen in this as was described with respect to Dr. B above: the gain on the investment did not enter into any positive-income calculation, yet in addition to that exclusion, it is allowed as a deduction. Note that over the two-year period, each doctor has improved his or her economic position by \$900,000. Dr. A earned \$1,000,000, and gave away \$100,000 in cash; Dr. B earned \$900,000, having given away \$100,000 in services; and Dr. C has earned \$1,000,000 from his practice, and \$100,000 on his investment fund, and has given away \$200,000 of assets. By their different routes, each has improved his or her economic position by the same net amount, before consideration of taxes. But Drs. A and B will be taxed on the full measure of their \$900,000 improvement in position, while Dr. C will only be taxed on \$800,000 of net economic gain, if he is allowed to deduct the full value of his charitable gift.

The combination of excluding gain but allowing deduction of gain elements in charitable gifts can reach almost comic proportions in the case of gifts of self-created property. Imagine, for example, that a very successful artist is

104. For convenience, assume that this amount is in excess of any exemptions or deductions (other than the charitable-contributions deduction under examination) that might be allowed, so that this amount would equal each doctor's taxable income.

105. Treas. Reg. §1.170A-1(g) (as amended in 2008).

contemplating the sale of the last three paintings she has created in, say, 1965. She knows that she can sell each for about \$100,000. But she knows also that she is already in the top marginal tax bracket of 70%, so that selling all three paintings for \$300,000 total will net only \$90,000 after application of the 70% rate. She will do better, however, if she sells just two and gives the third to charity, so long as she can deduct the value of the donated painting. Her marginal income will be \$200,000 from the sale of two of the paintings, but she will qualify (by assumption of this hypothetical) for a contributions deduction of \$100,000, leaving her at the margin with additional taxable income from the last three paintings of only \$100,000 and a tax bill with respect to that income of only \$70,000. But recall that she collected a full \$200,000 for the two paintings she sold; she thus has \$130,000 remaining after tax from the disposition of the three paintings. The situation is thus one in which the artist can earn greater after-tax income if she gives away some of her work than if she sells it all. A more conclusive demonstration of defective accounting is difficult to imagine. The contributions deduction is premised on the idea that the taxpayer suffers some sacrifice in making the donation; in this case, the donation has turned out to be a profit center from a tax viewpoint.

This precise scenario was possible until 1969, when Congress responded to some of the abuses in this area by enacting several provisions of the Tax Reform Act of 1969 dealing with gifts of appreciated property.¹⁰⁶ The full detail of those changes is unnecessary for the analysis here, but a brief description will make clear that while Congress filled a few loopholes with this Act, it left the fundamental accounting error solidly in place. In essence, Congress limited the deduction of the full value of gifts of appreciated property, but only for gifts of assets whose sale would have generated long-term capital gain.¹⁰⁷ This takes care of the artist's abusive transaction, since her paintings would be inventory,¹⁰⁸ and not eligible for capital-gain treatment.¹⁰⁹ It also limits deduction of gains on property held for less than one year. Both of those types of gifts are deductible, but only to the extent of the taxpayer's basis in the asset.

What was left, of course, was most of the previously existing range of abuse in this area. It is still possible to make a gift of appreciated real estate or stock to a university, or an appreciated work of art to a museum, with the knowledge that, so long as the property has been held for at least a year, a deduction of the full value will be allowed.

106. Tax Reform Act of 1969, Pub. L. No. 91-172, § 201, 83 Stat. 487, 549-55 (1969).

107. This is oversimplified in several respects, none of which are relevant for present purposes. For the full details on contributions of appreciated property, *see* I.R.C. § 170(e).

108. The paintings would not in fact truly be inventory, but they would be treated similarly to inventory in terms of their status as other than a capital asset by I.R.C. section 1221(a)(3).

109. The Tax Reform Act of 1969 also limited the percentage of income that could be deducted in the form of appreciated-property contributions to a maximum of 30% of the taxpayer's "contribution base," essentially his adjusted gross income. Pub. L. No. 91-172, § 201(b)(1)(D), 83 Stat. at 551.

In 1986, Congress did make one timid attempt to further limit the application of this defective accounting for gifts: it added rules, in I.R.C. section 57(a)(6), that would have made the gain portion of the contributions deduction—the portion that embodies the double-counting defect—a tax preference item for alternative minimum tax (AMT) purposes. That would have meant that taxpayers who were in the range of exposure to AMT liabilities would find that for purposes of that tax calculation, only the basis of contributed assets would be deductible. Unfortunately for universities and museums, those taxpayers included many who were in a position to make large appreciated-property gifts.¹¹⁰

This led to a repetition of the carryover-basis saga of the decade before. In this case, the lobbyists were universities and museums, rather than banks, but they were working from the same playbook. Characterizing Congress's modest attempt to diminish the effects of defective accounting for appreciated property gifts as "punitive" to the arts community, museums asserted that the era of museum acquisition of great art by charitable gift was over, and that future generations would be able to view important new art only if they happened to be wealthy enough to buy it. The campaign worked, and, like the carryover basis rules, the AMT rules with respect to charitable gifts of appreciated property were first suspended, then repealed altogether with retroactive effect.¹¹¹

The rules in this area thus achieve a super-charged version of the option 3 outcome: if the gift meets minimal conditions to qualify for the deduction of full value, deductions are allowed not merely for the amount sacrificed by the donor but for an amount that has been inflated by gain on which the donor has never been taxed.

VI

CONCLUSIONS AND RECOMMENDATIONS

When the historical analysis of the third, fourth, and fifth parts of this paper are overlaid on the theoretical framework of the second part, two very different pictures emerge. As to what might be called the background rules of gifts,

110. In recent years, largely because of Congress's failure to index the AMT, or to cut its rates in parallel with the rate cuts under the regular income tax, the AMT has come to bear more heavily on taxpayers who are merely comfortable, rather than truly wealthy. That was not the case in 1986, however. For example, in 1987 only 140,000 taxpayers paid the AMT. For 2007, the number was projected to be 22 million, with 80% of taxpayers having incomes between \$100,000 and \$200,000 paying the AMT. JOINT COMMITTEE ON TAXATION, PRESENT LAW AND BACKGROUND RELATING TO THE INDIVIDUAL ALTERNATIVE MINIMUM TAX (JCX-38-07) 9, 14, (June 25, 2007), *available at* <http://www.jct.gov/x-38-07.pdf>.

111. *See* Tax Extension Act of 1991, Pub. L. No. 102-227, § 112, 105 Stat. 1686, 1689 (suspending provision treating untaxed appreciation of capital gains of donated personal property for alternative minimum tax); Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13171, 107 Stat. 312, 454 (repealing untaxed capital gains on charitable contributions as a tax-preference item for the alternative minimum tax).

including the treatment of faux gifts, the income tax has achieved reasonable coherence, meeting both its policy goals and the practical constraints of the system within which the rules operate. With the benefit of historical perspective, some amount of bumbling is apparent, especially on the part of the Supreme Court, which has had several at-bats with which to address this issue, but has largely whiffed on those opportunities. But the Executive and the Congressional branches of the government have succeeded in embodying the symmetry principle in legislative and administrative positions that reasonably control abuse and neither create nor destroy income that is appropriately within the tax base.

In contrast, the rules as to appreciated property include two of the most egregious errors in our tax rules, allowing in one case a substantial amount of gross income to be buried with decedents, and allowing in the other case donors to charity to take contribution deductions that systematically exaggerate their sacrifice. And the heroes of the first story are the villains of the second, because it is some combination of administrative and Congressional missteps that have created and sustained the defective accounting rules for gifts of appreciated property.

The recommendations that emerge from this analysis are virtually nil with respect to the background tax rules on gifts; those rules serve their purposes reasonably well. Alternatives could be imagined, but it is not clear that any would be superior to the present rules, and it is clear that many alternatives would be worse.

As to appreciated property, technical solutions to the defects in the present rules are readily at hand. It would be fatuous to urge Congress to show some backbone, ignore the lobbyist torpedoes, and move straight to the obvious reforms. But, to address the growing revenue needs of the country, it may be slightly helpful to suggest that when the time arises, as it soon will, some consideration be given to questions that touch on the integrity of the tax base. The two errors discussed with respect to appreciated property should occupy prominent positions on any list of items threatening the integrity of the tax base, and it may be hoped that in the context of a broader effort to address revenue needs, these items might receive the appropriate consideration.