The “Charities” Provisions of the Internal Revenue Code

Joseph B. Lynch
By the "charities" provisions of the Internal Revenue Code are meant those sections or subdivisions of the Code which relate to a corporation, trust, or community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals, or which relate to gifts or bequests for the above described purposes. These provisions represent a development in Federal tax laws extending over many years. Thus, while the Revenue Act of 1913 exempted religious, charitable, scientific and educational corporations from income taxes, contributions to such organizations were first allowed as income tax deductions to individuals in the Revenue Act of 1917, to estates and trusts in the Revenue Act of 1918, and to corporations in the Revenue Act of 1935. In the Revenue Act of 1917, income tax deductions were permitted to individuals for contributions to corporations or associations organized for the purposes therein described. The provision was expanded in the Revenue Act of 1921 to include a community chest, fund or foundation, and in the Revenue Act of 1924 to include a trust. In the Revenue Act of 1938 it was restricted to such organizations only if "domestic", and in the Revenue Act of 1939 it was somewhat broadened to include such organizations, if "created or organized in the United States or in any possession thereof or under the law of the United States or of any State or Territory or of any possession of the United States". Meanwhile, the provision with respect to income tax deductions to individuals was altered from time to time in other respects. New charities provisions were added, and these in turn were amended in the successive revenue acts, now by way of enlargement, now by way of limitation. Today, the provisions are fairly numerous, but instead of the finely coordinated series of sections which one might expect as a result of gradual evolution over so long a

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1. Income tax deductions: Internal Revenue Code, 26 U. S. C. A. §§ 23(o), 120 (citizens and residents); §§ 23(q), 102(d)(1)(B) (corporations); § 162(a) (estates and trusts); § 183(c) (partnerships); § 213(c) (nonresident alien individuals); § 232(b) (foreign corporations); § 336(a)(2) (foreign personal holding companies); 505(a)(2) (personal holding companies).

Income tax exemption: Internal Revenue Code, 26 U. S. C. A. § 101(6). Also exemption from other taxes, e.g., capital stock taxes [§ 1201(a)] by reference to § 101.

Estate tax deductions: Internal Revenue Code, 26 U. S. C. A. § 812(d) (estates of citizens and residents); § 861(a)(3) (non-resident aliens).

Gift tax deductions: Internal Revenue Code, 26 U. S. C. A. § 1004(a)(2) (citizens and residents); § 1004(b) (non-resident aliens).

Employment tax exclusions: Internal Revenue Code, 26 U. S. C. A. §§ 1426(b)(8), 1607(c)(8).

period, an examination of the charities sections of the Code discloses a con-
glomeration of inconsistencies, inaccuracies and omissions.

The public policy underlying the charities provisions is indicated in the Ways
and Means Committee Report on the Revenue Bill of 1938, C. B. 1939—1, 742,
as follows:

"The exemption from taxation of money or property devoted to charitable and
other purposes is based upon the theory that the Government is compensated for
the loss of revenue by its relief from financial burden which would otherwise have
to be met by appropriations from public funds, and by the benefits resulting from
the promotion of the general welfare. The United States derives no such benefit
from gifts to foreign institutions, and the proposed limitation is consistent with
the above theory. If the recipient, however, is a domestic organization the fact that
some portion of its funds is used in other countries for charitable and other purposes
(such as missionary and educational purposes) will not affect the deductibility of
the gift."

The Congressional theory, whether one accepts it as sound or rejects it as too
narrow, especially in these times, is that gifts to foreign institutions confer no
benefit upon the United States. Except as circumscribed by this theory, the
Congressional policy is to encourage gifts to charity, which promote the general
welfare or relieve the Government of financial burdens. The present Code
provisions, however, do not appear fully to reflect the above stated theory, nor
do judicial interpretations of the charities provisions always harmonize with
the underlying Congressional policy.

In the interpretation of the charities sections of the Code, the ordinary
rules of judicial construction are usually thrust aside. There are probably
no rules more familiar to the tax practitioner than that a tax deduction, being
a matter of legislative grace, must, to be sustained, be brought squarely within
the statutory language, and that exemption provisions are strictly construed.
The most recent statement of the general rule by the Supreme Court was made
in Deputy v. DuPont, in which Mr. Justice Douglas, delivering the opinion of
the Court, said:

"But allowance of deductions from gross income does not turn on general equitable
considerations. It 'depends upon legislative grace; and only as there is clear pro-
vision therefor can any particular deduction be allowed'. New Colonial Ice Co. v.
Helvering, 292 U. S. 435, 440."2

This was an income tax case involving the deduction of a business expense.
The same rule has since been reechoed by Judge Bratton in his dissenting
opinion in Commissioner v. Bonfils Trust, as follows:

"Deductions from gross income depend upon legislative grace. They do not rest
upon equitable considerations. A taxpayer seeking a deduction must find his claim
upon a statute and bring himself within its terms."3

3. 115 F. (2d) 786, 793 (C. C. A. 10th, 1940).
This, also, was an income tax case involving, however, a deduction for a charitable contribution. The Court declined to be bound by the rule, but followed the theory that since it was the purpose of Congress to encourage charitable gifts, the provisions of the statute should be construed so as to further and not to hinder their beneficent purpose. Although the dissenting Judge pointed out that it could not "be foretold with absolute certainty" that the funds in question were "permanently set aside" for charitable purposes, the Court took a practical view and held that the statute did not require absolute certainty.

But even starting with the premise that the legislative policy is to encourage transfers to charitable institutions, and that the judicial inclination is to effectuate that policy, there are certain definite limitations beyond which even the most liberal-minded court will not pass.

Developing the foregoing considerations, the scope of this paper is to note the inconsistencies, inaccuracies and lack of uniformity in the charities provisions, to demonstrate the lengths to which the courts have gone to favor the charities, and to mark the outside boundaries.

I. Inconsistencies in the Present Provisions

Two of the limitations which the Code provides upon tax deductions for gifts and bequests to charities are the limitations with respect to (1) the place of creation or organization of the charity, and (2) the place where the gift is to be used. The following table indicates such limitations:

<table>
<thead>
<tr>
<th>Sections of I. R. C.</th>
<th>Tax Deduction</th>
<th>Donee</th>
<th>Place of Organization of Charity</th>
<th>Place Where Gift to be Used</th>
</tr>
</thead>
<tbody>
<tr>
<td>23(o) Income tax</td>
<td>Corporation</td>
<td>U. S. or Possessions</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>(Citizen or Res.)</td>
<td>Trust, &amp;c.</td>
<td></td>
<td>&quot;</td>
<td></td>
</tr>
<tr>
<td>23(q) Income tax</td>
<td>Corporation</td>
<td>&quot;</td>
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<tr>
<td>(Corporation)</td>
<td>Trust, &amp;c.</td>
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<tr>
<td>162(a) Income tax</td>
<td>Corporation</td>
<td>&quot;</td>
<td>U. S. or Possessions</td>
<td></td>
</tr>
<tr>
<td>(Estate or Trust)</td>
<td>Trust, &amp;c.</td>
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<td>&quot;</td>
<td></td>
</tr>
<tr>
<td>213(c) Income tax</td>
<td>Corporation</td>
<td>U. S.</td>
<td>&quot;</td>
<td></td>
</tr>
<tr>
<td>812(d) Estate tax</td>
<td>Corporation</td>
<td>None</td>
<td>&quot;</td>
<td></td>
</tr>
<tr>
<td>(Citizen or Res.)</td>
<td>Trustee</td>
<td></td>
<td>&quot;</td>
<td></td>
</tr>
<tr>
<td>861(a)(3) Estate tax</td>
<td>Corporation</td>
<td>U. S.</td>
<td>&quot;</td>
<td></td>
</tr>
<tr>
<td>(Nonres. Alien)</td>
<td>Trustee</td>
<td>None</td>
<td>U. S.</td>
<td></td>
</tr>
<tr>
<td>1004(a)(2) Gift tax</td>
<td>Corporation</td>
<td>&quot;</td>
<td>&quot;</td>
<td></td>
</tr>
<tr>
<td>(Citizen or Res.)</td>
<td>Trust, &amp;c.</td>
<td>&quot;</td>
<td>&quot;</td>
<td></td>
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<tr>
<td>1004(b) Gift tax</td>
<td>Corporation</td>
<td>U. S.</td>
<td>&quot;</td>
<td></td>
</tr>
<tr>
<td>(Nonres. Alien)</td>
<td>Trust, &amp;c.</td>
<td>None</td>
<td>U. S.</td>
<td></td>
</tr>
</tbody>
</table>
It will be noted that there is little uniformity in these limitations. For some of the differences there is a sound foundation; for others, no reasonable explanation is apparent. In the case of a citizen or resident claiming an income tax deduction for a charitable contribution, the limitation with respect to the place of organization of the charity is the United States or its possessions, while in the case of a nonresident alien claiming a similar deduction, the limitation with respect to the place of organization of the charity is the United States, which excludes its possessions. This discrepancy is not illogical. Since the nonresident alien is taxed only on income from sources within the United States, excluding its possessions, it is quite consistent that his deduction for charitable contributions should be limited to organizations created in the United States. But not all of the differences are so logical.

(1) If a citizen or resident is allowed an income tax deduction for gifts to a corporation only if the corporation is organized in the United States or its possessions, why should he be allowed a gift tax deduction for gifts to a corporation, irrespective of the place of organization of the corporation? Accepting the announced Congressional theory that the “United States derives no . . . benefit from gifts to foreign institutions”, is it not inconsistent to disallow as an income tax deduction a gift to a foreign corporation, but to allow as a gift tax deduction a gift to the same corporation?

(2) If a citizen or resident is allowed an income tax deduction for gifts to a trust, community chest, fund or foundation only if the donee is created in the United States or its possessions, why should a corporation be allowed an income tax deduction for gifts to a trust, community chest, fund or foundation only if both (a) the donee is created in the United States or its possessions, and (b) the gifts are to be used in the United States or its possessions? What public policy dictates that only one limitation should be imposed in the case of an individual taxpayer, and two limitations in the case of a corporate taxpayer?

(3) If a nonresident alien is allowed an income tax deduction for gifts to a community chest, fund or foundation, if the donee is created in the United States, whether or not the gifts are to be used in the United States, why is a nonresident alien allowed a gift tax deduction for gifts to a community chest, fund or foundation, if the gifts are to be used in the United States, whether or not the donee is created in the United States? Why, for the purpose of one tax, should the limitation be with respect to the place of organization of the donee, and, for the purpose of the other, the place where the gift is to be used?

Among the discrepancies of lesser importance may be noted the following:

(a) In the sections of the Code allowing to citizens or residents and to cor-

porations income tax deductions for charitable contributions, the deductions are allowable if the contributions are "to or for the use of" the specified charities, but in the section relating to nonresident aliens, the deduction is allowable only if the contribution is "to" the specified charities.

(b) Similarly, in such sections, the specified charities include a "trust, or community chest, fund, or foundation", while Section 213 (c) specifies "community chests, funds, or foundations" but not trusts.

(c) The phrase "under the law of the United States or of any State or Territory", appearing in Section 23 (o) and elsewhere in the Code, in relation to the place of organization of the charity, is amplified in Section 23 (q) to "under the law of the United States, or of any State or Territory, or of the District of Columbia".

(d) Organizations created "for the prevention of cruelty to children or animals", specified in Section 23 (o) and elsewhere in the Code as qualified charities, are, in Section 23 (q), limited to organizations created "for the prevention of cruelty to children".

(e) The phrase, "encouragement of art", is included as an educational purpose under the gift tax provisions in relation to a gift to a corporation or foundation organized for educational purposes, and in relation to a gift to a fraternal society to be used for educational purposes, and is included as an educational purpose under the estate tax provisions in relation to a bequest to a corporation organized for educational purposes, but is not included therein in relation to a bequest to a fraternal society to be used for educational purposes; nor is the phrase included as an educational purpose in any of the income tax provisions of the Code.

(f) Throughout the Code, a charity, wherever described, is uniformly restricted by the clause:

"no part of the net earnings of which inures to the benefit of any private shareholder (in some sections 'stockholder') or individual",

except in Section 1004 (b) (3), providing for certain gift tax deductions in the case of nonresident aliens, wherein the restrictive clause is omitted.

From the foregoing it is apparent that the charities provisions of the Code are scarcely models of coordination or draftsmanship. Revisions based upon the following considerations should, it is thought, result in an improvement:

If Congress wishes to impose a limitation on deductions for gifts to incorporated charities by reference to the place of organization of the charity (U. S. or possessions), the limitation should be made uniformly to apply to gifts by citizens or residents, by corporations and by estates and trusts, under the income tax provisions, and by citizens or residents, under the estate and gift tax provisions, of the Code.

If Congress wishes to impose a limitation on deductions for gifts to unincorporated charities by reference either to the place of organization of the charity (U. S. or possessions), or to the place where the gift is to be used (U. S. or possessions), the limitation should be made uniformly to apply to gifts by citizens or residents, by corporations and by estates and trusts, under the income tax provisions, and by citizens or residents, under the estate and gift tax provisions of the Code.

If Congress wishes to impose a limitation on deductions for gifts to unincorporated charities by reference either to the place of organization of the charity (U. S.), or to the place where the gift is to be used (U. S.), the limitation should be made uniformly to apply to gifts by nonresident aliens under the income tax, estate tax and gift tax provisions of the Code.

In the interest of simplicity and accuracy, it appears that the Code should supply a definition of the term "charity", the defined term to be substituted for the lengthy and varying descriptions of charities now appearing in the several charities provisions. Thus, Section 3797, which defines various terms, might be amended by adding a further subdivision to read:

"The term 'charity' means 'any corporation, trust or community chest, fund or foundation organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation'."

II. The Extent of Judicial Liberalization

(a) Charitable and Educational Organizations

The courts have defined "charitable" in many tax cases, relying on sources that hark back to the days of Chancellor Kent, and even to biblical quotations. The application of the definitions to cases arising under the revenue laws has, however, produced some extraordinary results.

Thus, in *Gimbel v. Commissioner,*14 deductions were allowed for contributions to Gimbel Brothers Foundation whose "main or dominant purpose" was the grant of pensions to employees of Gimbel Brothers, Inc. The Board of Tax Appeals15 found no evidence that the financial condition of the recipients was one of the reasons which entitled such persons to pensions. Another purpose of the Foundation was "carrying life insurance of employees". This, too, was "regardless of their financial need". To label an organization "charitable" whose principal object is to grant pensions without reference to the financial needs of the pensioners, was too liberal a construction for the Board.
to allow, but the Court held the donations to be deductible as contributions to charity.

Similarly, in *Havemeyer v. Commissioner*, an organization was formed and operated by members of a family and a close business associate. It was customary for each contributor to suggest the person to be aided, and the funds were mainly given to old family retainers. The Board of Tax Appeals, thought that the purpose of the organization was "to confer a private benefit" on those in whose welfare the petitioner and his family were interested, and that neither the public nor the community in general was concerned in any way. Although the policy underlying the statute does not seem to have envisaged such a family association dispensing private gifts as a charitable organization, the Court held it to be such, reversing the Board.

The term "educational", like the term "charitable", is also given the broadest application. As construed by the courts, the term relates rather to the "imparting of knowledge" than to "the training of the mental and moral powers". Obviously, this opens a wide field. Thus, in *Weyl v. Commissioner*, the Board held that the League for Industrial Democracy, whose object was "education for a new social order based on production for use and not for profit", was not an educational corporation, since its printed literature, "far from being devoted to 'educating' in the sense of presenting both sides of the matter in which it was interested, advocated its side". Member Sternhagen dissented, agreeing, however, that "as used in the statute the word educational does not carry the broadest signification to be found in the dictionary"; but the Circuit Court, after quoting with approval the most comprehensive dictionary definition, reversed the Board.

The latest published court decision relating to an educational corporation under the Code, deals with the question whether an organization, one of whose main objectives was "to warn the unsuspecting purchaser . . . against the fascinating and intriguing neighborhood canvasser and impostor", and to stress "integrity in advertising and in business transactions", was a corporation organized exclusively for educational purposes, and, as such, exempt from employment taxes. For income tax purposes, the Internal Revenue Bureau had classified the organization as a civic league. As such, it would not be exempt from Social Security taxes. The Court, although admitting that the question was novel, and one on which the appellate courts had not passed, held the organization to be exclusively educational.

In *U. S. v. Proprietors of Social Law Library*, the Court had under con-

18. 18 B. T. A. 1092 (1930).
sideration the question whether a private law library was exempt from Federal capital stock taxes. The Library was financed by and open mainly to subscribers within the legal profession. The Court, observing that it was "of inestimable benefit to the public" that all cases arising in the practice of law be subjected to the widest possible examination and study, and that the knowledge acquired by lawyers through the facilities of the Library resulted in "the better administration of the law", affirmed the District Court which had allowed the exemption. The fact that lawyers, individually, received "direct benefits in their business from the acquisition of knowledge contained in the books of the Library" was disregarded as incidental and immaterial. In view of the foregoing, it would seem that the finding in *Cook v. Commissioner*,22 that the Association of the Bar of the City of New York was not an educational corporation, might be otherwise, if the question arose again. Article II of the Bar Association's Constitution provides:

"The Association is established for the purposes of cultivating the science of jurisprudence, promoting reforms in the law, facilitating the administration of justice, elevating the standard of integrity, honor and courtesy in the legal profession, and cherishing the spirit of brotherhood among the members thereof."

If, in the cited cases, the Better Business Bureau, stressing integrity in advertising and business, and the Library, promoting "the better administration of the law", are corporations organized and operated exclusively for educational purposes, the Bar Association might well be given a similar classification under the Code. This is especially likely since the Board in the *Cook case*23 complained that the evidence did not show to what extent the Bar Association in its actual activities was "educational" as distinguished from "social".24

The requirement of the Code that organizations, to come within the scope of the charities provisions, must be organized and operated *exclusively* for the purposes enumerated, has been somewhat emasculated by court decisions. An organization wherein social features predominate can scarcely be classified as an exclusively charitable or educational organization. College fraternities, for example, despite their close connection with institutions of learning, are predominantly social organizations, yet in *Smith v. Commissioner*25 gifts to the

22. 30 B. T. A. 292 (1934).
24. However, a bequest to the Waterbury Medical Association was held not to be deductible in *Colonial Trust Co. v. Commissioner*, 19 B. T. A. 174 (1930). The Association's purposes were threefold: "(1) To establish the practice of medicine and surgery in the city of Waterbury upon a respectable footing; (2) to devise and carry into effect measures for the mutual improvement of the members, and (3) to promote a good understanding and harmonious intercourse with each other." The Board decided that these were not purposes envisaged by the statute. The Board also denied a deduction for a gift to the American Institute of Accountants whose object was to "unite the accountancy profession . . . ; to safeguard the interests of public accountants . . . ; to encourage cordial intercourse among accountants." *May v. Commissioner*, 1 B. T. A. 1220 (1925).
25. 28 B. T. A. 422 (1933).
national organization and certain local chapters of Chi Psi Fraternity were held deductible, presumably (since there was no evidence of the use to which the gifts in question were to be put), on the ground that the fraternity was an educational organization. The Board relied chiefly on evidence that the charter and by-laws of the local chapters contained scholastic standards for admission to the fraternity, and also a system of tutoring by upper classmen in the various chapters.

Although even before the amendment to the revenue laws restricting organizations within the charities provisions to those "no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation", it was recognized that an organization formed to disseminate such propaganda was not educational, organizations apparently vulnerable on that score have been given an exempt status. Thus, in Leubuscher v. Commissioner, it was held that one of the Manhattan Single Tax Club's purposes was to advocate the Henry George doctrine, that to advocate meant "to plead in favor of", and that this did not express an educational purpose, but rather a purpose to disseminate controversial propaganda. In the same case, however, the court reversed the Board which had disallowed an estate tax deduction for a bequest to a corporation the purposes of which were, not only to disseminate the Henry George theories, but also "to assist in all proper ways to establish the same in practical operation of law". The decedent's will contained the recital:

"Being firmly convinced that the principles expounded by Henry George in his immortal book entitled 'Progress and Poverty' will, if enacted into law, give equal opportunity to all and tend to the betterment of the individual and of society",

and provided a bequest to a corporation directed to be formed "for teaching, expounding and propagating the ideas of Henry George". The Board, correctly, it seems, held that the bequest was not deductible, saying that despite the fact that the corporation's activities had been confined to libraries and colleges, "the power to engage in legislative and other nonelectoral operations deprives the corporation of the exclusively educational or charitable character required by the statute". Here was an organization devoted to propagating ideas its founder wished to see "enacted into law", an organization formed to establish such ideas "in practical operation of law". Was it not an over-liberalization of the statute to hold that such an organization did not have for one of its main purposes the advocacy of the Henry George principles? Was not the organization quite as vulnerable, from the standpoint of the charities provisions, as the Manhattan Single Tax Club?  

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26. 54 F. (2d) 998 (C. C. A. 2d, 1932).
28. Contributions have been held not deductible because the organization was engaged in legislative activities. Fales v. Commissioner, 9 B. T. A. 828 (1927) (International Reform Bureau, Massachusetts Anti-Saloon League, and Massachusetts Anti-Cigarette League);
In *Faulkner v. Commissioner* 20 the Board had disallowed an income tax deduction for a gift made in 1935 to the Birth Control League of Massachusetts. The first object of the League was to collect and correlate information regarding birth control and educate the public on the subject. Its principal activities consisted of operating Mothers' Health Offices at which contraceptive advice was given. One of the Health Offices in Massachusetts had been closed by the police in 1937. In 1938, the Supreme Court of Massachusetts found that at that office the Massachusetts Penal Statutes had been violated. The Board held that it

"would be contrary to public policy, if not directly contrary to the intention of Congress, to construe the Federal taxing statute as granting privileges to taxpayers which would lend encouragement to the support of activities inimical to the laws of the several states",

but the Circuit Court, reversed, holding that the illegal acts had occurred after the gift, and that even if the activities were illegal,

"it would not necessarily follow that the deduction should be disallowed. Interpretation of the word 'charitable' in a federal revenue act is a matter of federal, not local, law." 30

This would seem to open up interesting possibilities. Would it not be an anomalous situation that an organization illegally operated under a State law, could be favored by tax exemption under a Federal law?

The difficulty, of course, with over-liberalization of the charities provisions is that it may in time produce a public reaction in which organizations clearly entitled to the benefits of the Code provisions and those whose right thereto is not so clear will suffer alike. The statement of Acting Director C. B. Pond of the New York State Research and Statistical Bureau, appearing in the July, 1940 issue of *The Tax Magazine* that the "majority of citizens regard tax exemptions as a parasitic growth upon taxable values, one which in time may destroy its host", is surely an exaggeration, but there is a considerable body of public opinion opposed to further extension of exemption in matters of local taxes. May not ultra-liberalization of the Code provisions by judicial decisions cause the pendulum to swing in the opposite direction in matters of Federal taxes?

**[b] Limitations Based on Net Income**

The statutory limitation upon deductions for charitable contributions relates

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*Cf. Forbes v. Commissioner*, 7 B. T. A. 209 (1927) (American School Citizenship League);

*Cf. Cochran v. Commissioner*, 78 F. (2d) 176 (C. C. A. 4th, 1935) (World League Against Alcoholism);


29. 40 B. T. A. 1379 (1939).

only to income taxes, affects only individuals and corporations, and is measured by 15% of the net income, excluding charitable contributions in the case of an individual, and 5% thereof in the case of a corporation. In holding that a capital net gain should be included in the computation of income to which the 15% limitation applies, the Supreme Court observed that the charities provisions and the capital gains provisions

"were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed."31

If, in the case of a capital net gain, the gain should be added in arriving at the base to which the percentage formula applies, it appeared to the Commissioner that in the case of a capital net loss the loss should be deducted from such base; but the Court of Claims in a carefully reasoned opinion,32 held that such was not the Congressional intent, and the Supreme Court, repeating the observation quoted above added: "That observation is equally pertinent here",33 and affirmed the judgment of the Court of Claims.

Applying these decisions to the present provisions of the Internal Revenue Code, the Bureau has ruled34 that in all cases where there is a net long-term capital gain, the gain is to be included in computing the income to which the 15% limitation applies, and that in all cases where there is a net long-term capital loss, and the taxpayer computes his tax under the alternative provisions, the capital net loss is not to be taken into account in computing the income which is the basis of the 15% limitation.

One further problem in relation to the 15% limitation remained for judicial determination—whether, where a husband and wife file a joint return, the aggregate income of both, or only the income of the spouse making the contribution, should be the base for the percentage formula. After an uphill fight, the taxpayer prevailed. Mr. and Mrs. H. W. Taft's 1934 joint income tax return showed an aggregate net income of over $83,000, after a deduction of $2,852 on account of contributions made by both. Mrs. Taft's net income before any deduction for charitable contributions was only $12.10. Her contributions amounted to $1,477. Of the last mentioned amount, the Commissioner disallowed all but $1.81 (15% of $12.10). The 1935 joint return reflected a similar situation. The Board sustained the Commissioner,35 ruling that the "spouses do not lose their identities as individual taxpayers by joining in a single income tax return". The circuit court affirmed per curiam,36 but the Supreme Court reversed,37 holding that the base for the calculation of the

34. I. T. 3345, C. B. 40-1, 54.
contribution deduction was the aggregate income of the husband and wife.

The liberality of the courts in construing the charities provisions even extends to approval of an obvious device for the purpose of avoiding the 15% limitation. Thus, in *Andrus v. Burnet*, eight individuals transferred property worth $400,000 to a charity, and took back notes of $400,000 in denominations of $10,000 maturing serially over five years. The notes were cancelled as they matured, and the grantors sought corresponding income tax deductions for charitable contributions during the years of such cancellations. The Board had ruled that when the property was transferred to the corporation, a gift thereof was made then and there, and disallowed the deduction in the subsequent years; but the Circuit Court upheld the device and allowed the deduction, seeing no "wrongful evasion of the tax... even if conceded to have been an arrangement of properties to minimize taxation". If the *Andrus* case had involved any provisions of the Code other than the charities provisions, is it not likely that the arrangement for issuing and cancelling notes would have been characterized as a mere ritual, to be ignored for tax purposes?

An even broader avenue of escape was allowed by the Board in *Giannini v. Commissioner*. In this case, the taxpayer had declined to accept compensation for services rendered to a corporation of which he was President, in addition to the amount previously credited to him, although the Board of Directors had unanimously adopted a committee report recommending such additional compensation. He had indicated to his Board, however, that he would find keen satisfaction in seeing the corporation, if it should be so minded, devote the money to the establishment of a foundation by the University of California. It was then estimated that the compensation would amount to $1,500,000. Thereupon, the Board approved the donation to the University. When, later on, it was ascertained that the actual amount of the proposed compensation was short by approximately $140,000 of the original estimate, the taxpayer personally made up the difference. The Board held that he was not taxable on any part of the compensation so voted to him but actually donated to the University. Here, again, it may be doubted whether the same result would have been reached had the donee of the fund been other than a charity.

If taxpayers were permitted "carry-overs" of excess contributions, resort would not so frequently be made to obvious devices designed to avoid the 15% limitation, such as that employed in the *Andrus* case or that of lending an art collection to an educational corporation in one year, and donating from year to year thereafter specified works in the collection.

To the rule that an individual's deductible charitable contributions may not exceed 15% of his income, the Code provides a single exception. The enactment of this provision arose from an unusual situation. A wealthy

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40. 42 B. T. A. 546 (1940)
41. 26 U. S. C. A. § 120.
woman, having become a nun, relinquished her income to the religious order with which she was affiliated. She had paid no taxes on the income over a period of years, but the Internal Revenue Bureau, applying the 15% statutory limitation, found substantial taxes due. Recognizing the equities of the case, Congress, in the Revenue Act of 1924,\textsuperscript{42} provided that the 15% limitation should not apply if, in the taxable year, and in each of the ten preceding taxable years, the charitable contributions exceeded 90% of the taxpayer's net income for each year, as computed without the benefit of deductions for such contributions. It was then discovered that since a substantial part of the net income was needed to pay the taxes due for prior years, the new provision served no purpose, whereupon, in the Revenue Act of 1928,\textsuperscript{43} Congress amended the section to provide for an unlimited deduction if the charitable contributions plus income taxes for each of the years aggregated 90% of the net income.

Only one case under this section has come before the Board of Tax Appeals. In that case, the deduction for charitable contributions was disallowed because, although the donor's contributions and income taxes for the ten-year period averaged over 90% of his income, there were three years in which the percentage was less than 90% of the income. Since the statute applied only in case "in each of the ten preceding taxable years" the contributions and taxes exceeded 90% of the income, the Board was constrained to hold:

"We cannot disregard language so specific as that which is set forth in the statute."\textsuperscript{44}

(c) Income Tax Deductions of Estates and Trusts

The charities provision allowing income tax deductions to estates and trusts differs from the other charities provisions allowing such deductions in that it is not necessary thereunder that the gift be paid to an organized charity, but is sufficient that "pursuant to the terms of the will or deed creating the trust" it be "permanently set aside" for charitable purposes. As in the case of all the other charities provisions, the rule of liberal construction has been applied here. The term "permanently set aside", as judicially interpreted, means not "with absolute certainty permanently set aside", but "in all probability permanently set aside"; the term "pursuant to the terms of the will or trust instrument" means not "as required" by such terms, but "as permitted" by such terms, and the term "to be used exclusively for charitable purposes" does not preclude use for other purposes. The following cases illustrate the point.

In \textit{Commissioner v. Bonfils Trust}\textsuperscript{45} the terms of the decedent's will required that capital gains be added to the corpus of the trust, which was payable to a charity after the death of the last survivor of several annuitants. One of the

\begin{thebibliography}{9}
\bibitem{42} Revenue Act of 1924, § 214(a)(10).
\bibitem{43} Revenue Act of 1928, § 120.
\bibitem{44} Post v. Commissioner, Board of Tax Appeals, Docket No. 83921, Memo. Op. entered April 26th, 1939.
\bibitem{45} 115 F. (2d) 788 (C. C. A. 10th, 1940).
\end{thebibliography}
issues involved was whether the trust was entitled to an income tax deduction of the amount of the capital gains so claimed to have been set aside during the year for charitable purposes. The annuities for the years considered by the court were well covered by income. Still, as the dissenting Judge pointed out, it could not "be foretold with absolute certainty that such condition will always exist to the death of the last survivor of the annuitants". But the court determined to be "realistic", reached its conclusion by a consideration of the "degree of probability" that the fund would not be resorted to for other than charitable purposes, found that it was "practically certain" that the fund would not be so resorted to, and sustained the Board in allowing the deduction. Of a companion case decided the same day, in which the same question was presented, the Board had said that the facts proved that "the probability of the invasion of corpus is so remote as to be negligible." In Upjohn v. Commissioner the Board had a similar situation before it, and followed the rule of the Bonfils case.

It was in Old Colony Trust Co. v. Commissioner that the Supreme Court determined that "pursuant to the terms of the . . . deed creating the trust" included mere authorization under the trust instrument. Accordingly, where trustees were authorized to pay to charities such sums as in their judgment might be paid without jeopardizing annuities, the payments were held to be "pursuant to the terms" of the trust deed.

In Bedford v. Commissioner, the decedent's will provided that his wife should have the use for life of his country estate, valued at over $1,000,000, whereon he had maintained extensive gardens which were open daily to the public without charge. His will also provided that after the death of his wife, his daughter might occupy the residence during her life, and directed his trustees to pay his daughter in any one year such sum, not exceeding $10,000, as might be necessary in maintaining the gardens if she should continue to maintain them, and permit the public to enjoy them, as he had done during his lifetime. During the year, $7,500 was paid to her for that purpose, and was claimed as an income tax deduction by the estate as an amount paid pursuant to the terms of a will exclusively for educational or charitable purposes. The Commissioner, having disallowed the deduction, argued that the money so

50. 301 U. S. 379 (1937).
paid was not to be used "exclusively" for charitable purposes, since not only would the life tenant benefit from the maintenance of the gardens, but the re-sale value of the estate, whenever sale took place, would thus be enhanced. The Board, however, applying the familiar rule first established in Trinidad v. Sagrada Orden de Predicadores, held that the word "exclusively" would not serve to defeat a claimed deduction where the primary use was charitable, and found for the estate.

(d) Estate Tax Deductions

The cases dealing with estate tax deductions where the representative of a decedent's estate is vested with certain discretion to devote assets of the estate to charitable purposes further evidence the disposition of the courts to find a basis for sustaining the deductions. Four cases, in two of which the deduction was disallowed, will illustrate this point.

In Taylor v. Commissioner the testator bequeathed to his executors a sum of money for the purpose of establishing a "memorial" to his parents. The executors, acting under the will, paid to Grace Church, a religious corporation, the sum of $6,000. The Board disallowed the deduction, holding that "memorial" did not connote any limitation within the language of the statute, and that reasonably a memorial might have been established without any charitable, scientific, educational or religious purpose. The fact that the trustees in the exercise of their discretion had actually paid the money to a religious organization was disregarded.

In Mississippi Valley Trust Co. v. Commissioner, testator provided:

"I have hitherto expressed to my sons my wishes as to certain charitable gifts, and I therefore make no such bequests herein, preferring that my sons shall make such donations within their sole discretion as shall seem to them to be best."

The most that could be said of that provision, said the Court, was that the sons were permitted to give, or not, any or all of the estate to such charities as they might determine, and disallowed the deduction although the record showed that the sons had donated $1,000,000 to St. Louis University for the purpose of erecting a hospital in memory of their father.

In Beggs v. United States, the testator made the following provision:

"I devise and direct that all the net proceeds from the sale of my estate as herein provided shall under the direction of my executor, with the advice of my sister . . . be . . . given to such charities and worthy objects as they . . . shall determine, . . . It is my intention to write to my said sister, indicating to her my special friends, charities and worthy objects, I may wish my executor with her advice to provide for, . . ."

52. 263 U. S. 578 (1924).
53. 40 B. T. A. 375 (1939).
55. 27 F. Supp. 599, 600 (Ct. Cl. 1939).
Here, at least, there was a devise to "such charities and worthy objects" as the executors should select, and although there was room for an opinion that "worthy objects" might have been other than objects specified in the statute, the court took notice that in fact the amounts were distributed to tax-exempt institutions, and held that "worthy objects" and "special friends" were used in the sense that the testator directed that the proceeds be given to charities.

The farthest that the courts have gone, however, is in Brown v. Commissioner. Here it was provided that the trustees of a decedent should use the residue of a trust

"in such way or manner, and at such time or times, and in such proportions and upon such conditions as said Trustees or the survivors of them may, in the exercise of their sole and uncontrolled judgment, deem to be wise and best, bearing in mind the ideals of said Settlor with reference to the ownership of money and to the ideas on the general subject as expressed by him from time to time."56

It will be observed that no mention or even suggestion is made herein of a charitable bequest, yet the court considered evidence that the trustees were personal friends of the decedent and knew of his plans to erect a church as a memorial to his wife. Actually, they did devote the residue of the estate to this purpose. Sustaining the deduction, the court concluded that it was as though the knowledge of the trustees was incorporated into the will, and that they had exercised a power which related back to the testator's death.

It is most natural that a testator should first provide for his family, but once he seeks to make a bequest to a charitable organization, and at the same time ties strings to the bequest so that his family may obtain the funds if needed, the estate tax deduction for the charitable bequest is put into jeopardy. A deduction in such a case was allowed in Ithaca Trust Co. v. U. S.,57 but in Knoernschild v. Commissioner,58 the estate was not so fortunate. In the Ithaca Trust Co. case the will provided that the residue was to be placed in trust, the income was to be paid to the wife for life, and upon her death the residue was to go to charities. The trustees were given the power, however, to pay to the wife from the principal any sum "that may be necessary to suitably maintain her in as much comfort as she now enjoys". Evidence was introduced that the income had at all times been sufficient, and that there was little likelihood that this power would be used. The Court concluded that the remainder was deductible, saying: "There was no uncertainty appreciably greater than the general uncertainty that attends human affairs". In the Knoernschild case the decedent had left to Holy Angels Academy of the City of Milwaukee, an institution admittedly exempt under the law, a sum of approximately $114,000, but at the same time granted to his daughter, who was then in the sisterhood, the privilege

56. 50 F. (2d) 842, 843 (C. C. A. 3d, 1931).
57. 279 U. S. 191 (1929).
58. 97 F. (2d) 213 (C. C. A. 7th, 1938).
“to direct said trustees to pay from said fund any part of the income or principal as my daughter may in her judgment see fit for the purpose of providing for her mother or any of her brothers or sisters in case they are in need of financial assistance.”

“Financial assistance”, the Court pointed out, was a broad term which might include vast sums of money, and since the gift to the Academy was not by its terms final and conclusive, the deduction was disallowed.

Similarly, in Nicholas v. Commissioner, where a decedent left a bequest to a charitable corporation to be selected by his sister and nephew under a provision which directed that if the executor did not receive from them a notice in writing designating the educational institution within a year from the date of probate of his will, the legacy should lapse and become part of his residuary estate, the Board had no alternative except to hold that the last word was that of the sister and nephew of the decedent; that all the will did was to create a simple alternative, a charitable bequest if certain living individuals so chose, a bequest to private legatees, if such individuals elected otherwise.

**Conclusion**

(1) If it be the Congressional theory that the United States derives no benefits from gifts to foreign institutions, and, therefore, that tax deductions for gifts and bequests to foreign institutions should not be allowed, the charities provisions should be amended consistently to reflect that theory. In any event, they should be revised to eliminate existing discrepancies.

(2) The judicial approach is that of sympathetic liberalization, the consistent disposition being to lay aside the rules of strict construction of a tax statute, to strain every word and phrase of the charities provisions, and to seek to harmonize therewith every provision of a trust or will relating to a

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59. 97 F. (2d) 213, 214 (C. C. A. 7th, 1938).
60. 40 B. T. A. 1040 (1939).
61. So, too, where a testator bequeathed property in trust for charities but empowered his wife to invade the corpus to the extent that she “may at any time and from time to time need or desire,” an estate tax deduction for a charitable bequest was denied on the ground that the word “desire” was so broad as to make the amount which would go to the charities unascertainable. Gammons v. Hassett, 36 F. Supp. 529 (D. C. Mass. 1941). In Robbins v. Commissioner, 39 B. T. A. 599 (1939), aff’d 111 F. (2d) 828 (C. C. A. 1st, 1940), it was held that a gift to a charity depending on the exercise of a power of appointment was not deductible. Similarly, a bequest in default of the exercise of a power of appointment was held not deductible. The Board held that an irrevocable renunciation of the power five years later would not relate back to the date of the testator’s death. Davison v. Commissioner, 31 B. T. A. 101 (1934).

That conditional bequests to charities are not deductible is well settled. United States v. Fourth National Bank in Wichita, 83 F. (2d) 85 (C. C. A. 10th, 1936), cert. denied 299 U. S. 575 (1936); St. Louis Union Trust Co. v. Burnet, 59 F. (2d) 922 (C. C. A. 8th, 1932); Delaware Trust Co. v. Handy, 53 F. (2d) 1042 (D. C. Ore. 1931); Old Point National Bank v. Commissioner, 39 B. T. A. 343 (1939). See also Internal Revenue Regulations 80, Article 47; E. T. 13, 1939-2 C. B., 326.
charity, to the end that the charity or the donor may be favored, stopping only where, to hold otherwise, would open the door to wholesale evasion. So intent have the courts been to further the Congressional policy of encouraging gifts to charity that in several cases where the issue has been whether or not an organization was a charity, adequate consideration does not appear to have been given to the underlying theory of the charities provisions—promotion of the general welfare and relief of the Government from financial burdens. The needs of the Government are great, and growing; so, too, are the needs of our churches, our schools and colleges, our hospitals and asylums. These unquestionably promote the general welfare. These unquestionably relieve the Government from financial burdens. An overgenerous judicial disposition in favor of organizations whose claim to promotion of the general welfare is far less certain, may, in time, jeopardize the tax-exempt status of true charities. With this exception, it is believed that most will approve the judicial attitude toward the charities provisions.