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THE CASE FOR THE TAXPAYING GOOD SAMARITAN: DEDUCTING EARMARKED TRANSFERS TO CHARITY UNDER FEDERAL INCOME TAX LAW, THEORY AND POLICY

Johnny Rex Buckles**

The Good Samaritan may enjoy centuries of fame and adulation, but he finds little affirmation in the tax regime of the Internal Revenue Code. The cost of the bandages, oil and wine with which he nursed his roadside acquaintance en route to Jericho, and his payments to the desk clerk of that first century hotel for the room of his ailing “neighbor,” would be nondeductible personal expenses under United States federal income tax law. The law is well settled that no charitable contribution deduction is permitted for a taxpayer’s independent transfer of money or property to (or on behalf of) an individual, no matter how deserving the recipient of funds may be.

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** Assistant Professor of Law, University of Houston Law Center. The author gratefully acknowledges the financial support of the University of Houston in the preparation of this Article. The author is indebted to former students Bruce Munson and Melissa Williamson, and to the entire pool of research assistants (and their supervisors, Rod Borlase and Harriet Richman) at the University of Houston Law Center, for their efforts in collecting, cataloguing, and annotating sources. The author acknowledges the helpful comments to prior drafts of this Article from Professors Ira Shepard, Laura Oren, William Streng, Peter Linzer, and Alvin Warren; University of Houston Law Center Dean Nancy Rapoport; and the author’s wife, Tami Buckles.


4. See, for example, Tilles v. Commissioner, 38 B.T.A. 545 (1938), aff’d on other grounds, 113 F.2d 907 (8th Cir.), cert. denied, 311 U.S. 703 (1940), in which a music teacher of a poor, young woman solicited contributions from her friends, including
Under current law, the Good Samaritan would be eligible for a charitable contribution deduction only by channeling his charitable impulse through a qualified charitable donee (let us call it "Jericho Foundation") in hopes that Jericho Foundation will aid the injured traveler. The Good Samaritan has no guarantee that Jericho Foundation will use the donated funds to assist the person whom the Good Samaritan desires to benefit. But at least Jericho Foundation is in the business of helping others, and therefore the Good Samaritan has some assurance that the donated funds will be used to accomplish some socially desirable objective.

This last observation illuminates the probable reason that federal income tax law denies a charitable contribution deduction for transfers by Good Samaritans directly to individuals. The Internal Revenue Service ("IRS") would encounter great practical difficulty in verifying that taxpayers' numerous inter-personal transfers truly further charity (at least as long as charity is conceived to involve more than the mere redistribution of resources). By requiring the Good Samaritan to donate to a qualified donee such as Jericho Foundation, the law reduces the number of benefit-providing entities that the IRS must audit, and increases the probability that such donees will use donated funds to advance charitable goals.

Whatever the wisdom of this approach, unless the Good Samaritan wields a good deal of influence over the administration of Jericho Foundation, he cannot be certain that the foundation will use his charitable contribution to provide the suffering sojourner with the care and lodging which he so desperately needs.

the taxpayer, to help finance the young woman's musical education. The Board of Tax Appeals (the predecessor of the United States Tax Court) disallowed the taxpayer's deduction claimed for amounts contributed to the fund established for the benefit of the young woman. See id. at 551. The Board of Tax Appeals concluded that no deduction was proper for "a charitable gift which was for the benefit of only one person." Id. at 550.

5. See infra notes 170-172 and accompanying text. Qualified donees include not only qualified charities, but also four other types of entities. See I.R.C. § 170(c)(1)-(5). The most important of these other entities for present purposes are described in Code section 170(c)(1): governmental units receiving gifts for exclusively public purposes.

6. A qualified charitable donee must be created or organized in the United States (or in one of its possessions), or under the law of the United States (or under the law of one of its states or possessions, or the District of Columbia). See I.R.C. § 170(c)(2)(A). Nonetheless, I ask the reader to indulge me in my references to "Jericho Foundation" as I remain true to the historical context of the parable of the Good Samaritan.


8. Cf. Blasi & Denesha, supra note 7, at 161-62 (arguing that current law's requirements governing qualified donees facilitate monitoring by the IRS).

9. Perhaps Jericho Foundation is managed by the priest or the Levite, who apathetically passed by the injured traveler, see Luke 10:31, :32, or perhaps the
uncertainty, the Good Samaritan proposes a solution: he will offer to transfer funds directly to Jericho Foundation, but will designate such funds for the ultimate benefit of his wounded acquaintance. Does—and should—this approach enable the Good Samaritan to deduct his designated transfer to Jericho Foundation in calculating his taxable income? This Article attempts to answer this question.

Although the academic literature is quite sparse on the subject, a review of case law and administrative authorities suggests that taxpayers have attempted to utilize the basic method contemplated by our Code-conscious Good Samaritan in a variety of forms for decades, with mixed success. Let me be very clear on the approach at issue: a prospective charitable donor attempts to specify the ultimate beneficiary of funds to be transferred to the charitable donee at or prior to the time that the transfer to the charitable donee is executed. In these cases, the donor may explicitly condition the transfer on the charitable donee’s agreement to use the transferred funds to benefit a named person. Alternatively, the donor may simply express a non-binding preference that the charitable donee employ the transferred funds so as to benefit the named person.

Such contributions designated for the ultimate benefit of persons named by the transferor are referred to as “earmarked” transfers in the tax literature. This Article generally refers to taxpayers who make earmarked transfers to charity as “donors” or “transferors,” and to the charities that receive transfers therefrom as “charitable transferees” or “charitable donees.” The person designated to benefit from the taxpayer’s transfer to charity is referred to as the “secondary beneficiary.”

Part I of this Article initially discusses the deductibility of non-earmarked transfers to charitable donees under current law. Part I of
this Article next explores and analyzes the deductibility of transfers to charity which are earmarked for the benefit of a secondary beneficiary, upon the initiative of either the taxpayer or the charitable transferee. Part II surveys existing scholarship addressing the justification for the charitable contribution deduction under income tax theory, pervasive norms of tax policy, and broader policy objectives. This part also summarizes existing theories supporting the exemption of charitable organizations from federal income taxation. Based on the analysis in Part II, Part III critically examines the normative question of whether, and to what extent, earmarked contributions to charity should be deductible. Part III further discusses both the relevance of several factors that authorities have cited in determining the deductibility of earmarked transfers to charity, and how a deduction for such transfers fares under several norms and other guiding principles.

I. POSITIVE LAW OF CHARITABLE TRANSFERS

The case law and administrative authorities addressing earmarked transfers to charity are shaped largely by sections 170 and 262 of the Internal Revenue Code ("the Code"). Section 170(a) allows a deduction for any "charitable contribution" made within a taxable year.\(^{14}\) A charitable contribution is "a contribution or gift to or for the use of" designated entities that are "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes" and which meet certain requirements paralleling those set forth in Code section 501(c)(3).\(^ {15}\) Thus, Section 170 of the Code imposes two general requirements. First, no deduction under Code section 170(a) is available unless the taxpayer has made a "contribution or gift." Second, the contribution or gift must be "to or for the use of" a qualifying organization. Contributions are not deductible if they are made to a non-qualified transferee, including an individual.

Code section 262 generally denies a deduction for any "personal, living, or family expenses."\(^ {16}\) In certain contexts, courts have denied a deduction for amounts claimed to qualify under Code section 170 because they are more accurately characterized as a "personal, living, or family expenses."\(^ {17}\)

The first general requirement of Code section 170, and the prohibition of a deduction for personal, living, or family expenses under Code section 262, are of great importance when a taxpayer expects (or reasonably should expect) to receive some material

\(^{14}\) I.R.C. § 170(a) (1994).
\(^{15}\) Id. § 170(c)(2).
\(^{16}\) Id. § 262(a).
\(^{17}\) Id.
benefit from a charitable transferee in exchange for a transfer from the taxpayer. These provisions may result in disallowance of a deduction regardless of whether a taxpayer earmarks her transfer for the benefit of a secondary beneficiary. The second general requirement of Code section 170 is most important when a taxpayer claims a deduction for a transfer that she has designated to benefit a secondary beneficiary.

In order to appreciate the nuances of federal income tax law governing earmarked transfers to charitable organizations, one must understand the basics of the law governing non-earmarked transfers to charity. The law controlling the tax treatment of non-earmarked contributions to charity provides insight into the rationale of cases and administrative decisions of the IRS governing earmarked charitable contributions, and informs the broader policy question of under what circumstances earmarked transfers to charitable transferees should be deductible.

A. When Neither Transferor nor Charitable Transferee Specifies a Secondary Beneficiary

1. When Individuals Who Ultimately Benefit from Transferred Funds Are Unrelated Third Parties

The paradigmatic case of a deductible “charitable contribution or gift” to a qualified donee under Code section 170 is the transfer of funds to an eligible charitable recipient by a donor (i) who in no manner specifies the individuals who are to benefit from the funds transferred to the charitable donee, and (ii) who herself, and whose family and other household members, do not materially benefit from the transferred funds.18 An example of a quintessential charitable contribution is an unrestricted contribution of cash to the Girl Scouts of America by a retired taxpayer who has no living relatives in any way affiliated with the charity, who detests cookies and candies of every kind (even those chocolate-covered mint treats), and who refuses to be walked across the street by community-minded youth. Such “blind” contributions to charity are plainly deductible.19

18. See id. § 170(c).
19. See, e.g., United States v. Bank of Am. Nat’l Trust & Sav. Ass’n, 326 F.2d 51, 55 (9th Cir. 1963) (“We have no doubt that an unrestricted gift to a corporation organized and operated exclusively for charitable purposes meets the requirements of the Internal Revenue Code.”).
2. When Ultimate Beneficiaries Include Transferor or Persons Related Thereto

a. In General

A more problematic case involves the transfer of funds to a charitable organization by a taxpayer who does not expressly specify a secondary beneficiary, but who receives benefits from the charitable transferee as a result of the transfer. The precise circumstances under which a deduction under Code section 170 will be allowed in this context are not perfectly clear under existing case law and administrative authority. The basic rule to be derived from these authorities, however, can be stated as follows: when a taxpayer transfers funds to charity under circumstances in which she (or perhaps certain other members of her family or household) should reasonably expect to benefit more than incidentally or remotely from the transfer, a deduction under Code section 170 may be denied (in whole or in part), even if the taxpayer identifies no secondary beneficiary.20

The case of Winters v. Commissioner21 illustrates one way this issue commonly arises. In Winters, the taxpayers claimed a deduction for payments to an educational fund maintained by the taxpayers' church to support schools, one of which was attended by the taxpayers' children. The church requested and expected the taxpayers to make the payments, but neither the church nor the school formally demanded that they do so.22 The United States Court of Appeals for the Second Circuit held that the taxpayers could not deduct the payments.23 Relying on the United States Supreme Court's interpretation of the term "gift" in Code section 10224 in the oft-cited case of Commissioner v. Duberstein,25 the Winters court held that a

20. To articulate this "basic rule" as such obviously suggests that, in certain circumstances, a deduction will be allowed in whole or in part notwithstanding the foregoing generalization. This article suggests some of the situations that do or may require a departure from the general rule denying deductions in this context.
22. Winters, 468 F.2d at 779.
23. Id.
24. I.R.C. § 102(a) ("Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.").
25. 363 U.S. 278 (1960); see also DeJong v. Comm'r, 309 F.2d 373, 379 (9th Cir. 1962) (stating that Duberstein's criteria for determining whether a transfer qualifies as a "gift" that is excludible from gross income apply to the determination of whether a "gift or contribution" has been made under Code section 170); Ehrhart v. Comm'r, 42 T.C.M. (CCH) 1285, 1287 (1981) (citing Duberstein and stating that the issue is
"contribution" for purposes of Code section 170, like a "gift" for purposes of Code section 102, must proceed from a detached and disinterested generosity.26 Tuition payments are not deductible because the transferor expects, and in fact receives, a definite economic benefit.27 The evidence established that the taxpayers anticipated an economic benefit from their payments—the education of their children. The court found that the taxpayers realized that their payments were necessary for the operation of the schools, and the taxpayers determined the amount of their payments, at least in part, by reference to the expected cost to the school of educating their children. That the taxpayers were not legally required to make the payments was inconsequential.28 The United States Courts of Appeals for the Ninth Circuit29 and the First Circuit30 have reached

whether the payments under consideration constituted gifts). See generally Comment, Disinterested Generosity: An Emerging Criteria of Deductibility Under Section 170, 1968 Utah L. Rev. 475, 476 n.20 (collecting cases). In view of recent developments, these cases are highly suspect. See infra text accompanying notes 42-56.

26. See Winters, 468 F.2d at 780 & n.3. According to Duberstein, a gift within the meaning of Code section 102 is a transfer of property that proceeds from a "detached and disinterested generosity" and "out of affection, respect, admiration, charity or like impulses." 363 U.S. at 285 (quoting Commissioner v. LoBue, 351 U.S. 243, 246 (1956), and Robertson v. United States, 343 U.S. 711, 714 (1952)). If Duberstein guides the meaning of gift in Code section 170, any number of factors could lead a court to conclude that a taxpayer should be denied a charitable contribution deduction, insofar as the ultimate test is the taxpayer's intent (which, under Duberstein, includes her motives). See William A. Klein, An Enigma in the Federal Income Tax: The Meaning of the Word "Gift", 48 Minn. L. Rev. 215, 219 (1963) (stating that Duberstein's formulation of a gift "is a transfer motivated by a particular state of mind"). For a concise criticism of Duberstein in general, see Erwin Griswold, The Supreme Court, 1959 Term—Forward: Of Time and Attitudes—Professor Hart and Judge Arnold, 74 Harv. L. Rev. 81, 88-91 (1960).

27. See Winters, 468 F.2d at 781.

28. See id. at 780.

29. In DeJong v. Commissioner, 309 F.2d 373, 379 (9th Cir. 1962), the United States Court of Appeals for the Ninth Circuit held that the Tax Court properly disallowed a deduction for that portion ($400) of the taxpayers' contributions (totaling $1075) to an educational organization attended by taxpayers' children attributable to the estimated costs of educating the children. In DeJong, the charitable organization operating the school charged no tuition, but raised approximately seventy percent of its annual income from contributions from the parents of enrolled students. Parents of prospective students were asked to contribute to the best of their financial ability, and those who were financially secure were asked to contribute the estimated cost of education per child for each child desiring to attend the school. Id. at 375. Parents were also asked to sign pledge cards indicating the number of their children to be enrolled, and the amount of their expected contributions. Id. All contributions were credited to the school's general operating fund; no designations of funds for particular students were made. In addition, the school did not refuse admission to any student whose parent failed to contribute to the school. The Tax Court denied the deduction on the grounds that the payments were in the nature of tuition, and therefore constituted nondeductible personal expenses, rather than charitable contributions. See id. at 375-76. In affirming the Tax Court, the court applied the Duberstein criteria for determining whether an item of income is a "gift" and found that the Tax Court's characterization of the payments (as tantamount to tuition paid for educational services) was not clearly
essentially the same conclusion as the Winters court when presented with like facts. The interpretative position of the IRS is largely consistent with these cases.31

In numerous other situations, taxpayers have been denied deductions under Code section 170 for transfers made in circumstances involving the receipt by taxpayers (or persons closely related thereto) of significant benefits from charitable transferees following the transfers. Such situations span a wide spectrum, ranging from the provision of facilities and performance of personal services (including nursing home facilities32 and marriage-enrichment seminars33) to political favors (such as favorable governmental zoning decisions and the like34).

erroneous. See id. at 377-79. It appears that what most impressed the court was the expectation that parents who could so afford would transfer to the charitable organization an amount at least equal to the cost of educating their own children. See id. at 379.

30. In Oppewal v. Commissioner, 468 F.2d 1000 (1st Cir. 1972), the taxpayers transferred $900 to a tax-exempt school attended by two of their children. The school raised its funds from transfers from the public, and received approximately forty percent of its support from parents of children attending the school. Funds received were accounted for in a general operating fund, not in any type of individual account identified with any transferor or student. Admission of a student was in no way conditioned upon receiving a payment from the student's parent or guardian. The school solicited funds not on a per capita basis, but according to what the potential transferor could afford. Of the $900 charitable contribution deduction claimed by the taxpayers, the Tax Court denied an amount approximately equal to the per-student cost of educating the taxpayers' children. See id. at 1001. The United States Court of Appeals for the First Circuit affirmed the opinion of the Tax Court, although it invoked a different rationale. See id. at 1001-02. Whereas the Tax Court, following the type of analysis employed in Delong, denied the deduction because the payment to the school "proceeded primarily from the incentive of anticipated benefit to the taxpayers," id. at 1001, the First Circuit adopted the more objective test of whether the transfer by the taxpayers was to any substantial extent "offset by the cost of services rendered to taxpayers in the nature of tuition." Id. at 1002. The court favored this test because it obviates the need to determine the taxpayers' "motives" in transferring a sum to charity. Id. (quoting Crosby Valve & Gage Co. v. Commissioner, 380 F.2d 146 (1st Cir.), cert. denied, 389 U.S. 976 (1967)). Under this objective test of value received, the taxpayers were not entitled to deduct $640 of their transfer to the school. See id.


32. For example, in Sedam v. United States, 518 F.2d 242 (7th Cir. 1975), the taxpayer transferred money to a retirement home in connection with placing his mother. The court considered as controlling that the nonprofit home required the taxpayer's mother to make "founder's gift plan" payments in order to receive admission to the home. The taxpayer also admitted to having agreed to transfer certain amounts to the home. Because the payments were made with the expectation of receiving a commensurate benefit in return, they failed to constitute "contributions" under Code section 170. See generally John D. Perovich, Annotation, Payments Made in Connection with Placing Person in Home for Aged Operated by Qualified Charitable Organization as Constituting Tax Deductible Charitable Contributions Under §170 of Internal Revenue Code of 1954 (26 USCS §170), 34 A.L.R. Fed. 840, 840-45 (1977) (collecting and discussing cases).

33. E.g., Rev. Rul. 76-232, 1976-1 C.B. 62 (ruling that no deduction is allowed under Code section 170 for amounts paid by a taxpayer to an organization following
However, several courts have upheld a deduction if the taxpayer presented credible evidence that the non-earmarked donation was not made with the expectation of receiving a material economic benefit in return for the contribution, even though the taxpayer or her family would likely benefit to some degree from the contribution. An example is *Marshall v. Welch,* in which the taxpayers (husband and wife) transferred in excess of $1,000 to a tax-exempt organization operating a home for disabled children and the elderly. The taxpayer's son, who suffered from spinal disease, resided at the home. The home did not charge patients for the care provided them, but received support from voluntary contributions from the public. The

the completion by the taxpayer and her spouse of a marriage-enrichment seminar provided by the transferee to the extent that the amount transferred does not exceed the value of the benefits received by the transferor and her spouse.

34. To illustrate, in *Forkan v. Commissioner,* 36 T.C.M. (CCH) 798 (1977), the taxpayers conveyed a strip of land to a political subdivision in order to secure governmental approval of the taxpayers' plans for expanding a trailer park. The Tax Court denied the charitable contribution deduction claimed for the transfer on the grounds that the transfer was not a "gift" because it was made in expectation of the receipt of a benefit from the transferee (namely, permission to expand the trailer park). See *id.* at 800; see also *Stubbs v. United States,* 428 F.2d 885, 887 (9th Cir. 1970) (denying a deduction under Code section 170 for taxpayers' transfer of property to a city for use as a public road because the transfer was made with the expectation of receiving public street frontage for, and favorable zoning of, taxpayers' remaining property), cert. denied, 400 U.S. 1009 (1971); *Perlmuter v. Comm'r,* 45 T.C. 311, 317-18 (1965) (denying a charitable contribution deduction to taxpayers who transferred land to governmental entities pursuant to regulations requiring subdividers of large tracts of land to do so; stating that the transfers facilitated the ability of the taxpayers to obtain approval of their development plans and increased the value of taxpayers' remaining property).

35. See, for example, *Dowell v. United States,* 75-2 U.S. Tax Cas. (CCH) ¶ 9745, at 88,244 (N.D. Okla. 1975), aff'd, 553 F.2d 1233 (10th Cir. 1977), in which the court held that a transfer in excess of $22,000 by the taxpayer to an evangelistic association prior to establishing residency in a retirement village operated by the transferee constituted a deductible charitable contribution. The court found that the taxpayer had not made the transfer of funds with the intent of receiving consideration from the transferee. The transfer was not made in lieu of other payments by the taxpayer or others, the taxpayer had no obligation to make the gift prior to or after being admitted, and the size of the gift had no bearing upon the fact of admission or the quality of the residential unit occupied. *See id.* at 88,253-54.

Similarly, in *Estate of Wardwell v. Commissioner,* 301 F.2d 632, 636-38 (8th Cir. 1962), the court sustained a charitable contribution deduction for a transfer to a nursing home by a prospective resident one day prior to admission in fulfillment of a charitable pledge, where no evidence established that the parties considered such transferred amount as consideration for admission or care rendered thereafter. The amount transferred was to be used to endow a room for a resident not requiring special care, but the taxpayer never in fact occupied any such room. *Id.* at 634-35. Instead, she resided at all times in the home's infirmary, for which she paid monthly sums without claiming them as deductible charitable contributions. *Id.* at 635. In *Revenue Ruling 72-506,* 1972-2 C.B. 106, the IRS disagreed with *Wardwell* to the extent that it could be construed to deny a charitable contribution deduction only when the donor has a legally enforceable right to receive benefits as consideration for a transfer of money.

taxpayers claimed a deduction under Code section 170 for all amounts transferred to the home (a portion of which was for the purchase of a wheelchair for the exclusive use of their son). The court held that the taxpayers were entitled to a deduction for the non-designated portion of their transfers.\(^{37}\) The court simply reasoned that because this portion was a "voluntary payment,"\(^ {38}\) it satisfied the definition of a "charitable contribution" under Code section 170.\(^ {39}\)

b. The Implications of Hernandez on Non-Earmarked Transfers to Charity When the Taxpayer Receives a Benefit from the Transferee

Analyzing the myriad of factors bearing upon the taxpayer's intent in transferring funds to charity is no easy task.\(^ {40}\) Appreciating this difficult task, some courts have declined to follow Duberstein's literal approach of broadly focusing on whether the taxpayer has intended to transfer an amount with the requisite "detached and disinterested generosity." Instead, these courts look at the more narrow issue of whether the taxpayer receives (or, under the test of some courts, expects to receive) a material benefit (including, but not limited to,

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37. See id. at 875-76.

38. In Winters v. Commissioner, 468 F.2d 778, 780-81 (2d Cir. 1972), the court denied taxpayers a charitable contribution deduction, on account of a quid pro quo. The court distinguished this aspect of Welch from the facts before the court on the basis that in Welch, no evidence established that the parents were encouraged or expected to contribute to the charitable donee. See id. at 781.

39. See Welch, 197 F. Supp. at 875-76. In at least three limited circumstances, even the IRS has ruled that non-earmarked transfers to charity are deductible, notwithstanding that the transferor or a member of her family may benefit to some degree from the contribution. First, the IRS has allowed a deduction when the benefit which the taxpayer and her family can expect is no greater than that received by every other member of the class served by the charitable transferee, and such class constitutes a "charitable class" under the law of charitable trusts. See, e.g., Rev. Rul. 80-77, 1980-1 C.B. 56 (ruling that taxpayers in each of four situations were entitled to a charitable contribution deduction notwithstanding that they benefited from the activities of the charities). Second, the IRS has allowed a deduction when the taxpayer or a member of his family is an agent providing services to or on behalf of the charitable transferee, and the agent receives from the charitable transferee reasonable compensation or reimbursement of expenses in connection with the performance of such services. See, e.g., Rev. Rul. 62-113, 1962-2 C.B. 10 (ruling that the father of a missionary may deduct non-earmarked contributions to a church fund used to reimburse missionaries for certain qualified living and traveling expenses; stating that the test in each case was whether the organization had full control of the donated funds, and discretion as to their use). A third situation in which the IRS has allowed a deduction is where the benefit to be received by the transferor is incidental, remote, and small relative to the benefit to be received by the general public (or perhaps some other charitable class). See, e.g., Rev. Rul. 67-446, 1967-2 C.B. 119 (ruling that contributions by taxpayers to a city for the removal of an unsightly railroad were deductible, including those by taxpayers who owned property or conducted business in the central shopping district).

40. This point is nicely advanced by the United States Court of Appeals for the First Circuit in Crosby Valve & Gage Co. v. Commissioner, 380 F.2d 146 (1st Cir.), cert. denied, 389 U.S. 976 (1967), discussed infra at notes 331-332, 337.
bargained-for legal consideration) from a charitable transferee following a transfer of property.\textsuperscript{41} The most recent guidance from the United States Supreme Court supports the conclusion that \textit{Duberstein} should not be applied expansively in Code section 170 cases.

In \textit{Hernandez v. Commissioner},\textsuperscript{32} the issue before the Court was whether the taxpayers, practitioners of scientology, could deduct as charitable contributions payments made to scientology branch entities in order to receive services known as "auditing" (involving an encounter between a participant and an official using a machine, with the goal of obtaining heightened spiritual awareness) and "training" (doctrinal courses).\textsuperscript{43} The organization charged an amount characterized as a "fixed donation" to participants in these services.\textsuperscript{44} The Court held that the payments do not constitute deductible contributions or gifts. The Court analyzed the legislative history of the "contribution or gift" requirement,\textsuperscript{45} and concluded that Congress intended to differentiate between voluntary payments to qualified donees (which are deductible) and payments made "in return for goods or services" (which are not deductible).\textsuperscript{46} The House and Senate Reports\textsuperscript{47} cited by the Court provide that a transfer is a deductible contribution or gift only if the transferor expects no quid pro quo from the transferee.\textsuperscript{48} The Court approvingly noted that in ascertaining whether a taxpayer's transfer to charity is made as a quid pro quo, the IRS "has customarily examined the external features of the transaction,"\textsuperscript{49} and "lower courts have generally embraced this structural analysis."\textsuperscript{50} The Court cited its opinion in \textit{United States v. American Bar Endowment}\textsuperscript{51} as an example of how even the Court has

\begin{enumerate}
\item[41.] \textit{Compare}, e.g., \textit{Singer Co. v. United States}, 449 F.2d 413, 422-23 (Ct. Cl. 1971) (stating that a deduction under Code section 170 should be denied a taxpayer who receives or expects to receive benefits from a charitable transferee which are greater than those received by the general public; refusing to adopt the "disinterested generosity" test of \textit{Duberstein} and citing cases that also have declined to apply such test), \textit{with Oppewal v. Comm'r}, 468 F.2d 1000, 1002 (1st Cir. 1972) (looking solely to the consideration received by the taxpayers in determining the deductibility of the transferred amounts under Code section 170).
\item[42.] 490 U.S. 680 (1989).
\item[43.] \textit{See id.} at 684-85.
\item[44.] \textit{See id.} at 685.
\item[45.] More precisely, the Court reviewed the legislative history of Code section 162(b), which denies a deduction as a trade or business expense for any "contribution or gift" which would be deductible under section 170 in the absence of certain limitations therein not relevant for present purposes. \textit{See id.} at 690.
\item[46.] \textit{Id.}
\item[48.] \textit{See Hernandez}, 490 U.S. at 690.
\item[49.] \textit{Id.}
\item[50.] \textit{Id.} at 691 (citing \textit{Singer Co. v. United States}, 449 F.2d 413, 422-23 (Ct. Cl. 1971)).
\item[51.] 477 U.S. 105 (1986). In \textit{American Bar Endowment}, the Court disallowed a deduction for a portion of insurance premiums paid under a group insurance policy to a charitable organization and claimed to be deductible as charitable contributions by
examined the external features of a transaction (rather than the subjective motivations of taxpayers) to determine whether a taxpayer has made a deductible contribution or gift to charity.\textsuperscript{52} Examining such external aspects of a transaction, reasoned the Court, advantageously "obviat[es] the need for the IRS to conduct imprecise inquiries into the motivations of individual taxpayers."\textsuperscript{53} Having examined the external features of the transaction, the Court concluded that the payments at issue were not contributions or gifts within the meaning of Code section 170, for they were part of a quid pro quo exchange. In exchange for money, the taxpayers received an "identifiable benefit" associated with a mandatory, fixed price.\textsuperscript{54}

The precise test which governs whether a taxpayer's contribution is part of a quid pro quo transaction, and therefore not deductible, under \textit{Hernandez} is not entirely clear. The starting point is to observe what \textit{Hernandez} sought to avoid: "the need for the IRS to conduct imprecise inquiries into the motivations of individual taxpayers."\textsuperscript{55} Thus, a test that seeks to determine a taxpayer's subjective state of mind broadly (i.e., her many motives) is inconsistent with \textit{Hernandez}.\textsuperscript{56}

A test which looks to whether the taxpayer actually anticipates the receipt of a commensurate benefit from the transferee in exchange for the non-designated transfer fares much better under \textit{Hernandez}. The \textit{Hernandez} Court cited two opinions that employed such a test,\textsuperscript{57} although the Court did so only for their "embrace" of the IRS's

the organization's members who participated in the policy. The amounts claimed by the taxpayers as deductions were the insurance policy dividends paid by the insurance company to the charitable organization, which amounts represented a refund of the difference between the insurance company's real cost of providing insurance to the organization's members and the amount of premiums paid thereby. Prior to participating in the group policy, members were required by the charitable organization to assign thereto all rights to future policy dividends. The deductions were denied all taxpayers because the evidence failed to demonstrate that the taxpayers had purposely contributed funds to the charitable organization in excess of the value of the benefit (insurance coverage) received in return. See American Bar Endowment, 477 U.S. at 118.

\textsuperscript{52} Hernandez, 490 U.S. at 691.

\textsuperscript{53} Id. at 690-91.

\textsuperscript{54} See id. at 691-92.

\textsuperscript{55} See id. at 691.

\textsuperscript{56} Cf. Nancy J. Knauer, \textit{The Paradox of Corporate Giving: Tax Expenditures, The Nature of the Corporation, and the Social Construction of Charity}, 44 DePaul L. Rev. 1, 39 (1994) ("The notion of applying the 'detached and disinterested generosity' test to a corporation is intriguing, but the prior practice of the IRS and the \textit{Hernandez} decision render such an inquiry moot . . .").

\textsuperscript{57} See Hernandez, 490 U.S. at 690-91 (citing Singer Co. v. United States, 449 F.2d 413, 422-23 (Ct. Cl. 1971), and United States v. American Bar Endowment, 477 U.S. 105, 118 (1986)). \textit{American Bar Endowment} looked to whether the taxpayers intentionally transferred amounts in excess of the value which they received from the charitable transferee. See 477 U.S. at 118.
approach of examining the "external features" of the transaction. One may also observe the Court's references to a taxpayer's "expectation" of receiving a quid pro quo. Thus, perhaps *Hernandez* supports an inquiry into a taxpayer's actual expectation of receiving a quid pro quo.

However, the *Hernandez* Court arguably was not validating the approach of looking at every atom of evidence bearing upon what benefits a taxpayer actually expected (such as the taxpayer's self-serving testimony that he lacked any hope of benefiting from a transfer). Rather, the opinion could be interpreted as endorsing the approach of looking at the objective evidence external to a taxpayer's mind to determine whether there should have been a reasonable expectation of receiving "this" (the benefit) for "that" (the transfer to the charitable organization). This understanding comports with the Court's conclusion that the taxpayers' payments were part of a quid pro quo exchange. Based upon all of the objective evidence, the Court determined that the taxpayers had received services "in return for" amounts transferred to the transferee. This determination followed the Court's prior statement that the external features of a transaction are examined "[i]n ascertaining whether a given payment was made with 'the expectation of any quid pro quo.'" Because the Court shunned the approach of searching for the taxpayers' actual motives, the Court arguably was conducting an analysis of what the taxpayers reasonably should have expected from their transferee.

Accordingly, *Hernandez* may, at a minimum, be understood as implicitly advancing the following test: a taxpayer will be denied a charitable contribution deduction, in whole or in part, whenever the taxpayer receives a benefit from the transferee that the taxpayer reasonably should expect to have been provided in exchange for the taxpayer's transfer. The benefit is presumed to have a value

58. See *Hernandez*, 490 U.S. at 690-91.
59. See id. at 690, 692, 693.
61. For the contrasting view that *Hernandez* should be read in harmony with prior decisions focusing on the taxpayer's subjective intent, see Joseph V. Sliskovich, *Charitable Contributions or Gifts: A Contemporaneous Look Back to the Future*, 57 UMKC L. Rev. 437, 493-98 (1989).
62. See *Hernandez*, 490 U.S. at 691-92.
63. See id. The objective evidence included the existence of fixed price schedules, the practice of refunding sums advanced for services not later provided, the method of accounting for pre-paid services, and the refusal to provide services free of charge. See id.
65. Of course, because the taxpayers in *Hernandez* actually received a "quid" for their "quo," one cannot be certain whether the Court also would deny a deduction to
commensurate with the amount transferred by the taxpayer to the charitable transferee. Those special exceptions to this general rule that have been recognized previously presumably survive Hernandez, for nothing in the opinion suggests that they are invalid.

B. When Transferor Specifies a Secondary Beneficiary

The courts have heard several cases in which a taxpayer has made a transfer to a charitable organization and designated a named person as the secondary beneficiary. These authorities are among the most important sources of law in the field of earmarked contributions, and are the subject of this section. For analytical purposes, it is helpful to distinguish earmarked-contribution authorities involving taxpayers who have no familial relationship to, and are not themselves, the secondary beneficiaries from those in which such a relationship or identity is present. The former category is addressed first.

a taxpayer who reasonably expects to receive a return benefit from a transfer, but in fact does not receive such a benefit. In such a case, the better view appears to be that the Court would still deny the deduction. This conclusion is supported by the Court's several references to the "expectation(s)" of taxpayers. See Hernandez, 490 U.S. at 690, 692, 693.

66. See supra note 39 (discussing three circumstances in which the IRS has ruled that non-earmarked transfers are deductible even though the transferor may benefit to some degree from the transfer).

67. One possible objection to this analysis is that the Court was interested only in looking at whether a taxpayer in form received a benefit "in exchange for" a transfer to a purportedly charitable transferee. For example, the Court stated that "[t]he relevant inquiry... is... not whether the payment secures religious benefits or access to religious services, but whether the transaction in which the payment is involved is structured as a quid pro quo exchange." Hernandez, 490 U.S. at 701-02. However, I do not believe this objection is ultimately persuasive. It is doubtful that the Court would have ruled in favor of the taxpayers had the church merely not been so explicit in stating the terms under which it would provide its services to transferors. Such a holding could result in the claiming of deductions for all types of transactions involving personal consumption, such as payments by taxpayers for their children attending religious schools (as long as no tuition is explicitly charged), a result clearly not favored by the Court. See id. at 693. Rather, the Court more likely just meant that a deduction will be denied whenever all of the facts suggest that reasonable parties would view the transaction as having the structural elements of an exchange—obtaining a benefit in exchange for transferring an amount to the transferee.

It would probably go too far to conclude that Hernandez implicitly endorses the view that a taxpayer will be denied a charitable contribution deduction whenever the taxpayer receives a commensurate benefit from the transferee as a result of the transfer. The reason that this test likely is too expansive is that it does not mandate a finding of a quid pro quo in order to disallow a deduction. The test would result in the denial of a deduction whenever a taxpayer has received "this" after transferring "that," even if no reasonable taxpayer would expect to receive a benefit in exchange for the transfer to charity. True, Hernandez was factually a quid-pro-quo case, and therefore the Court was not compelled to apply (or reject) this test. However, the Court's failure to adopt the test when it probably could have done so on the facts before it suggests that it is of doubtful validity. This conclusion is further supported by the Court's point that the "relevant inquiry" is "not whether the payment secures religious benefits." Id. at 701-02.
1. When Secondary Beneficiaries Do Not Include the Transferor or Members of Her Family or Household

a. Transferor's Binding Designation

When a taxpayer upon her own initiative designates a specific individual to benefit from the taxpayer's transfer to a charitable organization, the question arises as to whether the taxpayer may deduct the amount transferred to charity under Code section 170. Consider the following example: The taxpayer, a dedicated philanthropist who regularly participates in a local youth-mentoring program, identifies an intelligent young person who is from an indigent family. The taxpayer calls a prestigious private school, which qualifies under Code section 170(b)(1)(A), and offers to pay the child's tuition if the school will accept the youth. The child, to whom the taxpayer is not related, is accepted to the school, and the philanthropist writes a check to the school for the child's tuition, as agreed. In like circumstances, existing authorities have concluded that the taxpayer may not claim a deduction under Code section 170(a) for her earmarked contribution, if such designation is legally binding on the charity.

A most apropos illustration of these authorities is *Tripp v. Commissioner*, in which the taxpayer claimed charitable contribution deductions for sums paid to a tax-exempt college. The taxpayer transmitted his first payment with a letter to the college expressing his interest in both the college and the career of a certain young man interested in attending the college. In the letter, the taxpayer acknowledged his understanding that a donation to the college for a scholarship fund is deductible only if it does not specify the scholarship recipient. Nonetheless, the taxpayer stated as follows: "[H]owever, if in your opinion and that of the authorities, [this donation] could be applied to the advantage of Mr. Robert F. Roble, I think it would be constructive." The college informed the taxpayer that it had credited his first payment to the account of the named individual. Subsequent payments were accounted for similarly.

The United States Court of Appeals for the Seventh Circuit upheld the IRS's disallowance of the claimed deduction. The court observed that it was clear that the taxpayer "intended to aid" the designated individual and that the transfers "were earmarked for that

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68. 337 F.2d 432 (7th Cir. 1964).
69. Id. at 435.
70. Id.
71. Id.
72. Id. at 435-36.
73. Id. at 436.
The college never awarded a scholarship to the named young man, nor "took any other action obligating it to provide him with tuition, book requirements, or miscellaneous requirements" from any funds of the college. The payments had not been made to the school's general scholarship fund to be used however it deemed best, but in payment of one person's expenses. The court treated the payment as a contribution to an individual, which, under federal income tax law, does not qualify as a deductible charitable contribution.

Although the facts of *Tripp* are analogous to those of the hypothetical problem raised at the beginning of this subpart, *Tripp* is probably not the most significant case in this area of law. Perhaps the seminal case on the deductibility of earmarked contributions is *Thomason v. Commissioner*. In *Thomason*, the taxpayer promised to pay to a children's aid society the expenses for maintenance and education of the taxpayer's former foster child, while the child was in the legal custody of the society. After the taxpayer conferred with the supervisor of the society, the society sent the boy to a for-profit boys' ranch, which directly billed the taxpayer for the boy's expenses. The taxpayer sent the checks in payment of such expenses directly to the boys' ranch. Had the taxpayer not agreed to pay for such expenses, the children's aid society would have been unable to finance the former foster child's attendance at the boys' ranch.

The Tax Court rejected the taxpayer's argument that his payment of the boy's expenses should be considered "for the use of" the society and held that the taxpayer's claimed deduction was improper. Citing Supreme Court precedent on the essential characteristics of charitable trusts, the Tax Court stated that "[c]harity begins where certainty in beneficiaries ends" and "the uncertainty of the objects... forms the essential element of charity." A "bequest" is private, rather than charitable, "[w]henever the beneficiary is designated by name." The payments secured "special privileges" for the boy that the society would not itself have provided, and the payments only incidentally relieved the society of its burdens. Moreover, this was not a case in

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74. Id.
75. Id.
76. Id.
77. Id.
78. 2 T.C. 441 (1943).
79. See id. at 442.
80. See id. at 442-43.
81. See id. at 443-45.
82. Id. at 443 (citing Russell v. Allen, 107 U.S. 163 (1883)).
83. Id. at 444. The Tax Court also cited *Tilles v. Commissioner*, 38 B.T.A. 545 (1938). *Thomason*, 2 T.C. at 444.
84. See *Thomason*, 2 T.C. at 444. Finding in favor of the taxpayer was not compelled simply because the payments relieved the society of "some financial burden." *Id.*
which "an exempt organization incurs liabilities in the general performance of its functions and requests its donors to pay their contributions to its creditors."85 Rather, the taxpayer paid the amounts for the benefit of only a "designated individual," not for any "other individuals" or "other purpose of the society."86

The Tax Court in Thomason did not limit its ruling to transfers purportedly made "for the use of" the charity, and thus Thomason is relevant to transfers made "to" the charity. Indeed, the court stated that the phrase "for the use of" "does not touch upon the essential requirement of indefiniteness of bounty."87 Instead, as previously discussed,88 the court emphasized that the payment was designated for the use of a specific individual. This designation still easily could have been present had the taxpayer made the society (rather than the boys' ranch) the nominal payee of his check; the taxpayer simply could have conditioned payment upon the society's transfer of funds to the boys' ranch in payment of the former foster child's expenses (a condition similar to the arrangement between the college and taxpayer in Tripp). Thus, the court's rationale applies to earmarked transfers made "to" the charitable transferee (as in Tripp), as well as to earmarked transfers made "for the use of" the charitable transferee.89

85. Id.
86. Id. At the inception of its legal analysis, the court summarized its rationale as follows:

The contributions here in question were paid directly to Sunset Ranch for the tuition and maintenance of a particular child. They were earmarked from the beginning not for a group or class of individuals, not to be used in any manner seen fit by the society, but for the use of a single individual in whom the petitioner felt a keen fatherly and personal interest.

Id. at 443.
87. Id. at 444. As discussed infra in the text accompanying notes 171-172, the Supreme Court interpreted the phrase "for the use of" generally as "in trust for" in Davis v. United States, 495 U.S. 472, 485 (1990).

88. See supra note 86 and accompanying text.
89. A case factually similar to Thomason is Davenport v. Commissioner, 34 T.C.M. (CCH) 1585 (1975), in which the taxpayers, who were parents of a minister employed by a tax-exempt charitable organization, made rental payments directly to the owner of certain property. Id. at 1585-86. The property was used both as a part-time residence for the minister and his family and as a storage and administrative site for the charitable organization. Id. at 1586. The taxpayers argued that their deduction was proper because the charitable organization would have been required to pay some amount of rent to house the minister's family and to store the organization's equipment had the taxpayers not paid it. Id. at 1586-87. The Tax Court rejected the taxpayers' argument and held that no deduction was proper. Id. at 1587-88.

Citing Thomason, the Tax Court stated that no evidence showed that the organization would have rented property had the taxpayers not done so, and even if such evidence existed, the deduction would still be improper. Id. at 1587. By making the payments directly to the property owner, the taxpayers removed the option of the charity to use the funds as it deemed advisable. Id. This observation does not imply that the court was requiring the charitable organization to be the direct recipient of a contribution made "to" the charity. On the contrary, the court acknowledged the propriety of a deduction for a gift in trust for a charity. Id. at 1587. The court stated as follows: "[T]he charity must have full control of the funds donated in order for a
The IRS has reached results similar to these decisions, with or without explicit reference thereto, in its official interpretive rulings. For example, in Revenue Ruling 57-211,90 the IRS ruled, with little analysis, that payments made to a state hospital for the purpose of reimbursing the state for the care of a patient are not deductible as charitable contributions because they are not contributions "to or for the use of" the state "for exclusively public purposes."91 Similarly, in Revenue Ruling 54-580,92 the IRS ruled that payments for tuition made on behalf of children attending parochial school are not deductible as charitable contributions because they are made for the benefit of a particular child or children.93 In contrast, payments made to or for the use of organizations operating the schools "in carrying out their general purposes and not in any way earmarked for the benefit of particular children" would be deductible.94 In Revenue Ruling 61-66,95 the IRS denied a deduction for transfers to a university where the transferor specifically instructed the transferee to use the taxpayer to be entitled to a charitable deduction, and such is not the situation where the funds are designated by the donor for the use of a particular individual." Id. at 1587-88.

In addition to citing Thomason, the court cited Kluss v. Commissioner, 46 T.C. 572 (1966), and McMillan v. Commissioner, 31 T.C. 1143 (1959), as direct authority. In Kluss, the Tax Court held that a taxpayer's contribution to a noncharitable organization was made "to or for the use of" such organization (and therefore was not deductible), rather than to the charitable organizations that ultimately received some benefits from the recipient organization's operations, where the donor's intent was to benefit the noncharitable organization and to give it complete control over disposition of the funds. 46 T.C. at 574-76. In McMillan, the Tax Court held that the taxpayers' payment of the living expenses of a child they received into their household with the expectation of adopting the child were not contributions to the charitable organization legally obligated to support the child prior to adoption. 31 T.C. at 1146-47. The Tax Court also opined that a critical factor in the determination of the deductibility of an amount claimed to be a charitable contribution is the transferors' intent. See Davenport, 34 T.C.M. (CCH) at 1588. According to the Tax Court, the evidence indicated that the taxpayers intended to benefit their son, and therefore the contributions should be viewed as having been made for his benefit, not for that of the charity (even though the payments may have incidentally relieved the charity of a financial burden). Id.; see also Marshall v. Welch, 197 F. Supp. 874 (S.D. Ohio 1961) (holding that payments by taxpayers to a home for crippled children and elderly people were not deductible to the extent that funds were apparently designated for the purchase of a wheelchair for the taxpayers' son); Patterson v. Comm'r, 53 T.C.M. (CCH) 847, 849 (1987) ("Where a taxpayer donates funds to an individual ostensibly as a representative of a charity (or earmarks donated funds for a particular individual), in determining whether the funds are used 'to or for the use' of a charity, so as to be deductible, the critical factor is the taxpayer's intent (i.e., did the taxpayer intend to benefit the charity or the individual?).... A taxpayer's intent to benefit the charity is manifested by placing the contributed funds under the charity's control.").

90. 1957-1 C.B. 97.
91. Id.
93. See id. (citing Thomason v. Comm'r, 2 T.C. 441 (1943)).
94. Id.
95. 1961-1 C.B. 19.
money as an independent research grant for a named professor. In denying the deduction, the IRS reasoned that the university lacked control over the disbursement of the transferred funds, and therefore functioned as a mere conduit between the transferor and the professor.

One other administrative ruling is noteworthy for its clear articulation of what test, in the opinion of the IRS, should govern earmarked contributions. In Revenue Ruling 68-484, a corporation was a significant employer that hired employees primarily from the pool of graduates of educational institutions. The corporation established programs financially supporting these schools. The IRS ruled that the transfers by the corporation to qualified charities pursuant to these programs were deductible charitable contributions. The IRS set forth the following test:

For purposes of determining that a contribution is made to or for the use of an organization described in section 170 rather than to a particular individual who ultimately benefits from the contribution, the organization must have full control of the use of the donated funds and the contributor's intent in making the payment must have been to benefit the charitable organization itself and not the individual recipient.

As discussed infra, the authorities discussed in this section do not uniformly articulate the test that governs the deductibility of an earmarked transfer to a charitable organization. However, these authorities do reach uniform results in cases involving a donor who, upon her own initiative, restricts the charitable transferee's use of funds so as to benefit a person selected by the donor. In all such cases, a deduction has been denied.

b. Transferor's Non-Binding Preference

When, if at all, is a deduction available to a transferor who does not contractually restrict the charitable transferee's use of funds, but instead merely expresses her preference that the funds be used to benefit a person named by the transferor? Considering certain language in the opinions and rulings discussed above, one might expect that a taxpayer will be denied a charitable contribution.

96. Id. at 19-20. At the time, the professor was on sabbatical and received no compensation from the university and performed no services for the university. Id. at 20.
97. Id.
99. See id. at 106.
100. Id. at 107.
101. Id. at 106-07 (citing Thomason v. Comm'r, 2 T.C. 441 (1943), and McMillan v. Comm'r, 31 T.C. 1143 (1959)).
102. See infra Part I.B.1.c.
deduction for a transfer to charity that is in any manner specified for the benefit of a particular individual, even if that specification is not legally binding on the charity. After all, we have been told by the authorities that "the uncertainty of the objects . . . forms the essential element of charity," and that a deduction is proper only if the donor’s intent is to benefit the charitable transferee, rather than an individual designee. One also may readily imagine situations in which a taxpayer transfers sums to a charity coupled with an expression of a preference that the charity use the funds in a specified manner, yet the taxpayer and the charity alike are fully aware of the minimal probability that the charity will use the funds in a manner contrary to the taxpayer’s wishes.

A case that generally supports the deductibility of contributions made by a donor who merely expresses a non-binding preference that funds be used to benefit a secondary beneficiary is *Peace v. Commissioner.* In *Peace,* the taxpayer mailed numerous checks during the years in issue to a Christian missions organization. Each check was made payable to the organization, although the taxpayer wrote the names of four missionaries on the notation section of eleven of the checks. The taxpayer also wrote three letters to the organization at various times, each of which referred to the taxpayer’s contributions “for” or “for the support of” or to “take care of” missionaries specified by name. Further, the taxpayer enclosed checks for four months in remittance envelopes that designated the missionaries to be supported by the transfers. In response to the taxpayer’s statement on one such envelope that he preferred his donation to support only the designated missionaries, the organization sent the taxpayer a pamphlet making clear that all funds donated for the support of missionaries were pooled and distributed equally amongst all missionaries for their support.

The Tax Court held that the taxpayer’s charitable contribution deductions were proper. The court reasoned that the taxpayer’s designation was merely an expression of desire that the organization credit the sums to the support allowances of the named missionaries. Under its policy, the transferee organization had “exclusive control” of the “administration and distribution” of

103. *Thomason,* 2 T.C. at 443 (citing Russell v. Allen, 107 U.S. 163 (1883)).
105. See infra text accompanying notes 374-376.
106. 43 T.C. 1 (1964).
107. Id. at 2-3.
108. Id.
109. Id. at 3-4.
110. Id. at 5-6.
111. Id. at 7-8.
112. Id. at 7.
donated funds. The taxpayer was aware of this fact, and intended the contributions to be placed in a common pool. The court distinguished this case from others such as Thomason, in which "the intent of the donor was that the gift . . . go directly to or be used solely for certain specified individuals." As in Revenue Ruling 62-113, the taxpayer's intent was to place the contributions in a fund subject to the donee's control.

Peace is an important case in the law of earmarked transfers to charity, particularly when one is careful not to segregate the Tax Court's legal conclusions from the facts of the case. No honest, realistic observer can deny that the taxpayer desired to support the named missionaries affiliated with the transferee religious organization. Yet the court concluded that the taxpayer's intent was not that the gifts pass directly to the named missionaries, but that the funds be placed in a common pool subject to the organization's control, in accordance with the organization's stated policy. A plausible reading of Peace is that a transferor may express a preference or wish that the transferee use the transferred funds to benefit a person designated by the donor in furtherance of its charitable purposes, at least where (i) the designated person is not related to the transferor, and (ii) the charitable transferee is not legally bound to comply with the donor's preferences (i.e., the charity has control over the administration and distribution of the transferred funds). Under this reading, the "donor's intent" is irrelevant, and the determining factor is whether the donor has subjected the transferred funds to the charitable transferee's legal control.

The IRS appears unwilling to interpret Peace quite so broadly. In Revenue Ruling 79-81, members of a leadership-training entity affiliated with a religious organization solicited funds on behalf of the religious organization. The amount solicited approximated each member's education-related costs of participating in two years of the

113. Id.; cf. Estate of Robinson v. Comm'r, 1 T.C. 19 (1942) (holding deductible from testator's gross estate the value of property placed in trust to provide scholarships to persons in need of financial aid, with a non-binding preference for relatives of the testator).
114. See Peace, 43 T.C. at 7.
115. Id. at 7-8.
116. 1962-2 C.B. 10 (discussing contributions to church fund for support of missionaries).
117. See Peace, 43 T.C. at 8.
118. The taxpayer was personally interested in the work of those specific missionaries, and had given some of them personal gifts apart from the transfers to charity. See id. at 4. He plainly considered himself to be supporting the named missionaries (as evidenced by the language of his correspondence), see id. at 3-5, and even once transparently (albeit sincerely) expressed a desire that his contribution be used exclusively for the named missionaries. See id. at 5 ("I would prefer the whole amount in [the] future to go to their support only;[;] do not break it up.").
119. Id. at 8.
120. 1979-1 C.B. 107.
training program. Before actually making any transfers, prospective supporters would sign a pledge form that listed the name of the member whom they would "sponsor."\footnote{121}{See id. at 107. Often, a donor was a member's parent. See id. However, when a member's parents were unable to contribute, she was expected to solicit sponsorships from others. Id. Because the IRS did not distinguish transfers from parents from those from non-relatives, this revenue ruling should not be explained exclusively in terms of the familial relationship between some sponsors and their individual designees.} The pledge form stated that the entity's governing board retained discretion over the use of the funds, and that they were non-refundable.\footnote{122}{Id.} When fulfilling their pledges by making payments to the entity, donors would list the student names on pre-addressed payment envelopes.\footnote{123}{Id.} On these facts, the IRS held that the transferors could not deduct their payments to the religious organization.\footnote{124}{See id. at 108.} The IRS reasoned that transfers to charitable donees which have been "earmarked" by the transferor for a specified individual are nondeductible gifts to that individual.\footnote{125}{Rev. Rul. 62-113, 1962-2 C.B. at 10. The IRS cited Tripp v. Commissioner, 337 F.2d 432 (7th Cir. 1964), as a case denying a deduction for an earmarked transfer. For a discussion of Tripp, see supra text accompanying notes 68-77.} Citing Revenue Ruling 62-113, the IRS stated that a deduction is available if "a gift is intended by the donor for the use of the organization and not as a gift to an individual,"\footnote{126}{Id. (citing Rev. Rul. 62-113, 1962-2 C.B. 10). The IRS cited Tripp v. Commissioner, 337 F.2d 432 (7th Cir. 1964), as a case denying a deduction for an earmarked transfer. For a discussion of Tripp, see supra text accompanying notes 68-77.} and then approvingly cited Revenue Ruling 68-484 for its two-part "transferee control" and "transferor intent" test.\footnote{127}{Rev. Rul. 62-113, 1979-1 C.B. at 108 (citing Rev. Rul. 68-484, 1968-2 C.B. 105). The point of this remark in the revenue ruling is not entirely clear. Presumably, the IRS meant only that funds received by the religious organization were necessarily used to provide the educational services and facilities for the benefit of the students, rather than for other exempt purposes.} In the opinion of the IRS, a transferor's designation of a particular student on the pledge form and payment envelopes evidenced the transferor's intent to benefit the individual recipient, rather than the religious organization, which was the immediate transferee of the funds.\footnote{128}{Id.} Moreover, because the costs of educational services and facilities consumed by each student approximated the expected solicitations by each student, the IRS viewed the religious organization's control of the use of funds as limited to that of any school over tuition payments.\footnote{129}{Id.}

c. Summary and Assessment

Unhappily for many charities and prospective donors (not to mention the government), the law in this area lacks clarity. The
judicial and administrative authorities do not uniformly articulate any single test for determining whether a transfer to charity is deductible if the transferor to some degree designates the secondary beneficiary. Most authorities appear to rely upon the law of charitable trusts, either explicitly or by implication. The apparent position of the IRS is far from generous to transferors in this area.

An analysis of the relevant authorities indicates that the courts and the IRS have relied most extensively on one or more of three factors in determining whether a transferor is entitled to deduct a transfer to a charitable transferee when the transferor, upon her own initiative, designates the secondary beneficiary. The first factor is whether the charitable transferee has the right to exercise legal control over the disposition of the transferred funds. Both Davenport and Peace relied heavily upon the presence or absence of the charity’s legal control over the funds at issue in reaching their decisions. Thomason may be understood similarly, insofar as the court noted that the taxpayer’s payments were marked for a particular person, “not to be used in any manner seen fit by the society.” Likewise, in Tripp the court observed that the payments received by the college had not been made to a general scholarship fund from which the school could disburse sums to whomever it wished. The IRS views the presence of the charitable transferee’s control over transferred funds as a necessary, though not sufficient, condition for deductibility under Code section 170, as is apparent from the two-part “transferee control” and “transferor intent” test of Revenue Ruling 68-484, followed in Revenue Ruling 79-81.

A second relevant factor is whether the taxpayer’s transfer is used to pay an amount that the charitable transferee otherwise would be responsible for paying, without any designation by, or agreement with, the taxpayer. Thus, the court in Tripp observed that the transferee college never obligated itself to provide for the secondary beneficiary’s education from its own scholarship funds. Similarly, in

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130. As discussed below, some authorities also rely on a fourth factor: the relationship between the transferor and the secondary beneficiary. See infra notes 360-373 and accompanying text. In cases not involving a quid pro quo payment securing benefits for a taxpayer or a member of his family, it does not appear that this factor, standing alone, has been accorded the same importance as the other three factors discussed herein. Rather, it is probably seen as relevant in establishing the presence of another factor: transferor intent.

133. See supra notes 89, 106-129 and accompanying text.
134. Thomason v. Comm’r, 2 T.C. 441, 443 (1943).
135. See Tripp v. Comm’r, 337 F.2d 432, 436 (7th Cir. 1964).
137. 1979-1 C.B. 107, 108. The absence of transferee control was also fatal to the deduction in Revenue Ruling 61-66, 1961-1 C.B. 19, 20.
138. See Tripp, 337 F.2d at 436.
Thomason, the court emphasized that the taxpayer's payments purchased "special privileges" for the former foster child that the charity would not have extended in its usual operations, and contrasted the facts before the court with the situation in which a charity asks donors to pay outstanding liabilities incurred by the charity in conducting its normal activities.\textsuperscript{139} Moreover, although the court in \textit{Peace} did not cite this factor as such, in ruling for the taxpayer it heavily relied upon the organization's general policy of pooling all contributions supporting its missionaries.\textsuperscript{140} Therefore, one may understand \textit{Peace} as holding for the taxpayer in part because the charitable transferee had indeed assumed responsibility for the support of the missionaries designated by the taxpayer through the donations the charity received from all sources.

Notwithstanding the judicial reliance upon this factor, the IRS does not appear to place great weight on it, at least not consistently.\textsuperscript{141} For example, the IRS ruled in Revenue Ruling 57-211 that payments made to a state hospital to reimburse the state for the care of a patient are not deductible because they are not contributions "to or for the use of" the state "for exclusively public purposes."\textsuperscript{142} Because the ruling provides few facts, discerning its full force and scope is difficult. Namely, it is not clear whether the patient was expected to pay for her care. If so, a reasonable person would not expect the state to provide the hospital care for free, and therefore the taxpayer was rightly disallowed the deduction. However, if the patient was not able to pay for her care, it would generally fall upon the state to incur all costs associated with the hospital care. In that case, the taxpayer's payment surely would have relieved the state of a liability for costs incurred in carrying out its public purposes, and under the foregoing cases, this factor would suggest the propriety of the charitable contribution deduction. The failure of the ruling to distinguish the two cases of patients (one financially stable, and the other poor) at least suggests that this factor is not always accorded great significance by the IRS.

A final factor of importance to some courts and the IRS is whether the transferor's intent in making the transfer is to benefit the secondary beneficiary, rather than the charitable transferee. To illustrate, the \textit{Tripp} court noted that the taxpayer intended to benefit the secondary beneficiary from the time he transferred amounts to the college.\textsuperscript{143} Perhaps more importantly, the court in \textit{Davenport} characterized as a "critical factor" that the transferor intended to benefit the secondary beneficiary.\textsuperscript{144} Most striking of all is the IRS's

\begin{footnotes}
\footnotetext{139. See \textit{Thomason}, 2 T.C. at 444.}
\footnotetext{140. See \textit{Peace}, 43 T.C. at 7-8.}
\footnotetext{141. See Rev. Rul. 57-211, 1957-1 C.B. 97.}
\footnotetext{142. \textit{Id.}; see also supra notes 90-91 and accompanying text.}
\footnotetext{143. \textit{Tripp}, 337 F.2d at 436.}
\footnotetext{144. \textit{Davenport} v. Comm'r, 34 T.C.M. (CCH) 1585, 1588 (1975).}
\end{footnotes}
two-part test of Revenue Ruling 68-484, the second prong of which states that "the contributor's intent in making the payment must have been to benefit the charitable organization itself and not the individual recipient." The IRS later applied this test in Revenue Ruling 79-81 to deny a deduction for contributions designated for particular students, notwithstanding that all transfers to the charity were non-refundable, and that the charity’s governing board reserved the legal right to dispose of funds however it so determined. The IRS opined that a transferor's designation of a particular student manifested the transferor's intent to benefit the individual recipient, rather than the immediate charitable transferee of the funds.

In addition to failing a normative analysis, this reliance by the IRS and some courts upon the transferor's intent to benefit a named individual is at least suspect in the wake of Hernandez. Of course, in Hernandez, the Court was not called upon to address the deductibility of transfers to charity coupled with the transferor's designation of an unrelated secondary beneficiary. But the rationale and approach of the Court in Hernandez are quite relevant to the matter of whether, or perhaps to what extent, the courts and the IRS may continue to probe the transferor's "intent" to benefit the secondary beneficiary, rather than the charitable transferee. In Hernandez, the Court extolled the virtues of examining the external features of a transaction in determining whether a taxpayer has made a deductible contribution or gift to charity. Examining such external aspects of a transaction precludes "the need for the IRS to conduct imprecise inquiries into the motivations of individual taxpayers." Thus, if the inquiry into the deductibility of a certain transfer involves a determination of what motivated the transfer, the inquiry is misguided under Hernandez. In other words, under Hernandez, the courts and the IRS should not determine the deductibility of a transfer to charity on the basis of whether a given taxpayer was motivated by the desire to benefit in some way a named person affiliated with the charitable transferee. However, if the inquiry is limited to examining the "external features" of the transaction so as to determine whether the transferor has truly subjected the transferred funds to meaningful control and oversight by the charity, the inquiry into the transferor's intent would appear acceptable under Hernandez.

146. See supra notes 120-129 and accompanying text (discussing Revenue Ruling 79-81, 1979-1 C.B. 107).
147. See infra Part III.A.1.
149. See supra notes 42-67 and accompanying text.
151. See supra notes 104-117 and accompanying text for a discussion of Peace, which follows this approach.
A separate question is what should be the governing standards for determining the deductibility of a transfer to charity when the transferor designates a secondary beneficiary. Before such question is explored, this Article examines two other major aspects of positive law: the deductibility of transfers made to charity when the donor specifies himself or related persons as the secondary beneficiaries, and the deductibility of transfers made to charity with the knowledge that the charity has pre-selected a named secondary beneficiary who will benefit from the transferred funds.

2. When Secondary Beneficiaries Include Transferor or Members of Her Family or Household

a. Transferor's Binding Designation

Compared to the law governing earmarked transfers to charity in the circumstances described thus far, the law is refreshingly straightforward in its treatment of transfers to charity when the transferor designates herself or a close relative as the secondary beneficiary of the transfer, and the transferor's designation is binding on the charity. As a general rule, a charitable contribution deduction is not allowed in such cases. Such express designations resulting in benefits from the charity to the donor often constitute one of the most egregious types of efforts to designate the people who will benefit from donated funds. They generally represent the classic quid pro quo exchange resulting in the denial of a deduction under Hernandez. Insofar as Hernandez teaches that a taxpayer will be denied a charitable contribution deduction whenever she reasonably should expect that she will receive a benefit from the transferee in exchange for her transfer (which benefit is presumed to be commensurate to the amount transferred), it follows that a transferor's binding designation of herself (or perhaps a close relative or household

152. See, e.g., Cooper v. Comm'r, 264 F.2d 889, 891 (4th Cir. 1959) (holding that payments to a college and university for the expenses incurred by taxpayer's grandchild were not deductible charitable contributions); Marshall v. Welch, 197 F. Supp. 874, 875-76 (S.D. Ohio 1961) (holding that payments by taxpayers to a home for crippled children and elderly people were not deductible to the extent that funds were designated for the purchase of a wheelchair for the taxpayers' son; holding that funds not designated for the exclusive benefit of taxpayers' son were deductible); Channing v. United States, 4 F. Supp. 33, 34-35 (D. Mass. 1933) (holding that payments for tuition charged by an educational institution for the education of the taxpayer's children were not deductible as charitable contributions; stating that tuition paid on behalf of children is a type of family expense), aff'd, 67 F.2d 986 (1st Cir.), cert. denied, 291 U.S. 686 (1934); Fausner v. Comm'r, 55 T.C. 620, 623-25 (1971) (holding that payments made by taxpayers to parochial schools and a military academy for tuition and books for taxpayers' children were nondeductible personal, living or family expenses, rather than deductible charitable contributions).

153. See supra text accompanying note 65.
member) as the secondary beneficiary will foreclose a charitable contribution deduction. Indeed, even under the most restrictive possible interpretation of Hernandez—that a deduction is unavailable for a transfer to charity that is structured in form as a quid pro quo exchange—a transferor’s binding designation of herself as the secondary beneficiary should result in disallowance of a charitable contribution deduction.

When the private benefit inherent in the exchange is received directly by the transferor or a member of the transferor’s family, a deduction is also properly denied based on Code section 262, which generally denies a deduction for any “personal, living, or family expenses.” When the quid is received by the taxpayer in exchange for the quo provided to the charity, the transfer to charity would appear to be a nondeductible “personal” expense under Code section 262. Similarly, if the quid is received by a member of the taxpayer’s family in exchange for the quo provided to the charity, the transfer should be nondeductible as a “family” expense under Code section 262. Unsurprisingly, in quid pro quo cases involving the receipt of a benefit from a transferee charity by a member of the family of the transferor, several courts have cited Code section 262 as support for denying the deduction.

b. Transferor’s Non-Binding Expression of Preference

What are the tax consequences of a transfer to charity when the transferor designates herself or a close relative as the secondary beneficiary of the transfer, but the transferor’s designation is merely a non-binding preference communicated to the charity? Arguably, a deduction might be proper where the charity in fact conveys a benefit upon the secondary beneficiary who is “preferred” by the transferor, if the charitable transferee actually has legal control over distribution of the transferred funds. However, under Hernandez, this position would be unwarranted in many situations.

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155. Id. When the benefit provided by the charity in exchange for a transfer thereto is enjoyed by a member of the taxpayer’s family whom the taxpayer is legally obligated to support (such as a minor child), one could also characterize the expense as a “personal” expense of the taxpayer.
156. At some point, lines must be drawn concerning the degree of kinship that qualifies a person as a member of the taxpayer’s family, if the availability of the deduction hinges upon whether a secondary beneficiary is considered a member of the taxpayer’s family.
157. See, e.g., Channing, 4 F. Supp. at 34-35; Fausner, 55 T.C. at 624.
158. Some support for this position arguably appears in a line of cases involving testamentary trusts in which the trustee is directed to give preference to making distributions to the testator’s relatives, who are members of a large, indeterminate class of potential beneficiaries. See, e.g., Canal Nat’l Bank v. United States, 258 F. Supp. 626, 630 (D. Me. 1966) (stating in dicta that the purposes of a testamentary trust
The dispositive factor in *Hernandez* is whether the transferor reasonably should expect that she will receive a benefit from the transferee in exchange for the transfer. A taxpayer may reasonably expect a return benefit, even though her designation of the secondary beneficiary is expressly non-binding. For example, if the charity commonly provides goods, services, or other benefits to those who transfer to the charity sums equal to the fair market value of those goods, services, or benefits,159 under *Hernandez* the transfer should not qualify as a deductible charitable contribution. In such circumstances, the deduction should be denied regardless of whether the transferor makes a binding designation of herself as the secondary beneficiary, merely expresses a non-binding preference for herself as the secondary beneficiary, or remains absolutely silent about what individual shall benefit from the transfer.160

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159. See supra notes 92-97 and accompanying text (discussing transfers to charitable schools).

160. On the other hand, there may be situations in which a transferor who makes a non-binding recommendation of himself or a family member as the secondary beneficiary should be entitled to a deduction for his transfer to charity under *Hernandez*, even when the secondary beneficiary in fact receives a benefit from the charity following the transfer. For example, consider a taxpayer who endows a Boston homeless shelter with numerous beds, and expresses a non-binding preference that any relatives of the settlor are the primary beneficiaries of the trust. See *Davis v. Comm'r*, 55 T.C. 416, 422-25 (1970); cf. *Granger*, 57 F. Supp. at 504 (stating that had the testator "strictly limited his trusts to the use of his relatives," no deduction would have been proper).

159. See supra notes 92-97 and accompanying text (discussing transfers to charitable schools).
C. When Charitable Transferee Unilaterally Pre-selects an Individual to Benefit from Funds Transferred by Taxpayer

The final major situation to be analyzed under existing positive law is also the most thought-provoking. Consider the following example. An international hunger-relief organization solicits funds to feed children. The organization sends the taxpayer a picture of one hundred famished children and asks her to support a child whose picture has been circled by the charity by sending the charity an amount with which the organization can feed the child for one year. A brief biography of the pre-selected child is mailed with the solicitation for funds. The taxpayer is moved with compassion for the child, and sends the charity the amount requested, directing it to use the funds to feed the designated child. The legal question thus raised by this hypothetical is the following: when a charitable organization, rather than the transferor, initially designates a particular individual to receive the benefit of transferred funds in furtherance of the organization's charitable purposes, are transfers to the charity made by transferors specifically for such designated persons deductible as charitable contributions? At least under certain circumstances, existing authorities appear to answer this question affirmatively.

At first blush, permitting a taxpayer to deduct a transfer in this situation seems to contradict several principles and factors that courts and the IRS use to evaluate the deductibility of contributions to charity. For example, one guiding principle has been that "the uncertainty of the objects... forms the essential element of charity." Further, some authorities state that a deduction is proper only if the donor's intent is to benefit the charitable transferee, rather than an individual designee. Finally, the charity's post-transfer discretion over the use of the transferred funds is highly circumscribed. Although the charity will have physical control of the taxpayer's funds transferred thereto, the charity has accepted the transfer upon the express understanding that the funds will be used to benefit a specified individual.

Notwithstanding these observations, the taxpayer in the preceding hypothetical has a strong case for a charitable contribution deduction under existing precedent. In *Winn v. Commissioner,* three churches supported the work of a foreign missionary. To raise support for the missionary, one church sponsored several special days named in honor of the missionary, on which days a church elder (the missionary's father) deposited contributions he received on behalf of the church.

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161. Thomason v. Comm'r, 2 T.C. 441, 443 (1943).
162. See, e.g., Rev. Rul. 68-484, 1968-2 C.B. 105, 106-07. Of course, as discussed above, inquiring into the taxpayer's subjective motivation for making a contribution to charity is probably unjustified after *Hernandez.*
163. 595 F.2d 1060 (5th Cir. 1979).
into a personal account of the missionary. The taxpayer, a first cousin of the missionary, wrote a check designated for the missionary’s fund and claimed a charitable contribution deduction. Reversing the Tax Court, the United States Court of Appeals for the Fifth Circuit held that the contribution was “for the use of” the church, and therefore the deduction was properly claimed, because (i) the church sponsored the missionary days for the express purpose of raising money for a charitable purpose of the church; (ii) a church officer received the donations and handled them in accordance with the church’s wishes; and (iii) the contributions were in fact distributed as the church had intended.

The Fifth Circuit revisited the holding and rationale of Winn in Brinley v. Commissioner. The Brinley court interpreted Winn to hold that the church therein had maintained “control” over donated funds because the church had solicited funds for a specific charitable purpose. The court distinguished Winn from cases disallowing a deduction where donors unilaterally have restricted contributions for the use of private individuals: “A different situation arises . . . where the charitable organization solicits funds for a specific charitable purpose. . . . [T]he charity has control and discretion because it has created a specific charitable cause and has solicited funds in support of that cause.” The court concluded that control is established where, as in Winn, a donor makes a contribution to a charity in response to the charity’s solicitation of funds in support of a named charitable purpose.

A few years after Brinley, the Supreme Court decided Davis v. United States, which plainly overrules Brinley, but is not necessarily inconsistent with Winn. In Davis, the Supreme Court denied a deduction to taxpayers who (as in Brinley) claimed a deduction for payments made directly to their son, a missionary of their church, which payments were requested (at least in form) by the taxpayers’ church. The Court held that a contribution is “for the use of” a charity if it is held in a legally enforceable trust for the charity or in a

164. Id. at 1065.
165. Id.
166. Id.
167. 782 F.2d 1326 (5th Cir. 1986). The Brinley court was faced with the decision of whether the taxpayers could deduct payments made directly to their son, who was engaged in missions work in the United States. Vacating and remanding the judgment entered by the Tax Court, the court held that the taxpayers could deduct the payments if they could show either that their payments primarily benefitted their church or if the church maintained discretion as to the use of the donated funds. Id. at 1336. To the extent that Brinley held that the taxpayers could deduct payments made directly to their son, it has been overruled by Davis v. United States, 495 U.S. 472 (1990). See infra notes 170-172 and accompanying text.
168. Brinley, 782 F.2d at 1334 (emphasis added).
169. Id. at 1335.
similar legal arrangement.\textsuperscript{171} Most important to the present analysis, the Court reasoned that when contributions are placed in a trust for a charity, the charity "ha[s] significant legal rights with respect to the disposition of donated funds."\textsuperscript{172}

How \textit{Davis} affects \textit{Winn} is debatable. The \textit{Davis} Court did not interpret the phrase "to or for the use of," but only "for the use of." Nor did the \textit{Davis} Court even speak to the issue of the degree of "transferor uncertainty" that must exist as to the identity of potential ultimate beneficiaries. Therefore, the question remains as to whether a transfer made directly to a charity, or even one purportedly made in trust for a charity, is deductible as a charitable contribution when the transferor (i.e., the donor or settlor) responds to a solicitation by the charity for funds that will benefit designated individuals. To be sure, the Fifth Circuit in \textit{Winn} stated that the transfers made to the officer of the church were "for the use of" the church. If the court did not intend the phrase "for the use of" to mean "in trust for," the opinion is not good law under \textit{Davis}. But the opinion need not be so read. First, one may view the church officer in \textit{Winn} as the trustee of the transferred funds at issue, who disbursed the funds to the designated missionary's account at the request of the beneficiary of the trust (i.e., the church). Insofar as the intention to create a trust is necessary to establish a trust relationship,\textsuperscript{173} this view of the facts may be untenable. More plausible is that the church officer received the transferred funds at issue as an agent of the church, and in that capacity transferred them at the request of the church (the principal) to the designated missionary's account. Under this view of the facts, the court's decision is justified because there was a contribution "to"

\begin{itemize}
\item \textsuperscript{171} See \textit{id.} at 485. The Court found support for its interpretation in the legislative history of Code section 170, which initially allowed a deduction only for contributions "to" charitable corporations and associations; the section was thereafter amended to allow a deduction for contributions made to charitable trusts and foundations. \textit{See id.} at 480-81. Furthermore, the phrase "for the use of" suggests a "trust relationship" under the common law, which views a "use" as a form of trust arrangement. \textit{See id.} at 481. Moreover, understanding "for the use of" as "in trust for" (or in a similar legal arrangement) comports with the congressional goal of encouraging the development of useful charities, insofar as a charity that is the beneficiary of a trust has the legal authority to compel a trustee to adhere to the terms of trust and thereby "ensure that donated funds are properly used." \textit{Id.} at 483. Any broader interpretation of the phrase "for the use of" "would tend to undermine the purposes of § 170 by allowing taxpayers to claim deductions for funds transferred to children or other relatives for their own personal use." \textit{Id.} at 485.

In dictum, the Court also mentioned the nature of contributions "to" a qualified donee, one aspect of which is relevant for present purposes. The Court stated that "a contribution made in trust for a charity does not give the charity immediate possession and control, as does a donation directly to a charity." \textit{Id.} at 483-84. Thus, it appears to be the Court's understanding that "possession and control" of donated funds by the charitable transferee is generally inherent in a contribution "to" the charitable transferee.
\item \textsuperscript{172} \textit{Id.} at 483.
\item \textsuperscript{173} \textit{See infra} note 354 and accompanying text.
\end{itemize}
the church, even though the court characterized the contribution as having been made "for the use of" the church. This interpretation finds additional support in the court's reference to another opinion holding that a contribution designated for specific charitable purposes is still made "to or for the use of" the charitable transferee. 174

Moreover, the rationale of Davis does not compel the conclusion that the Supreme Court would have denied the deduction claimed by the taxpayer in Winn. The Davis Court observed that a statutory interpretation which conveys to the charity "significant legal rights" over funds is superior to one which does not. Although the charity in Winn relinquished the power to name ultimate beneficiaries upon establishing a fund on behalf of one missionary, it does not follow that the charity relinquished all legal rights to ensure that funds would be properly used. To the contrary, the charity in Winn took possession of the funds through a church elder and distributed its funds in accordance with a pre-approved plan to accomplish a specific charitable purpose. Moreover, the opportunity for fraud that was present in Davis was not present in Winn, at least not to the same extent. 175

Further support for the position that Winn remains good law appears in Estate of Hubert v. Commissioner. 176 In Estate of Hubert, the decedent's estate claimed a deduction for a bequest made to two trusts. The decedent's will provided that the income of each trust would be distributed to a charitable organization "for the purpose of implementing" the missionary work of two individuals designated by the decedent. 177 Upon the retirement of the missionaries, the income and principal of each trust would be distributed to a charitable organization for the purpose of supporting the two missionaries and their spouses. On the death of the two missionaries, any remaining principal would pass to the charitable organizations for mission purposes. 178

Citing Davis and Thomason, the IRS argued that no deduction was proper because the charitable organizations to which the trust income (and later the principal) were distributed lacked full control over the donated funds. 179 The Tax Court rejected the IRS's argument.

174. Wynn v. Comm'R, 595 F.2d 1060, 1065 (5th Cir. 1979) (citing Phinney v. Dougherty, 307 F.2d 357 (5th Cir. 1962) (emphasis added)).
175. Analogous support appears in two administrative rulings. See Rev. Rul. 69-473, 1969-2 C.B. 37 (ruling that taxpayers may deduct their unreimbursed expenditures for indigent expectant mothers placed in their homes by a charitable organization); Rev. Rul. 66-10, 1966-1 C.B. 47, 48 (ruling that a taxpayer may deduct his unreimbursed expenditures for providing necessaries for hurricane victims referred to the taxpayer by a charitable organization).
177. Id. at 1066.
178. Id.
179. Id.
According to the court, Davis and Thomason were distinguishable because the charitable organizations in those cases never actually received donated funds, either outright or in trust. The real issue, according to the court, was whether the decedent intended his donations to benefit the work of the charities through the named missionaries. The court noted that the missionaries had been engaged in missionary work for a number of years, and during his life the decedent had financially supported the missionaries at the request of a local church. The decedent had no relationship to the missionaries other than through the church. The charitable organizations retained discretion in determining the amount of funds to be given the missionaries during their retirement and the methods of applying the funds. Finally, under general principles governing charitable trusts, each charity had discretion in implementing its charitable purposes, and state attorneys general have responsibility for ensuring that a charity properly serves its purposes. Under all of these facts, the Tax Court held that the bequest had been made "exclusively for charitable purposes."

Estate of Hubert is hardly a model of clarity. The most important finding of the court is that the decedent "intended the bequests to be used to implement the missionary work of the charitable organizations through the named missionaries." This much of the opinion is consistent with Winn, which also involved a transfer to a charity to implement its work through a named missionary. However, Estate of Hubert goes even further than Winn, because no finding of the court establishes that, at the time of the bequest in trust, the decedent knew of a charitable beneficiary of the trust that had "pre-selected" both missionaries designated by the decedent. Rather, the decedent essentially created a trust to benefit whatever charity could be found that would carry out its purposes by supporting the missionaries designated by the decedent. Yet even as Estate of Hubert was quite generous to the taxpayer in this regard, its dictum leaves many open questions. The court stated that on different facts, it might have found that the transferor intended the bequest "to benefit one individual rather than the general public," in which case the charitable beneficiaries of the trusts would be mere conduits, and the deduction would be denied. Thus, the "transferor intent" factor appears again,

180. Id.
181. Id.
182. Id. at 1067.
183. Id. at 1066.
184. The opinion recites that both missionaries at one time had been supported at the request of a particular church (with which the decedent—the settlor of the taxpayer-estate—was once affiliated), and that one of the missionaries was still supported by that church. See id. at 1065. However, there was no finding that the other missionary was supported by that church as of the date of the decedent's death.
185. Id. at 1067 n.3.
even after Hernandez, and it is not clear in exactly what situations the Tax Court will disallow the deduction on the grounds that the transferor "intended" to benefit an individual, rather than the charitable transferee.

II. THE JUSTIFICATION OF THE CHARITABLE CONTRIBUTION DEDUCTION UNDER INCOME TAX THEORY, NORMS OF TAX POLICY, AND OTHER POLICY OBJECTIVES

In framing a methodology for determining whether, and to what extent, earmarked transfers to charity should be deductible by the transferor, it is helpful to discuss theories both rationalizing the Code section 170 deduction in general, and those rationalizing the exemption of charities from federal income taxation. While these theories may not provide a definitive answer to the question of when, if ever, earmarked transfers to charity should be deductible, the existing body of legal scholarship analyzing the justification for the charitable contribution deduction in general provides helpful normative and descriptive guidance. Three major scholarly discussions are particularly significant. The first discussion concerns whether the deduction makes sense under income tax theory. Commentators debate whether "income" as an economic concept can, to some meaningful degree, be determined, and whether charitable contributions are or should be a component of an income tax base under prevailing norms of tax theory and policy.186 In a second discussion, the deduction is analyzed primarily in light of objectives that plainly transcend the internal logic and structure of the income tax and prevailing tax policy norms.187 The third discussion seeks to justify the general exemption from federal income taxation enjoyed by qualified charitable donees as well as other entities described in Code section 501(c).188


187. In distinguishing the first and second approaches, I by no means intend to imply that income tax problems can be adequately resolved strictly by reference to "pure" economic concepts inherent in the definition of income. As others are quick to remind us, see, e.g., Mark P. Gergen, The Case for a Charitable Contributions Deduction, 74 Va. L. Rev. 1393, 1416-18 (1988), although concepts of "income" set broad parameters for what should be included in the tax base, ultimately all kinds of policy choices bear upon the decision to include or exclude an item from the tax base. I distinguish the various approaches in this paper primarily to highlight the emphases of their proponents, and to ensure that their perspectives are properly identified.

188. See generally I.R.C. § 501(a) (1994) (generally exempting from federal income taxation those entities described in Code section 501(c)).
THE TAXPAYING GOOD SAMARITAN

A. The Justification for the Charitable Contribution Deduction Under Income Tax Theory and Tax Policy Norms

1. Charitable Contributions as Non-Consumption

In his seminal article discussing what personal deductions should exist in arriving at an ideal income tax base,189 Professor William Andrews articulates his defense of the charitable contribution deduction primarily in terms of income tax theory (aided, to be sure, by tax policy norms).190 The general thesis of Professor Andrews is that under an ideal income tax, each taxpayer is taxed on his or her "aggregate personal consumption and accumulation of real goods and services and claims thereto."191 Professor Andrews embraces this thesis as a logical (if not literal) application of Henry Simons' familiar definition of personal income, which, reduced to its essence, is personal consumption plus accumulation.192 Andrews argues that if income indeed means consumption plus accumulation, a deduction is appropriate whenever money is expended for anything other than personal consumption or accumulation.193 For Andrews, taxable personal consumption consists solely of the consumption of "divisible, private goods and services," the consumption of which "by one household precludes enjoyment by others."194 Taxable personal consumption therefore does not include a taxpayer's consumption of "collective goods whose enjoyment is nonpreclusive," nor does it

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190. Cf. id. at 312 (stating that the ideal income tax must be "refined to reflect the intrinsic objectives of the tax," and that it is "imperative to consider carefully whether a provision can be defended by reference to intrinsic matters of tax policy before evaluating it as if it were something else").
191. Id. at 313.
192. Id. The long-form definition of income suggested by Simons is as follows: "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." Henry Simons, Personal Income Taxation 50 (1938).
193. See Andrews, supra note 189, at 325; cf. Alvin Warren, Would a Consumption Tax Be Fairer Than an Income Tax?, 89 Yale L.J. 1081, 1084 (1980) ("As used in this Article, 'consumption' means the ultimate use or destruction of economic resources... and 'accumulation,' the retention or saving of such resources."). Although Professor Warren does not discuss the charitable contribution deduction in this article, his thesis is relevant to the present inquiry. Warren argues that in designing a personal income tax system, one must consider not only the Haig-Simons concept of a taxpayer's personal income, but also the aggregate tax base. The aggregate tax base should be the product of society's total private capital and labor during the taxable period. Because gratuitous transfers are not productive in and of themselves, the law should not tax both the donor and the donee in the year of a gift. See id. at 1085-88. Under this theory, one can justify the charitable contribution deduction as a means of preventing the over-taxation of a society's aggregate income.
include the "nonmaterial satisfactions" derived from a taxpayer's mere act of charitable giving. 195

Professor Andrews discusses contributions to two types of charitable entities, and argues that in both cases, contributions do not constitute consumption which should be subject to tax. First, in the case of contributions to an organization which redistributes donated funds to the poor, consumption or accumulation represented by the funds (i.e., the "using up" of private goods and services during the taxable period or the increase in wealth during the taxable period) is shifted from the donor to the impoverished recipients of funds donated to charity, and the latter should not be subjected to taxation at the higher rates of tax designed for the donor's relatively higher standard of living. 196 Moreover, allowing a charitable contribution deduction places the donor in the same position as a similarly situated taxpayer who donates services to a charitable donee; in the case of the latter, although no deduction is available for the value of the contributed services, no taxable income is imputed to the volunteer for her services. 197 Andrews also discusses contributions to charity that are not necessarily used to meet the basic needs of the poor. 198

Such contributions include those made to churches, private schools, symphony associations, and other institutions which to some degree directly benefit the contributors. Andrews posits that a deduction is proper for contributions to such organizations because they generally produce public goods (or common goods), and such goods are not enjoyed by contributors in proportion to the level of their contributions. Such goods may even be (and often are) open to enjoyment by those who did not contribute anything. 199 According to Andrews, not taxing a contributor for the amount of a mere donation to such an entity, in contrast to an amount specifically paid in purchase of a good or service, is proper because there is often no satisfactory way to value the benefits provided by the charitable donee to a particular recipient of the common benefit. 200

195. Id. at 315.
196. Id. at 347. Andrews recognizes that this analysis logically would result in allowing a donor a deduction made for gifts to individuals. However, under the assumption that interpersonal gifts occur mostly between members of the same family, one may justify the current tax treatment of gifts under the theory that income is ultimately taxed at rates appropriate to the household whose consumption it supports. The charitable contribution deduction may be seen as authorizing a deduction only for consumption that a taxpayer shifts to parties who are not in the taxpayer's own household. See id. at 348-51.
197. See id. at 347 (describing situations in which individuals are not taxed on the value of the service rendered).
198. See id. at 356-70.
199. See id. at 357-61 (discussing gifts to churches and educational institutions that may be used by those who did not contribute).
200. Id. at 358-59. Moreover, insofar as the benefits from the operations of the entity flow beyond the immediate recipients of a good provided by the entity, the tax system encourages the entity to provide such benefits by allowing a deduction for
The justification for the charitable contribution deduction advanced by Professor Andrews has its share of critics. In some sense expanding on the work of Professor Mark Kelman, Professor Stanley Koppelman raises one of the most ambitious objections to Andrews' theory. Professor Koppelman relies upon the concept of income championed by Professor Stanley Surrey—"the power to consume that is reduced to economic rights and is capable of valuation." Under this concept of income, what really matters is accretion, which represents the increased power to consume. Although Professor Simons formulated income as consumption plus accumulation, those two elements should be viewed merely as "the two possible uses of accretions to wealth during the accounting period," not as "terms to be defined independently." Professor Koppelman finds support for the concept of income as the power to consume in theories of social welfare, which focus on the welfare of the individual, or on the aggregation of individual welfare. He argues that "[t]axation intended to promote individualistic conceptions of welfare should also be based upon individual measures of welfare." If income is selected as the tax base because it is the best measure of economic well-being, "it should be interpreted in an individualistic way." An individual taxpayer's "power to consume" is, according to Koppelman, the only major concept of income that "adopts an individualistic measure of welfare." What distinguishes nondeductible personal consumption from deductible expenditures is the "current personal benefit" derived by a taxpayer from the transaction. Professor Koppelman then argues, in relevant part, that if income means the power to consume, all voluntary expenditures unrelated to income-producing activities constitute

contributions thereto. See id.

201. See, e.g., Gergen, supra note 187, at 1414-26 (criticizing Andrews' theories concerning deductions); Mark G. Kelman, Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far from Ideal World, 31 Stan. L. Rev. 831, 831-58 (1979) (criticizing Andrews' notion of "private preclusive appropriation").

202. See Kelman, supra note 201, at 834 (arguing that income "tautologically consists of consumption plus savings" and that all money which a taxpayer controls or disposes of voluntarily must be characterized as either consumption or savings).


204. Id. at 694. Prof. Surrey's concept of income is rooted in the writings of Professor Henry Simons. See generally Simons, supra note 192, at 49 (conceptualizing income as the value of rights that may be exercised in consumption).

205. See Koppelman, supra note 203, at 694.

206. Id.

207. See id. at 697-705 (discussing various theories on promoting welfare in society).

208. Id. at 703.

209. Id.

210. Id. at 705.

211. Id.
taxable consumption. He specifically states that charitable contributions should not be deductible, because "[t]he expenditure of cash or property represents a clear personal benefit to the donor." What is this "clear personal benefit" received by the donor? Koppelman never supplies the answer explicitly. He does, however, refer to "the personal satisfaction resulting from voluntary expenditures" as a form of personal benefit. Perhaps, then, the "clear personal benefit" is nothing more than the utility presumed to be derived from a donation by a rational donor.

For present purposes, I need not contribute to the debate between Professor Andrews and others such as Professor Koppelman. It is now sufficient to observe only two points. First, if Andrews is right, both earmarked and non-earmarked transfers to charity generally should be deductible under Code section 170, unless the transfers secure special, private privileges for the transferor (or perhaps for members of her household). Secondly, if Koppelman is right, a deduction should be denied for non-earmarked transfers to charity and earmarked transfers alike. Both transfers consist of funds that represent the pre-transfer power to consume wealth.

2. Charitable Contributions as Reductions in Individual Welfare

Some tax policy theorists take a different track from that of Professor Andrews, and one that conflicts with the theory of Professor Koppelman, in defending the charitable contribution deduction, but one still grounded primarily in the familiar language of tax policy norms. These theorists argue that a charitable donor is less well-off after making a charitable donation than she was before the contribution. One expression of the argument is that a taxpayer who makes a charitable contribution "has neither the ability to use these funds for his or her private benefit nor the same ability to pay taxes" after making the contribution. One could also express the argument purely in terms of utility: a charitable contribution deduction is appropriate because the contribution reduces the taxpayer's welfare.

212. See id. at 706.
213. Id. at 707.
214. Id. at 705.
216. C. Eugene Steuerle & Martin A. Sullivan, Toward More Simple and Effective Giving: Reforming the Tax Rules for Charitable Contributions and Charitable Organizations, 12 Am. J. Tax Pol'y 399, 405 (1995). In discussing this view, these commentators purport to be explaining Professor Andrews' income measurement theory. See id. at 404-05. However, their brief explanation appears to reduce the rationale for the deduction to the need to account for the difference between a taxpayer's material well-being pre- and post-transfer. Professor Andrews' theory is considerably more complicated.
Professor Mark Gergen sees this argument as resting on both the premise that taxable income should be computed by reference to the satisfaction that a taxpayer receives from entering into financial transactions (albeit, through general rules that do not probe any specific taxpayer's utility), and the premise that the pleasure derived by a donor from a gift to charity is not commensurate with the pleasure from other personal expenditures. While the first premise is debatable, it surely represents one tax policy norm that enjoys a wide following. The second premise is more commonly attacked on the theory that the "voluntary" nature of a charitable contribution implies that it is just as utility-enhancing as any other personal expenditure; otherwise, a rational taxpayer would not make the charitable contribution. According to this objection, insofar as a charitable contribution does not reduce the well-being of the transferor (by theoretical necessity), her tax base must not be reduced by the amount of the charitable contribution. Of course, this objection assumes that people always act so as to maximize their utility. Although this assumption is one supported by traditional economics theory, it is subject to no small number of difficulties. However, at a minimum, it is safe to say that charitable giving likely generates some utility to donors. Such utility may consist of the pure joy of knowing that one's donated dollars may improve society in general, the relief of a conscience burdened by an awareness that some people are suffering because of poverty, a sense of merit or self-righteousness in fulfilling a perceived moral duty to share, the "bragging rights" for a large gift to a respected charitable institution, or the mere desire to silence those who repeatedly solicit funds for charity.

For present purpose, it matters not how much utility, or what form of utility, a charitable donor reaps from a gift. What matters is simply that the charitable contribution deduction is quite firmly entrenched under federal income tax law, notwithstanding that charitable contributions likely generate utility to donors in a variety of forms.

217. See Gergen, supra note 187, at 1426.
218. Cf. Dodge et al., supra note 186, at 23, 24 (discussing reasons for the "wide intuitive appeal" of the principle that taxpayers should sacrifice to government according to their standard of living or well-being). Professor Koppelman's argument against the charitable contribution deduction, discussed supra text accompanying notes 203-214, is another example of an argument relying upon the taxation of individual well-being as a norm of tax policy.
219. E.g., Kelman, supra note 201, at 880.
220. See Gergen, supra note 187, at 1429.
221. See id. at 1429-33 (criticizing the view that charitable giving necessarily results from the utility-maximizing behavior of donors).
and that such utility may be, in any given case, a significant motivation for making the charitable gift.

B. The Justification for the Charitable Contribution Deduction
Under Broader Policy Objectives

Another important theory justifying the deduction is that it provides a necessary subsidy to institutions that produce public goods. Professor Gergen offers a nice exposition and refinement of this theory, which may be summarized as follows: Without some sort of governmental subsidy such as the charitable contribution deduction, society will tend to underfund the provision of public goods on account of the freeriding problem. Numerous charitable organizations produce goods and services which may be characterized as public goods, on account of either the direct or indirect benefits of their activities. However, freeriding, the essence of which is that some people will refuse to pay for goods for which no formal charge can be imposed, tends to result in the under-production of public goods.

Borrowing from economics literature, Gergen explains why a charitable contribution deduction (or credit) may well be superior to a

223. A public (or collective) good is one, the consumption of which (1) does not reduce its availability to others (i.e., the good is non-rival); and (2) is non-exclusive among consumers (i.e., nobody can be excluded from partaking of the good). See Gergen, supra note 187, at 1393-98. A good may be classified as public even if it is not purely non-rival or non-exclusive. A good is considered public as long as the cost of excluding an individual from consumption of the good is greater than the marginal cost of supplying the good to her as an additional consumer. See id. Stated another way, a good is considered public if supplying it freely is cheaper to society than charging each user for it. See id.

224. See id. at 1396-1414.
225. Id. at 1398.
226. See id. (indicating examples such as churches, museums, and schools).
227. Instead, such people will rely on others to finance the provision of the goods. See id. The thinking goes something like this: If I will benefit from the provision of a good (say, clean air), but someone else will benefit equally from clean air, and if I will have plenty of clean air if someone else pays for it, then I will wait for someone else to pay for the clean air. The only way that my payment would ensure that I have enough clean air for myself is if I also pay for the air that others will breathe, but I am unwilling to pay for another person's use of clean air. If all or most of the population thinks in this manner, clean air will not be produced absent some type of intervention by government.

For a variety of reasons, even those who are willing to pay something will not pay a sufficient amount for the good. See id. Such reasons include the desire not to be exploited by freeriders, a lack of confidence in successful collective action, and undervaluing collective goods. See id.

direct governmental subsidy for the production of public goods. Private charitable giving enables small groups with a high preference for a public good to secure the good through collective action without the need to garner the political support for a direct governmental subsidy. If a majority of voters is indifferent as to the good, a significant probability exists that no direct subsidy for the good would be forthcoming. A tax subsidy in the form of a charitable contribution deduction or credit may therefore be necessary to overcome the freerider problem that would otherwise prevent production of a sufficient quantity of the good.\textsuperscript{229}

Why would we want to subsidize a public good that is unlikely to be produced by a direct governmental subsidy? After all, one might quite naturally posit that if the democratic process would not produce a public good through a direct subsidy, then such a good necessarily should not be produced. Professor Gergen explains by way of illustration why a charitable contribution deduction may result in the production of a public good that is closer to the ideal than the non-production of the good that would occur if voters were to reject a direct governmental subsidy:

The answer to this riddle lies in the allocative imperfection of taxes. People who desire more of a collective good, but who do not place great value on the increase, may refuse to support a subsidy because they fear that they will bear a disproportionate share of the tax cost. Recall our three-person society considering a two-unit park costing $3.00 per unit. A and B place a $1.00 value on a one-unit park and $0.50 of value on the second unit. C values each unit at $2.00. If A and B assume that the taxes to pay for the park will be shared equally, they will refuse to vote for a two-unit park because the marginal cost to each of them ($1.00) outweighs the benefit ($0.50). The problem exists because taxes are not calibrated to account for variations in preference for goods supported by government. Tax-free treatment of contributions is so calibrated, albeit roughly, because it imposes most but not all of the cost of increased support for a good on donors.\textsuperscript{230}

Professor Gergen concedes that a deduction is a blunt mechanism for allocating the cost of a good.\textsuperscript{231} However, notwithstanding its flaws, “it better matches expense with preference in cases of collective goods for which demand is universal but heterogeneous.”\textsuperscript{232} A deduction may be the sole available mechanism for distributing the cost of a public good among freeriders.\textsuperscript{233}

\textsuperscript{229} See Gergen, supra note 187, at 1398-99.
\textsuperscript{230} Id. at 1402.
\textsuperscript{231} Id. at 1402-03.
\textsuperscript{232} Id. at 1403.
\textsuperscript{233} See id. Stated another way, a deduction “enables people with a high preference for a good to shift some of its cost to low-preference free riders.” Id.
Professor Gergen also discusses an aspect of giving that economic models tend to ignore: the utility derived by donors from giving. Many donors are willing to subsidize a public good in an amount that far exceeds the value placed upon the good by the donors because of other utility generated from giving. Professor Gergen acknowledges that this "overpaying" for public goods by philanthropists may mean that too much of a good is sometimes produced, but considers it more likely that philanthropy just results in the rest of society paying a smaller "price" for the good than otherwise would be required. Gergen argues that because of the freeriding problem, most charities are more likely to be underfunded than overfunded. Providing a charitable contribution deduction shifts only a small part of the cost of a public good to freeriders by reducing the aggregate tax base, thereby increasing the portion of tax revenues that must be raised from all taxpayers, including freeriders. The utility that donors receive from charitable giving "makes this imperfection [i.e., the shifting of only a small portion of costs to freeriders] more tolerable." The idea is that the freeriding problem is so severe that the additional incentive to donate arising from the various forms of utility associated with giving is alone insufficient to result in the production of adequate public goods by charity; the charitable contribution deduction, coupled with the utility of giving, will likely result in a more optimal production of public goods.

C. Theories Supporting the Exemption of Charitable Transferees from Federal Income Taxation

A third scholarly discussion of relevance to the issue under consideration is that which seeks to explain the (or perhaps "a") rationale for exempting certain nonprofit entities from federal income taxation. To be sure, many theories of the income tax exemption for certain nonprofit entities would justify a governmental subsidy for organizations that are not qualified donees under Code section 170(c). Nonetheless, a working knowledge of the key features of each theory will prove quite helpful for present purposes because the
theories often raise points of application to the charitable contribution deduction and its justifiable scope.

1. Income Measurement Theory

One rationale for the exemption of certain nonprofit entities is the income measurement theory advanced by Professor Boris Bittker and George Rahdert. Under this theory, taxable income is a concept designed to apply to profit-seeking taxpayers; as a result, it is highly impracticable to determine the taxable income of many nonprofit entities, since these entities' "receipts" are often not revenues from sales of a product or service to the payors, and their "expenses" are not amounts paid for the generation of profits.241 Although appealing for its simplicity, the theory has been thoroughly debunked by other scholars. For example, Professor Henry Hansmann observes that (i) many nonprofits receive no or little income from donations, but rely instead on commercial operations as a source of funds; (ii) even donations to organizations providing services to third parties can be broadly viewed as "purchases" (that generate revenues to the nonprofit donees) of such services on behalf of the ultimate beneficiaries; and (iii) the costs of providing those services would be deductible "business-related" expenses of the charities.242

2. Subsidy Theory

More promising is the subsidy theory, which has been invoked to justify the charitable contribution deduction per se. It has also been raised in support of the tax exemption of organizations that provide goods which society deems worthy of governmental support—goods that generate a public benefit.243 The theory is often expressed in the form of the argument that charities deserve governmental subsidy through income tax exemption because they do what government otherwise would be required to do.244 As Professor Rob Atkinson has observed, the theory is also sometimes more broadly conceived to rest upon the premise that many nonprofits (especially charitable


243. See, e.g., Bob Jones Univ. v. United States, 461 U.S. 574, 591 (1983) (stating that charitable exemptions are justified because exempt entities confer a public benefit that enhances the operations of public institutions directly funded by government).

organizations) deserve governmental support not only because of the nature of the goods and services that they provide and to whom they provide them, but also because of the secondary benefits resulting from the manner in which the organizations operate. Such asserted benefits include innovation and the promotion of pluralism.

Professor Hansmann offers a nice assessment of the subsidy theory. First, Professor Hansmann observes that the exemption for nonprofit entities can be justified under the subsidy theory only if there is a sensible explanation of why the exemption is “not granted as well to for-profit providers of the same services” (assuming, of course, that they exist). One explanation is that because nonprofit entities are prohibited by law from distributing their net earnings to those who manage or control their operations, we have some assurance that a subsidy to a nonprofit will benefit consumers of the organization’s goods and services through lower prices or higher quality. However, even consumers of a for-profit firm would receive most of the benefits of a subsidy if the firm operates in a competitive market. Thus, confining the subsidy to nonprofits is appropriate only if market failure hinders competition among firms. Hansmann identifies “contract failure” as one likely form of market failure. The gist of contract failure is that some or most consumers are unable “to make accurate judgments concerning the quality, quantity, or price of services provided by alternative producers.” If contract failure is

246. See, e.g., Hopkins, supra note 244, at 11, 17-18.
248. Id. at 67.
249. Id.
250. Id.
251. Id. at 67-68. Hansmann articulates the contract failure argument in more detail as follows: Contract failure arises when, owing to the nature of the service itself or to the circumstances under which it is consumed, the purchasers of the service—whether we style them donors or consumers—are likely to have difficulty in (1) comparing the quality of performance offered by competing providers before a purchase is made, or (2) determining, after a purchase is made, whether the service was actually performed as promised. As a result of such conditions, ordinary market competition may be insufficient to police the performance of for-profit firms, thus leaving them free to charge excessive prices for inferior service. In such circumstances consumers often turn to nonprofit providers, which, owing to the nondistribution constraint, have less opportunity and incentive to exploit consumers than do for-profit firms, and thus serve as fiduciaries of a sort for their consumers.
Id. at 69. Professor Hansmann states that the problems of contract failure are most apparent in the operations of donative nonprofits, which typically deliver services to third parties (rather than to donors), and in the delivery of indivisible public goods. Id. at 70. However, contract failure can exist even in connection with commercial nonprofits that deliver complex personal services. See id. For a more detailed
present, it is conceivable that "profit-seeking producers" would "divert to themselves some portion of the benefit of a tax subsidy," unbeknownst to donors.\textsuperscript{252} Thus, in cases of substantial contract failure, nonprofit entities may actually serve consumers more efficiently than their for-profit counterparts.\textsuperscript{253} Notwithstanding this conclusion, Hansmann raises the following astute question: If consumers would rationally choose a nonprofit firm over a for-profit company on account of perceived contract failure, why is a governmental subsidy necessary?\textsuperscript{254} For Hansmann, a theory to supplement the subsidy theory is essential in order to answer this question.

An alternative basis for limiting the subsidy to nonprofit enterprises discussed by Hansmann is that they tend to produce public goods, "which would be undersupplied without subsidies."\textsuperscript{255} Professor Hansmann acknowledges this explanation as "a plausible rationale for subsidizing nonprofit producers of certain services," but dismisses its force with respect to those tax-exempt organizations (like schools, hospitals and nursing homes) that provide services for compensation, which Hansmann characterizes as "essentially private-service institutions."\textsuperscript{256}

3. Compensation for Capital Constraints

Dissatisfaction with the subsidy theory led Professor Hansmann to his capital formation theory. Tax exemption compensates for nonprofit entities' difficulties in raising capital, and a capital subsidy can promote efficiency when provided to nonprofit firms in those industries in which nonprofit entities are better service-providers than for-profit entities (on account of contract failure, for example).\textsuperscript{257} Hansmann explains that nonprofits necessarily lack access to equity capital because they are prohibited from distributing net profits to shareholders. The remaining sources of capital are therefore debt, donated capital, and retained earnings. Donations are an insufficient source of capital because of their unpredictable timing (as well as amount), and because freerider incentives "presumably keep the flow of contributions to donative nonprofits—many of which provide public goods—well below the socially optimal level."\textsuperscript{258} Debt is also

\textsuperscript{252} See Hansmann, \textit{The Role of Nonprofit Enterprise}, 89 Yale L.J. 835, 845-73 (1980) [hereinafter Hansmann, \textit{The Role}].

\textsuperscript{253} Id. at 70.

\textsuperscript{254} See \textit{id}.

\textsuperscript{255} Id. at 68. This argument, of course, is prominent in the subsidy thesis expounded by Professor Gergen in the context of justifying the charitable contribution deduction. See \textit{supra} text accompanying notes 223-233.

\textsuperscript{256} See Hansmann, \textit{The Rationale}, supra note 242, at 68.

\textsuperscript{257} Id. at 72.

\textsuperscript{258} Id. Having made this point, Hansmann recognizes that the charitable
an inadequate source of capital, because lenders are generally unwilling to provide a high percentage of the capital needs of nonprofits. Therefore, retained earnings assume critical importance in financing capital expansion. Hansmann reasons that without the exemption from income tax, retained earnings would significantly decrease, thereby further hindering nonprofit entities that are already constrained for capital.

Although Professor Hansmann's theory reflects many notable and useful insights, the theory has been criticized in certain respects relevant to this Article. Professor Atkinson has criticized Hansmann's rationale because (among other reasons) it "implies that a defense of the charitable exemption can only be made in terms of economic efficiency." Professor Atkinson reminds us that the subsidy theory, which Hansmann argues is inadequate, embraces values furthered by at least some nonprofits quite apart from considerations of economic efficiency:

[Efficiency is only one of several metabenefits that the traditional subsidy theory attributes to nonprofits. The most prominent others are pluralism and diversity. Hansmann's economic analysis raises a critical question that is answered only implicitly and unsystematically in the traditional subsidy theory: why are these metabenefits not provided in the market? More specifically, does not the free market provide the greatest possible pluralism and diversity? Certainly not, if these assorted virtues are interpreted—or expanded—to include modes of resource allocation that are alternatives to government fiat on the one hand and ability to pay on the other. On this view, the free market and its constituent for-profit firms by definition fail to supply the one metabenefit that charity by its nature does provide—altruism.

For Atkinson, who offers his own theory of tax exemption discussed in the next section, the "metabenefit" of altruism takes on extreme, even inexplicably extreme, importance.

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contribution deduction encourages a more generous flow of contributions than would be the case without the deduction. However, even with the incentive offered by the charitable contribution deduction, Hansmann opines that the private return from a donation in support of a public good is still considerably below the effective cost of the contribution to the donor. Id. at 72 n.65.

259. See id. at 73.

260. See id. at 74.


262. By "metabenefits," Atkinson means "benefits that derive not from what product is produced or to whom it is distributed, but rather from how it is produced or distributed." Id. at 605.

263. Id. at 608-09.
4. Altruism Theory

Professor Atkinson posits that the critical distinction between truly nonprofit entities (which deserve income tax exemption) and for-profit entities (which are and should be subject to income tax) is that the former organizations exhibit altruism. For Atkinson, an entity exhibits altruism whenever the satisfactions that donors obtain from giving do not take the form of a material quid pro quo for donations. An organization is "altruistic" if it is one that confers benefits on persons other than its controllers and financial supporters. Moreover, an organization is altruistic under Atkinson's formulation even if it provides certain benefits enjoyed by donors themselves, provided that such benefits are public goods, or that the receipt by individual donors of benefits is independent of the amount of their respective gifts. The essential concept, then, is that an entity merits tax exemption if it confers benefits on persons other than those who control and fund the entity. Professor Atkinson does not attempt a comprehensive defense of the virtue of subsidizing altruism. He is content to observe its "presumptive appeal," suggest that exempting altruistic organizations would necessarily "promote a pluralism of ends," and respond to a few anticipated objections to his theory.

Atkinson is careful to distinguish his concept of altruism from stricter notions of altruism. He describes his concept as "weak" altruism, in contrast to "strong" altruism, which exists only if an act is undertaken with completely selfless motives. Such is not true with respect to Atkinson's concept of altruism:

The altruism I have identified need not be subjectively pure. The donors I have described may be motivated wholly or in part by a desire for fame, a good name, divine favor (now or hereafter), or some other "selfish" concerns.... What is distinct about my donors is not that they give without gain, but that any satisfaction that they derive from giving is not in the form of a material quid pro quo for their donation.

In support of this concept of altruism, Atkinson notes the difficulty in ascertaining precisely what prompts a particular act—a purely selfless regard for others, a desire for social acclaim, or a clear

264. See id. at 509-10.
265. See id. at 526, 529-33, 537, 542, 552, 565-66.
266. See id. at 533.
267. See id. at 566.
268. Id. at 628.
269. Id. at 629.
270. See id. at 630-37.
271. See id. at 526.
272. See id.
273. Id.
conscience. He reasons that “human institutions must be satisfied with examining outer appearances, leaving things of the heart to higher authorities.” In short, subjective motives of donors “do not count.”

Atkinson’s altruism theory has been criticized primarily for (i) the enormous number of institutions that would qualify as “altruistic” and therefore would be exempt from income tax under his approach, and (ii) the absence of any clearly articulated normative basis for exempting all altruistic organizations from income tax. Chief among such critics are Professors Mark Hall and John Colombo, who offer their own theory of tax exemption of charitable organizations, a theory examined next.

5. The Donative Theory

Professors Hall and Colombo theorize that the only institutions worthy of tax-exempt “charitable” status are those able to “attract a substantial level of donative support from the public.” They reason that donative institutions merit a tax subsidy “because the willingness of the public to contribute demonstrates both worthiness and neediness.” Organizations selected as objects of philanthropy “are of special worth in the public’s estimation.” Specifically, the very existence of substantial giving to an entity indicates that the organization provides a collective benefit that the private market and the government cannot supply. The resort by such an organization to soliciting contributions “evidences that its needs are not being met elsewhere.” Why is an additional subsidy needed if the institutions are recognized as being both worthy of support and needy? Reminiscent of Professor Gergen’s analysis of charitable contributions and the freeriding problem associated with public goods, Professors Hall and Colombo summarize their answer to this question as follows:

We can be assured that donations themselves will not fully satisfy this need since donors do not lightly relinquish their assets; in the

274. See id. at 527.
275. Id. at 529; cf. 1 Samuel 16:7b (New International Version) (“The Lord does not look at the things man looks at. Man looks at the outward appearance, but the Lord looks at the heart.”).
279. Id. at 1385.
280. Id.
281. See id. at 1392.
282. See id. at 1385.
283. See supra text accompanying notes 228-233.
absence of a quid pro quo return, the free rider incentive that affects the motivation to give tells us that donors systematically will give less than the deservedness that they perceive (as measured hypothetically by their willingness to purchase the good if it were capable of being delivered in ordinary market transactions). Hence, the existence of substantial donative support from the public at large signals the need for an additional, shadow subsidy to take up the donative slack. 284

According to Hall and Colombo, organizations receiving donative support merit subsidization through every conceivable tax mechanism, including exemptions from tax as well as the charitable contribution deduction. 285 Indeed, Hall and Colombo believe that their theory explains the basis for the charitable contribution deduction just as thoroughly as it explains the rationale for tax exemption. 286 "The deduction encourages more giving, and the exemption helps the gift to go further." 287

A feature of the donative theory of Professors Hall and Colombo of special interest to this Article, and which resounds with a familiar "Atkinson" ring, is that the subjective motivation for a donation is completely irrelevant to the issue of whether the object of a donation qualifies for a subsidy (whether that subsidy be tax exemption or the charitable contribution deduction): "all that matters is whether a payment is in fact a donation, which is revealed by a quid pro quo test." 288 Hall and Colombo recognize that under economic theory, giving is never truly altruistic (i.e., completely selfless) because giving occurs only if some positive or negative incentive impels the donor to give. 289 A "cynical view of philanthropy" postulates that contributions to charity are merely the product of donors' self-interest; donors give because doing so results in some form of private benefit to them, not because their gift will provide a public benefit. 289 Hall and Colombo identify four categories of private benefits that may induce donors to give to charity: (1) "[d]irect, tangible benefits the donor receives from the supported services," such as the opportunity to view programs by those who give to public television; (2) "[p]sychic benefits" from the mere act of giving; (3) "[p]urely selfish [indirect] benefits," such as the prestige of philanthropy; and (4) benefits received as part of a quid

284. See Hall & Colombo, The Donative Theory, supra note 222, at 1385; see also id. at 1392-93 ("The free riding incentive tells us, however, that these donations systematically fall short of supplying the objects of philanthropy at an optimally desired level, that is, the level that would be supplied if the products or services were capable of being purchased (or did not suffer from government failure). ");
285. See id. at 1387.
286. See id. at 1393.
287. Id.
288. Id. at 1389.
289. See id. at 1399.
290. See id. at 1401.
pro quo exchange (i.e., the outright purchase of a good or service). Professors Hall and Colombo argue that a tax subsidy is unjustified only in the case of transfers securing the last category of benefits for a purported donor (who is really just a "purchaser"), because this category consists of transactions involving purely private consumption of goods and services.

Professors Hall and Colombo defend allowing a subsidy in the first of these categories—when the donor receives a direct, tangible benefit—because the receipt by the donor of a private benefit does not diminish the deservedness of the subsidized activity. For example, a person who contributes to public television may do so because she enjoys watching it, but because public television has characteristics of a public good, presumably she could have enjoyed just as much programming had she never donated a dime. Contrary to the conclusion that her gift is not worthy of a tax subsidy, the fact that she has an interest in the programming in some sense verifies that the service has real benefit, particularly if donations are made by many others. It is equally important that an organization is supported by donations rather than purchases of goods or services, because it indicates that supporters make a sacrifice. Even as a donor enhances her own welfare, she simultaneously enhances the welfare of other people. Moreover, because any given donor might have chosen to freeride on the contributions of others, we can expect contributions to be suppressed below the optimal level of desired shared benefits in the absence of a tax subsidy. Thus, the subjective motive of a donor in such situations, which may be grounded in a sense of moral obligation to pitch in for a service or good that the donor enjoys to some degree, is quite irrelevant to the issue of whether a tax subsidy is justified.

291. Id. at 1401-02.
292. Id. at 1413-15.
293. Id. at 1403.
294. See id. 1403-04.
295. See id. at 1404.
296. See id.
297. See id.
298. See id. at 1405.
299. See id. at 1404. In so arguing, Professors Hall and Colombo criticize Professor Gergen's analysis for "supposing that a tax subsidy is not deserved when giving is motivated by the donor's desire to benefit personally from the supported service rather than to benefit someone else." Id. at 1403. They explain that it is "incorrect, or at least incomplete" to argue that people who donate to public television do so because of the enjoyment that they derive from viewing programs. See id. While I agree with them that viewing public television does not alone answer the question of whether a viewer who donates to public television should be entitled to a charitable contribution deduction, I do not characterize the argument against a deduction (or the argument in favor of a partial deduction) in such cases as one based principally on the motive of the donor. Rather, I see the argument against a deduction (or the argument in favor of a partial deduction) as resting primarily on the objective fact
As to the second category of benefits received by donors, Hall and Colombo discuss the economics literature which distinguishes between a donor's "act utility" and her "result utility." Hall and Colombo acknowledge that if pure act utility characterizes most donations, their theory would be seriously weakened, insofar as the level of donations received by an entity may have nothing to do with its worthiness. However, they argue that "virtually all gifts are motivated by a mix of act and result utilities." Act utility is akin to a private good associated with giving that induces donors to discover an unmet public need, and result utility is akin to the public good associated with giving, which is characterized by the freerider problem. Although we cannot be certain whether act utility is less than result utility, and therefore whether society's pleasure in participating in charitable giving is less than the actual social value produced from donated funds, an inherently self-correcting feature of charitable giving tends to minimize the possibility that donations will exceed a socially optimal level. This mechanism—which Professors Hall and Colombo call the "market in altruism"—may be explained as follows: Because donors have many choices from which to satisfy the desire to give, they will tend to choose to donate to charitable donees furthering the most worthy and needy causes, for

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that the donor has made a transfer of consideration to a qualified donee and thereafter receives some material benefit from the transferee. The problem is how to value that benefit for income tax purposes, regardless of the donor's motivations for making the gift. A presumption that the value of the benefit received by the donor is at least equal to the amount of the contribution may merely serve as a convenience for valuing the benefit. Theoretically, the proper approach may be to allow the taxpayer to admit evidence in her individual case of the value of programming that she received during the year of her contribution so as to rebut the presumption. Of course, this approach presents its own practical difficulties, which are particularly acute in the case of public goods. I am not suggesting that I would endorse this whole enterprise. But analyzing the problem in this manner does, I believe, demonstrate that the fundamental reason for disallowing a deduction (or allowing only a partial deduction) in such cases is not ultimately based upon a donor's subjective motive, but upon her receipt of a material benefit from the donee.

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300. See id. at 1406.
301. Id. at 1407-10.
302. See id. at 1407.
303. Id. Another way to think of these terms is that act utility stresses means, whereas result utility stresses ends. See id.
304. See id. at 1408.
305. Id.
306. See id. at 1409.
307. See id.
308. See id. at 1410.
309. Id.
doing so will maximize their utility.\textsuperscript{310} As gifts combined with tax subsidies begin to approach the socially desired level, perceptive donors will tend to adjust their gift-giving. As social conditions change, donors will redirect contributions to donees supporting objects which become relatively worthier and needier.\textsuperscript{311} Thus, even recognizing the distinction between act and result utilities, Hall and Colombo conclude that the donor's motive does not matter.\textsuperscript{312}

Hall and Colombo then analyze the third category of benefits derived by donors: purely selfish benefits that the donor desires to receive indirectly from making a gift to charity (such as promoting one's reputation in the community).\textsuperscript{313} In the first two categories of benefits, a reasonable assumption is that the motive to give involves some regard for the welfare of another person.\textsuperscript{314} However, Professors Hall and Colombo acknowledge that some charitable giving may be motivated entirely by the donor's desire to promote his material well-being. They illustrate such giving with a donor whose contribution results in a building named after her in order to receive community recognition.\textsuperscript{315} They argue that, notwithstanding the donor's apathy about whether the quality of education is enhanced by the gift, the gift will likely "signal worthiness" because "the social approval desired by the donor" would be unattainable "unless the object of the publicized gift were considered worthy by a broad segment of the public."\textsuperscript{316} For similar reasons, purely selfish giving also likely signals an organization that needs a subsidy.\textsuperscript{317} Insofar as the object of the donation probably deserves a subsidy even in this extreme case where a donor is driven exclusively by selfish motives, Professors Hall and Colombo conclude that "donations generally deserve subsidy without engaging in close empirical examination of the precise motives behind individual acts or categories of philanthropy."\textsuperscript{318}

6. Risk Compensation Theory

A final theory that has been offered as a rationale for the income tax exemption of charitable organizations is the "risk compensation

\textsuperscript{310} See id.
\textsuperscript{311} See id.
\textsuperscript{312} Id.
\textsuperscript{313} See id. at 1410-13.
\textsuperscript{314} See id. at 1411.
\textsuperscript{315} See id.
\textsuperscript{316} Id. "Thus, even the most self-interested donation qualifies under our deservedness criterion if the private reputational benefit enjoyed by the donor serves as a proxy for social worthiness, in the same way that act utility serves as a proxy for result utility." Id.
\textsuperscript{317} See id. at 1412.
\textsuperscript{318} Id. at 1413.
theory” of Professor Nina Crimm. In brief, Professor Crimm argues that the value of income tax exemption is essentially a governmental subsidy that compensates providers of public goods for otherwise uncompensated risks inherent in the production of public goods. Crimm argues that the provision of public goods “is clearly associated with pure risk—that is, the potential for production of loss, but not gain, realization.” Because the provision of a pure public good can result only in loss (absent a governmental subsidy), a rational, risk-averse firm would never choose to supply such a public good as its sole product. If the choice is whether to supply a “mixed” public good (i.e., one that has characteristics of both private goods and public goods), a rational firm would not choose to supply such good if “it is perceived that the public portion of the mixed public good ... exceeds the private portion.” Crimm argues that because “in the real world” it is difficult for a firm to bifurcate the public and private portions of a mixed good for purposes of evaluating potential return, “it would be unexpected that a for-profit start-up firm would decide to provide a mixed public good or service.” Crimm reasons that, because charitable organizations by law must act in accordance with their purposes, they must provide “pure and mixed public goods and services,” and therefore must assume pure risk, “for which no pecuniary gains are possible.” Without being compensated for assuming such risk, organizations would not choose to form for the purpose of supplying public goods and services. The idea is that the market for public goods itself will not offer charitable organizations an expected return sufficient to compensate them for the risks that they assume. Income tax exemption, according to Professor Crimm, is an expected return that charitable organizations receive from the federal government, which functions as an insurer of such pure risk (i.e., “the government pays a risk premium”).

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320. See id. at 439-55.
321. Id. at 448.
322. See id. at 449, 451.
323. Id. at 450.
324. Id. at 451. On this latter point, Professor Crimm’s theory faces some difficulty, for in the “real world” private, for-profit firms do provide mixed goods and services. Prime examples are proprietary schools and hospitals. Presumably, in such cases, these firms perceive that the “private” elements of their goods and services have a value that is sufficient to justify business operations. But if this is so, we must question why nonprofit schools and hospitals need a subsidy. Professor Crimm’s theory, as articulated to date, does not appear to resolve this issue.
325. Id. at 452.
326. Id.
327. See id. at 453.
328. See id. at 454.
329. Id. at 455.
Although it is articulated in terms of risk compensation, Professor Crimm's theory can be seen as a variant of the traditional subsidy theory. Her essential idea is that charitable organizations produce public goods, and the consuming public, left to themselves, will not pay for the socially desirable quantity of such goods. Government is a suitable financier to pay for part of the price of public goods (i.e., the pure risk premium associated therewith) in order to result in their satisfactory production. This is the essence of the subsidy theory.

7. Concluding Observations of Rationales for the Charitable Income Tax Exemption

Selecting the most persuasive rationale for the exemption of a charitable entity’s income from federal income taxation is well beyond the scope of this article. Nor is it my task to attempt to harmonize these theories into a new grand theory of exemption. What is appropriate for present purposes is to offer some brief observations of what the foregoing theorists may contribute toward analyzing whether, and in what circumstances, earmarked transfers to charity should be deductible.

First, there are fairly persuasive reasons for concluding that the charitable income tax exemption and the charitable contribution deduction promote economic efficiency to some degree. In the absence of a tax incentive for charity, one would expect market failures to result in a sub-optimal production of public goods and services. If an earmarked transfer to charity helps correct a market failure, a deduction may be appropriate.

Secondly, non-economic factors may also support the charitable income tax exemption (and the charitable contribution deduction). Such factors include the promotion of diversity and altruistic behavior. If earmarked transfers to charity promote these values, the case for deducting them becomes stronger.

Third, the decision to grant an income tax exemption for charitable entities and to grant a charitable contribution deduction for transfers to those charities should not hinge on whether a court (much less the IRS) determines that a donor “desires” or “intends” to help the world, with no regard for the pleasure received by the donor in so doing. Such an inquiry is fraught with difficulty, and is often quite beside the point of attempting to encourage donations that benefit society. Thus, if the case against deducting earmarked transfers to charity rests largely on the position that an earmarking donor does not have a sufficiently selfless mental state, the argument for the deduction becomes even more compelling.
III. A NORMATIVE ANALYSIS OF THE DEDUCTIBILITY OF EARMARKED TRANSFERS TO CHARITY

In this section of the Article, I discuss various factors that should and should not bear upon whether, and to what extent, earmarked transfers to charity merit a charitable contribution deduction. Some of these factors may be thought of as "case specific," whereas others are more properly characterized as "systemic" considerations. This section evaluates factors that have been considered important by the courts, the IRS, and commentators, and determines their relevance to the present normative inquiry.

The analysis of this section forms the basis for a proposed framework for determining whether earmarked transfers to charity should be deductible. It is extremely important to bear in mind that the analysis of this section, and ultimately my proposed framework, assume the existence of the charitable contribution deduction of Code section 170 for non-earmarked transfers and the federal income tax exemption for charitable organizations described in Code section 501(c)(3). I do not evaluate whether, in an ideal world, the charitable contribution deduction should be available (or should be substantially overhauled). Nor do I argue the overall merits of federal income tax exemption for charitable organizations. Instead, I offer my framework for the deductibility of earmarked contributions as a way to improve (or in some cases, simply clarify) existing law under the assumption that Code sections 170 and 501(c)(3) will remain primarily as they now exist. In other words, the matter I seek to address in this section is how the federal income tax law should treat earmarked transfers to charity, in a world where current Code sections 170 and 501(c)(3) are largely unchanged.

A. Case Specific Factors

In this sub-section of the Article, I discuss the relevance of four factors that the courts and the IRS have relied upon in deciding the deductibility of earmarked transfers to charity: (i) whether the transferor's subjective intent in making the transfer is to benefit the secondary beneficiary or the charitable transferee; (ii) whether the charitable transferee exercises formal legal control over donated funds; (iii) whether the charitable transferee would have used the amount in question to benefit the secondary beneficiary "but for" the designated transfer; and (iv) the existence of some familial or other personal relationship between the transferor and secondary beneficiary.
1. Intent of Transferor to Benefit a Particular Individual

I reject the practice of the IRS and apparently some courts when determining the deductibility of an earmarked transfer to charity of broadly inquiring into whether the transferor subjectively intends to benefit the secondary beneficiary, "rather than" the charitable transferee. This inquiry (in its broad form) should be rejected both for practical administrative reasons, and for theoretical reasons. With respect to the former, the IRS (and the courts) would do well to follow the lead of the First Circuit in Crosby Valve & Gage Co. v. Commissioner, which artfully expressed that any attempt to decide the precise motivations for a transfer to charity is a futile task. Any number of factors may motivate a donor to transfer sums to charity, and it is virtually impossible to determine those that dominate in any case. Attempting to do so requires the expenditure of considerable judicial and administrative resources, with little hope of reaching the "correct" determination. Indeed, as discussed above, the Hernandez Court itself recognized the imprecise nature of inquiries into the subjective states of mind of taxpayers making transfers to charity. As Professor Atkinson has aptly remarked,

For legal purposes, we cannot simply say an organization is charitable if its collective heart, or the hearts of its supporters, are in the right place and leave it at that. We must be able to say, with a degree of assurance, that a particular organization in fact meets the test at a particular time. As I have said elsewhere, state of mind may

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330. See supra text accompanying notes 143-150.
331. 380 F.2d 146 (1st Cir. 1967).
332. See id. at 146-47. In Crosby Valve, the court was highly critical of employing Duberstein's "detached and disinterested generosity" standard in resolving controversies involving Code section 170, for reasons explained in the following excerpt:

While agreeing with the holding of the Tax Court, we think it necessary to register our disagreement with the majority's emphasis upon a purely charitable motive as a prerequisite for a deductible charitable contribution. Were the deductibility of a contribution under section 170(c) of the [Code] to depend on "detached and disinterested generosity", an important area of tax law would become a mare's nest of uncertainty woven of judicial value judgments irrelevant to eleemosynary reality. Community good will, the desire to avoid community bad will, public pressures of other kinds, tax avoidance, prestige, conscience-salving, a vindictive desire to prevent relatives from inheriting family wealth—these are only some of the motives which may lie close to the heart, or so-called heart, of one who gives to a charity. If the policy of the income tax laws favoring charitable contributions is to be effectively carried out, there is good reason to avoid unnecessary intrusions of subjective judgments as to what prompts the financial support of the organized but non-governmental good works of society.

Id.
be as provable in principle as the state of digestion, but it is a good
deal more difficult to prove in practice.333

In addition to the administrative problem of attempting to
determine the donor's intent, there is a far more compelling basis for
rejecting this factor: except in cases that are properly viewed as
involving disguised consumption of a predominately private nature,334
the transferor's desire to assist a named individual is, at worst,
theoretically irrelevant. Consider a taxpayer who donates $100 to a
charitable homeless shelter and specifies that his gift be used to feed
whatever homeless person the charitable donee may choose. Another
taxpayer donates $100 to the shelter and specifies that the money be
used to feed "Frank," an unrelated homeless person known by the
donor to reside at the shelter. Clearly, the donor in the latter case
intends to benefit a particular individual. But why does this fact
matter? If the response is that the latter donor has made a personal
gift, not a charitable contribution, this is actually no response at all,
but merely a conclusory statement. The issue to be decided is whether
the donor has made a personal gift (nondeductible under current
law) or a charitable contribution.

Equally unsatisfying is the response that, if the donor "intends" to
benefit a named person, his "intent" cannot be to benefit charity.335
Indeed, this position appears to be a premise of Revenue Ruling 79-
81.336 However, to assert that, in the illustration of the previous
paragraph, the taxpayer in the latter case has less desire to benefit the
charity than the taxpayer in the former case, is patently absurd. The
transfer in each case supports the work of the donee charity to the
same degree, for in each case, the donation is to be used to assist one
person who is a bona fide member of the charitable class served by the
charity. The only difference is that the latter taxpayer, like the Good
Samaritan, knows the face of the secondary beneficiary. But knowing
the face of the secondary beneficiary—and even wanting to feed him—in no way detracts from the legitimacy of the charitable work
subsidized by the transfer. What matters is not that the transferor
wants to ensure that the donee's charitable operations benefit a
named person, but that such transferor supports the donee so that it
will perform its charitable work. As the Crosby Valve court
insightfully recognized, "[I]n the case of a contribution to a charitable
organization, the law's policy finds charity in the purposes and works

334. See *infra* text accompanying notes 365-371.
(observing that a donor's gift to CARE for a child that the donor "adopts" for hunger
relief is probably motivated in part by a general desire to alleviate worldwide
starvation).
336. 1979-1 C.B. 107; see *supra* notes 120-129 and accompanying text.
of the qualifying organization, not in the subjective intent of the contributor.\(^{337}\)

Accordingly, when a donor transfers a sum to charity and designates the secondary beneficiary, as long as the secondary beneficiary is a member of the charitable class served by the donee, as a general proposition the gift, if accepted by the donee in its own right, is inherently "charitable" because it furthers the charitable purposes of the donee. There may be cases, of course, when one may rightly question whether a transfer sufficiently furthers the charitable purposes of a donee, or whether the transferor receives some benefit from the transferee that is inconsistent with characterization of the transfer as a deductible charitable gift.\(^{338}\) But these issues may be resolved satisfactorily without resorting to a judicial or administrative probe of the donor's state of mind. Absent such special circumstances, the law should simply recognize that a donor's desire to further indisputably charitable work may legitimately coincide with his desire to help a designated soul. The search for whether the donor "intends" to benefit a secondary beneficiary is, as a general proposition, quite beside the point of whether the gift furthers charity.\(^{339}\)

2. Exercise of Control by Charitable Transferee over Transferred Funds: Avoiding the Conduit Problem

As discussed above, many authorities stand for the proposition that a transfer purportedly made to a charitable transferee is not a deductible contribution "to" the charity if the charity does not exercise formal legal control over the donated funds.\(^{340}\) In the case of a donation made "in trust for" a charitable donee, presumably this test would look to whether the charity exercises some degree of control over the funds that are ultimately distributed from the trust.\(^{341}\) The question arises as to what extent the charitable donee must exercise "control" over donated funds so as to result in a deduction for the amount of the contribution.\(^{342}\)

\(^{337}\) Crosby Valve, 380 F.2d at 147.

\(^{338}\) See infra text accompanying notes 365-373.

\(^{339}\) This is not to say that donor intent is entirely irrelevant. As argued below, it is relevant for the limited purpose of ascertaining whether a donor intends to create an express trust for the benefit of a named individual (or a mere agency relationship with the charity), rather than to make a gift to the charity in its own right.

\(^{340}\) See supra text accompanying notes 131-137. Davis v. United States, 495 U.S. 472, 483-84 (1990), supports this requirement of donee control.

\(^{341}\) Cf. Estate of Hubert v. Comm'r, 66 T.C.M. (CCH) 1064, 1066-67 (1993) (finding adequate control by a charity receiving income from a trust to support the work of named missionaries through the charity, where upon the missionaries' retirement, the charity had discretion as to distributions of principal and income).

\(^{342}\) For ease of discussion, this section will focus on the control that must be present in the case of a transfer purportedly made "to" a charitable transferee. An
One view would be that the charitable donee must have the absolute right to use contributed funds in any manner that it sees fit, notwithstanding any expression of preference by the donor. This approach is consistent with, but not compelled by, Peace. A second view would be that the charity has exercised sufficient control over donated funds as long as either (i) the charity maintains absolute discretion over the use of donated funds at all times, or (ii) completely independently of any preference expressed by a potential donor beforehand, the charity itself has unilaterally committed itself to provide some benefit to the secondary beneficiary. In other words, under the second view, a deduction is still available to donors if the charity has “pre-selected” a particular beneficiary, and then solicits contributions from donors who contribute funds to the charity which are designated for the secondary beneficiary. This approach is consistent with Winn. A third view, and the one adopted in this Article as a general proposition, is that a charitable donee exercises a sufficient degree of control over an earmarked contribution as long as the charity receives delivery of the donation and accepts the donation in its own right. No case of which I am aware has explicitly adopted this approach. However, for several reasons, I believe this approach is superior to the others.

I must first explain exactly what this approach entails. By stating that sufficient control is present if the charity “receives delivery of the donation and accepts the donation in its own right,” I mean to convey two major points. First, the charity, or one acting on behalf of the charity (who is not, and who is not acting for, the secondary beneficiary or the transferor), must receive actual, symbolic or constructive delivery of the donated cash or other property. Secondly, acceptance of the contribution by the charitable organization “in its own right” means that the charity must receive the funds as its own assets; the charity must not be acting merely as an agent for the

343. An even more demanding standard would be to deny a deduction for any contribution made by a donor who in any manner specifies even a preference that the donation be used to benefit a particular individual. This approach would plainly run afoul of Peace v. Commissioner, 43 T.C. 1 (1964); Winn v. Commissioner, 595 F.2d 1060 (5th Cir. 1979); and Estate of Hubert v. Comm’r, 66 T.C.M. (CCH) 1064 (1993). For reasons discussed below, I would disagree with any attempt to modify existing law so as to adopt this approach.

344. See supra notes 106-129 and accompanying text for a discussion of Peace.

345. See Note, Does Charity Begin at Home? The Tax Status of a Payment to an Individual as a Charitable Deduction, 83 Mich. L. Rev. 1428, 1441-42 (1985) (arguing that a charitable donee that makes a grant to a researcher whom it desires to support and then solicits funds to fund the grant “is presumably exercising an appropriate level of oversight”).

346. Although the facts in Estate of Hubert can justify a contrary interpretation, one may argue that this view is largely consistent with the reasoning of this opinion.
transferor or the secondary beneficiary, nor may the charity receive the funds as trustee of an express private trust for the benefit of the secondary beneficiary. By accepting the funds "in its own right," the charity is therefore bound by law to use the funds in a manner consistent with its charitable purposes, both under state law and in furtherance of its tax-exempt purposes, as required by Code section 501(c)(3).

In order to understand why this third view of control is defensible, it will be helpful to compare initially the first two views. What is the rationale for rejecting the first view (absolute control over donated funds by charitable donee at all times prior to distribution thereof) in favor of the second view (absolute control of funds or pre-selection of secondary beneficiary by charity)? In the case of the second view, there is a very high probability that donations will be used in furtherance of the charitable purposes of the donee. Consider the following example of a church like that in Winn. The church, desiring to further world missions in obedience to the Great Commission, ordains an individual to the mission field. The church desires to send the individual to proclaim the gospel in Singapore. Lacking sufficient funds, the church solicits contributions specifically for the purpose of financing the missionary's work across the seas. Should the fact that donations designated for the missionary are now restricted for a particular purpose (and will support a named individual) result in denial of a deduction because the donee does not have absolute "control" of donated funds following receipt thereof?

347. Insofar as the "intent to create a trust" is a pre-requisite to the formation of a trust, I am well aware that "donor intent" rears its head once again. However, under my proposed approach, establishing whether a donor intends to create a private trust at least confines the scope of the inquiry into donor intent. If the transferor and charitable donee take the necessary steps to make clear that a transferor has not created a private trust (which, as I suggest infra, can be done fairly expediently), determining "donor intent" presents no major difficulties.

348. See supra notes 163-166 and accompanying text.

349. See Matthew 28:18-20; Luke 24:46-49. The Great Commission refers to Jesus' post-resurrection, pre-ascension commandment to His disciples to make disciples of all the peoples of the earth. See 1 Warren W. Wiersbe, The Bible Exposition Commentary 107 (1989). The commission includes both the proclamation of salvation from sin through faith in Jesus and the exhortation to obey his teachings. See id.; Louis A. Barbieri, Jr., Matthew, in The Bible Knowledge Commentary: An Exposition of the Scriptures by Dallas Seminary Faculty, supra note 1, at 13, 93-94; cf., e.g., John 20:31 (stating that the Apostle John recorded his account of the miraculous signs performed by Jesus "that you may believe that Jesus is the Christ, the Son of God, and that by believing you may have life in His name"); Acts 4:12 (recording the address of the Apostle Peter in which he proclaimed that "salvation is found in no one else" but Jesus); Acts 16:31 (recording the exhortation of the Apostle Paul to "believe in the Lord Jesus, and you will be saved."). In the context of Matthew's gospel, the Great Commission is quite striking, for its international vision is the culmination of a text that emphasizes Jesus as the Servant-King of Israel who has fulfilled the prophesies of Hebrew scripture. See Donald Guthrie, New Testament Introduction 32-33 (4th rev. ed. 1990).
The Winn court answered this question negatively, and rightly so. The need for a charity to exercise "control" over donated funds is ultimately grounded in the desire to ensure that donated amounts are expended for bona fide charitable purposes. In the case of "blind" contributions, the federal income tax law assumes that a charitable donee will use donated funds in furtherance of its charitable mission. In a sense, the law "trusts" the donee to act charitably and uses various enforcement mechanisms\textsuperscript{350} to attempt to ensure that the donee does so. We assume that the appropriate officer, committee, or even governing board of a charitable donee will ascertain an appropriate charitable disposition of donated funds, and then will dispose of such funds after due reflection. But there is no reason to assume that a worthy disposition of funds can or should be determined only after such funds have been received. To continue with my previous illustration, there is no apparent reason that a decision by a church body to support a particular missionary is any more credible when it is made with funds in hand, rather than before the funds have been raised. In both cases, the same people bound by law to act in the interests of the church are responsible for charting a course of action, and in both cases, they may be liable for breaching their duties to the church. What is critical is that the appropriate decision-makers within an organization actually exercise judgment concerning the disposition of donated funds, not that they exercise such judgment at a particular point in time before disposing of such funds. For this reason, unless there are systemic reasons for disfavoring a deduction for donations to charities that have pre-selected secondary beneficiaries,\textsuperscript{351} the second view of sufficient charity control is superior to the first.

This analysis brings me to an evaluation of the third view of sufficient charity control. Under this view, which as a general proposition I adopt, a charitable donee exercises a sufficient degree of control over an earmarked contribution as long as the charity receives delivery of the donation and accepts the donation in its own right. At first blush, this view seems quite expansive. It does not query whether a donor has expressed a mere preference (as opposed to making a legally restricted gift), and it does not explicitly look to any outward manifestation of pre-contribution decision-making activity by charitable donees (as does the second view of sufficient charitable donee control). Upon closer inspection, however, this third view of sufficient donee control is not at all radical. Indeed, this view requires virtually the same degree of "trust" in the credibility of charitable decision-making as that required under the first two views.

\textsuperscript{350} See infra text accompanying notes 396-402.
\textsuperscript{351} See infra Part III.B.
As argued previously, and consistent with the second view, a deduction may be entirely proper even if the charitable donee decides upon the disposition of funds that it merely contemplates receiving (but has not yet received). Once this point is accepted, it becomes clear why a deduction is generally appropriate whenever the charity accepts an earmarked contribution in its own right. In such cases, by accepting the donation that is restricted for the purpose designated by the taxpayer-donor, the charity presumably has exercised decision-making authority concerning the disposition of donated funds. That is to say, just as a decision to decline the gift implies that the charity has determined that benefiting the secondary beneficiary will not further its charitable purposes, so does a decision to accept the gift imply that the charity has determined that benefiting the secondary beneficiary does further its charitable purposes. Otherwise, the charitable organization exposes itself to considerable legal risks. If the premise of Code section 170—that a charity will dispose of a donation in a manner consistent with its charitable purposes—is correct, the presumption should be that it makes no difference whether the charity reaches its decision with respect to such disposition prior to or after receiving the gift. If the premise of Code section 170 is not correct, then the entire system of allowing a deduction for charitable contributions should be questioned, not just the deductibility of earmarked contributions.

The preceding analysis makes apparent why the third view requires a charity to receive funds in its own right and to take delivery thereof. A charity that is not in actual or constructive possession of donated funds is less able to supervise the disposition of funds so as to ensure that they are in fact deployed in a manner that furthers charitable purposes. Thus, the court reached the correct result in Davenport v. Commissioner for the simple reason that the charity never received the funds and thus could not decide upon their disposition. In addition, a charity that does not receive funds “in its own right” has less incentive to use funds in a manner that furthers exempt purposes. Hence, the presumption of Code section 170 that

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352. 34 T.C.M. (CCH) 1585 (1975); see supra note 89.
353. Consider, for example, a transfer of cash to a charitable organization by a taxpayer who restricts the use of the cash for the purchase of a new television set for the executive director of the organization. Because the executive director is adequately compensated, the board of directors is unwilling to accept the gift on behalf of the organization and supplement her salary in kind. However, the board is perfectly willing to authorize one member of the board to accept the cash on behalf of the executive director and purchase the gift for her. In this situation, the cash is never received by the organization in its own right. At most, the organization (through its board member) is an agent of the taxpayer and/or the executive director with respect to the acquisition of the television set. As such an agent, the charitable organization is not bound to use the cash to advance charitable purposes.
donations will be used for charitable purposes is inapplicable. In such situations, the deduction is properly denied.

Admittedly, the legal relationship between the transferor and the charity must be determined under this third view, and in this regard, the "intent" of the transferor is relevant to a limited degree. For example, in ascertaining whether the relationship between the transferor and the charity is that of settlor and trustee (i.e., whether an express trust has been created), it is basic common law that such a relationship exists only if the settlor intends to create a trust.\(^{354}\) However, determining whether a transferor intends to create a trust relationship is a more limited inquiry than probing donor intent for the purpose of seeking out primary motivations for the transfer, such as the desire to see a secondary beneficiary assisted. Thus, the inquiry does not suffer from the same weaknesses of broadly probing "donor intent," as some authorities have done.\(^{355}\) Indeed, charities can do a great deal to reduce the complexities of determining the existence of the requisite donor intent. For example, before accepting an earmarked gift, a charity may simply inform the donor that by accepting the gift, the charity is receiving it as its own property and will use the donation in the manner specified by the donor because the charity has concluded that doing so furthers its charitable mission. Further, the charity can plainly state that it is not accepting the funds as trustee of an express private trust, and that the donor will be assumed to agree to these terms of the gift upon acceptance thereof by the charity. A standard form letter to a prospective donor of an earmarked gift should usually suffice.\(^{356}\)

The major foreseeable objection to the third view of donee control is the argument that allowing a deduction in cases sanctioned under the third view (but not under the first or second views) tends to place too much pressure on charities to defer to the judgment of donors as to the allocation of funds dedicated to charitable purposes. The

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355. See supra notes 21-28 and accompanying text (discussing Winters v. Commissioner, 468 F.2d 778 (2d Cir. 1972)); supra notes 68-77 and accompanying text (discussing Tripp v. Commissioner, 337 F.2d 432 (7th Cir. 1964)); supra note 89 (discussing Davenport v. Commissioner, 34 T.C.M. (CCH) 1585 (1975)); supra notes 106-119 and accompanying text (discussing Peace v. Commissioner, 43 T.C. 1 (1964)); supra notes 120-129 and accompanying text (discussing Rev. Rul. 79-81, 1979-1 C.B. 107); see also supra text accompanying notes 143-146 (summarizing cases in which the donor's intent was an important factor).

356. If a charity does not take such steps, a court called upon to decide the deductibility of an earmarked transfer to charity must look at other available evidence bearing upon whether the transferor has created an express trust. Yet even then, the inquiry is more precise than examining the various motives of the donor to determine whether she intended to benefit a private party "rather than" the charitable transferee.
argument is not that the charity lacks sufficient legal control over earmarked funds, but that the charity in such cases will be more inclined to accept the judgment of donors as to the worthiness of the secondary beneficiaries, or perhaps to appease such donors, than in the case of non-earmarked transfers. I address this argument below, for I see it more as a "systemic" consideration. For present purposes, I am content to demonstrate that the "control" test advanced by courts is in some sense illusory, if it requires any more legal control than that which I have advocated. The three views of sufficient donee control discussed herein tend to collapse. As long as a charity accepts a donation in its own right and takes delivery of the donation, we have presumptive assurance that the charitable donee will use the restricted donation for a charitable purpose, and therefore that a deduction is generally appropriate.

3. The "But-For" Test of the Benefit Provided to the Secondary Beneficiary

Some courts have denied a deduction for an earmarked transfer to charity partly because no evidence established that the charity would have used the amount in question to benefit the secondary beneficiary in the absence of the designated transfer.\(^357\) We may think of this as the "but-for" test of the benefit to be conferred upon the secondary beneficiary: no deduction is proper if, but for the designated transfer to charity, the charity would not have conferred a benefit upon the secondary beneficiary. The rationale for the test presumably is that, absent evidence that the charitable transferee would have expended donated funds in any event precisely as contemplated by the transferor, we have no guarantee that the funds will be employed for a legitimate purpose (or at least for a purpose worthy of a tax subsidy). In the limited case in which the primary effect of the transfer is to secure the secondary beneficiary's private consumption of a good or service without regard to whether doing so uniquely furthers a charitable purpose of the charitable transferee, I agree with this approach.\(^358\) However, in most cases, I believe that employing this "but-for" test is misguided.

In the first place, the apparent rationale of the "but-for" test has been largely discredited by the analysis in the immediately preceding section of this Article. As demonstrated therein, insofar as the law generally assumes that a charitable donee will use donated funds in a manner that advances a charitable purpose which therefore is worthy of a tax subsidy, and because the precise point in time at which a charitable donee determines that a disposition of funds for a certain purpose is appropriate makes no difference, the presumption should

\(^{357}\) See supra text accompanying notes 138-142.

\(^{358}\) See infra Part III.B.3.b.
be that a charitable donee will use the restricted donation for a charitable purpose (which is worthy of subsidy).

Perhaps more compellingly, the "but-for" test potentially ignores the marginal benefit to charity of an additional dollar of donations. Consider a charitable organization that cares for orphaned children in a group home. Of the ten rooms in the home, nine are occupied by children, and one is vacant and unfurnished. The organization has a steady flow of non-designated contributions each month sufficient to feed and clothe the nine children and provide for their other basic needs, but has no excess funds. A generous donor who knows of a certain child whose parents have both tragically died in a car accident offers to pay the costs of furnishing the tenth room and the added costs of providing for the basic daily needs of the child, as long as the home agrees to accept the child into residency. Having considered the child's circumstances, and having determined that admitting the child would clearly further the charitable purposes of the home, the organization accepts the designated donation. In this hypothetical, prior to accepting the designated transfer, the organization is using its funds in a manner that furthers charity to the best of its ability. But this does not mean that the organization has no desire to do more. Indeed, as I have so crafted the facts, the organization furthers charity much better by accepting the earmarked contribution. The important point for present purposes is simply that the "but-for" test potentially has the perverse effect of stifling legitimate charitable operations. The test ignores that a charity may value a marginal dollar precisely because it enables the charity to further its charitable mission by benefiting an individual who otherwise would be without assistance, or by providing a valued benefit to an individual who otherwise would have received some lesser benefit.

This latter point also serves to indict the "but-for" test for overlooking the reality of similar charitable fundraising practices which do not result in the disallowance of a charitable contribution deduction. Consider a law school (described in Code section 170(c)(2)) seeking to fund an endowed chair for a professor of human rights law. Currently, the school does not have the money to support a teacher in this field, but all the faculty and senior administration agree that offering courses in human rights law would greatly enhance the curriculum of the school. So the school launches a campaign to raise funds restricted for the purpose of building an endowment to provide a reasonable salary for a new professor of human rights law. On these facts, contributions to the school which are restricted for the endowment are plainly deductible under federal income tax law. This is so even if the endowment is financed through the contribution of a

359. Not only is an additional member of a charitable class benefitted, but also the organization eliminates the waste of excess capacity in its building.
single taxpayer. That the school would not offer human rights courses or hire a professor with any expertise in human rights law "but for" the restricted contribution is wholly irrelevant. Indeed, the whole point of soliciting funds for the restricted purpose of building an endowment for a human rights law professor is to meet a need that otherwise would be unmet.

Of course, in this example, there was substantial evidence that the restricted contribution furthered exempt purposes. We must further analyze below whether there are systemic considerations that militate against a deduction for earmarked contributions which are destined for secondary beneficiaries. For present purposes, I seek only to show that the "but-for" test, as a general matter, is largely inconsistent with the premise of Code section 170, may stifle charitable operations, and is theoretically inconsistent with accepted practices of charitable organizations in fundraising.

4. Identity, or Pre-Existing Relationship, Between Transferor and Secondary Beneficiary

Some authorities discussing the deductibility of earmarked transfers to charity apparently have considered relevant the existence (or non-existence) of some familial or other personal relationship between the transferor and secondary beneficiary. The better view is that this "relationship factor" is relevant only in cases involving (or, perhaps, potentially involving) an identity or special relationship (to be discussed below) between the taxpayer and the secondary beneficiary, where the designated contribution is part of a quid pro quo exchange.

a. Where No Special Relationship or Identity Exists Between Transferor and Secondary Beneficiary

Perhaps the best place to begin the analysis of the relevance of the relationship factor is to determine when the relationship between the transferor and secondary beneficiary generally should not be a negative factor: when the taxpayer and the secondary beneficiary are separate taxpayers who have never been members of the same family or household. Let me return to the taxpayer who makes a designated contribution to a homeless shelter for the purpose of feeding his street-side acquaintance named Frank. The secondary beneficiary is not related to the taxpayer by blood or marriage and is not a member of the taxpayer's household, so we need not concern ourselves with the disallowance of "family expenses" under Code section 262. Further, the taxpayer's securing of benefits for Frank will not relieve the taxpayer of any support obligation imposed upon her by state law

(such as the duty of a mother to support her child), so the taxpayer’s contribution in no way confers a non-tax financial benefit upon her. Moreover, the goods and services provided by the shelter to Frank are not those for which he is expected to pay any amount approaching market value. In other words, this example is not one involving a charity that functions as a “commercial nonprofit” (such as a private parochial school charging tuition, or a hospital charging room fees). Accordingly, if the shelter accepts the designated gift, we have good reason to believe that the shelter considers Frank a worthy, needy homeless person, and a member of the organization’s charitable class. As argued above, and as developed more fully below, the federal tax laws generally should allow philanthropy to have a face. That this face is known by the taxpayer is usually no grounds for disallowance of the deduction.

Some judicial authority is consistent with this much of the analysis. In *Estate of Hubert*, the Tax Court in upholding a charitable contribution deduction observed that the only personal relationship between the transferor and one of the supported missionaries was through a church that supported the work of the missionaries, a church in which the settlor had taught one of the missionaries as a youth in Sunday School. This relationship can properly be considered one of minimal personal contact; certainly, the missionary was never a member of the settlor’s household. Moreover, the benefit received by the missionary, from whatever charity accepted distributions from the trust established by the settlor, was in the form of financial support for conducting ministry, a benefit for which the missionary was not expected to pay. In these respects, *Estate of Hubert* is similar to the case of the taxpayer who makes a designated contribution to a homeless shelter for the purpose of feeding Frank. Neither secondary beneficiary is a member of the taxpayer’s household, and the benefits provided to the secondary beneficiary are not those for which he is expected to pay a market price. Just as the taxpayer who donates to the homeless shelter should receive a deduction for his designated contribution, so should (and did) the estate in *Estate of Hubert*.

361. I borrow the term “commercial nonprofit” from Professor Hansmann. See Hansmann, *The Role*, supra note 251, at 840-41.

362. See, e.g., *Estate of Hubert*, 66 T.C.M. (CCH) 1064. See supra notes 176-185 and accompanying text for a discussion of *Estate of Hubert*.

363. More precisely, as discussed above, the deduction for charitable bequests for estate tax purposes was upheld. The transferor was the settlor of the trust established under the will of the decedent leaving the taxable estate at issue.

364. See *Estate of Hubert*, 66 T.C.M. (CCH) at 1065.
b. Where Transferor and Secondary Beneficiary Are Identical or Have a Special Relationship: The Case of Commercial Benefits

In contrast to those instances involving no identity or relationship between the taxpayer-transferor and the secondary beneficiary, we have good reason to deny a deduction in the case of certain relationships between the taxpayer-transferor and the secondary beneficiary, especially when they are the same person. This is perhaps most clear where the benefit provided by the charitable transferee is a market-priced, private or semi-public good or service. Consider, for example, a law school charging $20,000 for tuition per student. A law student transfers $20,000 to the school and designates herself as the secondary beneficiary, who is to receive $20,000 worth of credit to her financial account at the school. If the law school accepts the restricted transfer, the student should not be allowed a charitable contribution deduction. The student's designated transfer inherently constitutes a quid pro quo exchange. By designating herself as the secondary beneficiary, the law student conditions her transfer on the receipt of a material commensurate benefit. Indeed, the charitable transferee's acceptance of the transferred amount requires the charity essentially to return the value of the transferred amount to the transferor. Where a taxpayer structures a transaction with a charity to plainly receive a commensurate material benefit, we have serious reason to doubt that such transfer is worthy of a tax subsidy in the form of the charitable contribution deduction.

First, and most obviously, such a transaction involves private consumption; the law student in our example has really just "purchased" the value of benefits that she will receive. As a matter of positive law, the transfer is a nondeductible personal expense under Code section 262. Normatively, the transfer is plainly not a deductible charitable contribution under Professor Andrews' theory of personal deductions because it secures private consumption for the taxpayer. Moreover, the law student has not suffered a decrease in material well-being (assuming that her education is worth at least as much as what she paid for it). Further, the transaction is not characterized by altruism, the theoretical justification for one form of tax subsidy (income tax exemption) advanced by Professor Atkinson. In addition, because of its inherent quid pro quo, the transaction is not properly characterized as a "donation" worthy of subsidy under the

365. By a "market-priced" good or service, I mean a good or service provided by nonprofit entities in the business of providing goods and services to customers at prices that likely are not substantially below the cost of providing them. Goods and services provided by the typical "commercial nonprofit" are those in view. I do not mean to suggest that the goods and services are necessarily priced the same as those provided by for-profit firms.

366. See supra Part II.C.4.
analysis of Professors Hall and Colombo. More generally, the traditional subsidy theory would not support a charitable contribution deduction for a payment of tuition as long as one makes the reasonable assumption that the value of the private benefit secured by the payment (i.e., the value of education enjoyed by the law student in our example) is at least as great as the monetary amount of the payment. There is no need to subsidize the transfer through the charitable contribution deduction to induce the taxpayer to make tuition payments which are equal to the value of the education that she will receive.

A similar case is that involving a designated transfer to charity that secures consumption of a market-priced, private or semi-public good or service by another member of the taxpayer's household. The textbook example of this case is the taxpayer's payment of tuition for her child attending private elementary school. If the secondary beneficiary (i.e., her child) is someone whom the taxpayer is legally obligated to support, characterizing the tuition payment as the taxpayer's private consumption of a good or service presents no major difficulties. In exchange for the tuition payment, the taxpayer secures educational services for her child, which the law requires her to do (in some form). The taxpayer is simply buying a service that she must in some manner provide her child. For the reasons discussed in the previous paragraph, no charitable contribution deduction should be available to the taxpayer. This, of course, is precisely the result compelled by current law.

One may argue more generally that a deduction should be denied in any case in which the secondary beneficiary—whose consumption of a market-priced, private or semi-public good or service is secured by the taxpayer's designated transfer—is a member of the taxpayer's household (regardless of whether the taxpayer is legally obligated to support the secondary beneficiary). This argument would borrow from those provisions of the Code that tend to treat the proper taxpaying unit (for certain purposes) as the household or family, rather than as the precise individual whose consumption is at issue. Of course, in order to implement this view of the "household," one must draw lines so as to determine exactly what persons constitute members of the same household of the taxpayer. Such line-drawing is never easy, and is to some degree arbitrary in distinguishing close cases. However, some courts have considered the "familial-like"

367. See supra Part II.C.5.
368. See supra notes 21-31 and accompanying text.
369. For example, the so-called "kiddie tax" may result in the imposition of a tax on the unearned income of a minor child of the taxpayer at the rate that would apply to the taxpayer's income. See I.R.C. § 1(g) (1994). In addition, some, like Professor Andrews, view the nondeductibility of personal gifts between individuals as resting on the assumption that most such gifts occur between persons of the same consuming taxable unit (such as family members). See Andrews, supra note 189, at 348-49.
relationship of the taxpayer and the secondary beneficiary to be relevant. Namely, the Tax Court in *Thomason* (in which a charitable contribution deduction was denied) observed that the taxpayer who paid for his former foster child's residency at a special ranch had a "keen fatherly and personal interest" in the boy, who had been a member of the taxpayer's household for several years prior to the transfer. The most plausible theoretical justification for the court's reliance on this factor is that no deduction should be available for a taxpayer's payments securing the private consumption of a good or service by a member of the taxpayer's household.

**c. Where Transferor and Secondary Beneficiary Are Identical or Have a Special Relationship: The Case of No Commercial Benefits**

The examples that I have employed thus far in this section of the paper—those involving payments securing market-priced goods and services consumed by the taxpayer or members of her household—present a fairly obvious case for denying the deduction. What if the benefit provided by the charitable transferee to the secondary beneficiary is not a market-priced, private or semi-public good or service? The following hypothetical, which involves an identity between the taxpayer and the secondary beneficiary, illustrates the question presented. A charitable organization headquartered in New York City is organized to promote justice for the poor through the legal system. To encourage pro bono representation of clients by members of the bar in private practice, each year the organization has awarded $1000 to an attorney in recognition of outstanding service to the indigent. The taxpayer, a partner of a large New York law firm, offers to donate $1000 to the organization for the purpose of awarding a grant to the taxpayer, who for the past twenty years has spent 300 hours per year representing indigents. The organization accepts the designated transfer, and awards the $1000 to the taxpayer in a public ceremony. Should the taxpayer receive a charitable contribution deduction for the transfer?

Under the typical quid pro quo analysis, the answer is "no." The transaction is, at bottom, a type of exchange. Because the taxpayer's transfer to the organization is conditioned on the charity's acceptance of the "gift's" restrictions, the charity can accept the transferred funds only by committing itself to retransfer them to the taxpayer. That is to say, in exchange for the transferred funds, the charity will award an

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370. Thomason v. Comm'r, 2 T.C. 441, 443 (1943).
371. That the taxpayer in *Thomason* once served as a foster parent of the child then in the custody of the children's aid society does not necessarily mean that the child should be considered a member of the taxpayer's household at the time of the transfer. The precise boundaries determining who should be considered members of a taxpayer's household are not obvious. I do not attempt to decide these boundaries in this paper.
equal sum to the taxpayer pursuant to the taxpayer’s designation. Such is the essence of a quid pro quo. The very structure of such an earmarked transfer causes the deduction to fail under *Hernandez*. More generally, one may conceptualize the transaction as a “purchase” of an award by the taxpayer, which results in no deduction under the donative theory of Professors Hall and Colombo. Finally, the transaction lacks the element of altruism, and therefore fails the test of Professor Atkinson’s altruism theory.

On the other hand, could one not argue that the representation of indigents indeed produces great public benefit, and therefore it is appropriate to encourage transfers that tend to foster the production of this benefit? The argument would reason that the charitable organization in the hypothetical reasonably believes (as indicated by its history of providing awards) that public awards for pro bono representation tend to increase the provision of legal services for the poor. Further, because the charitable organization in the hypothetical agreed to accept the designated transfer on its own terms, the organization presumably concluded that accepting the transfer and issuing the award to the taxpayer would further its charitable mission (as argued above). The charity must, if challenged by the IRS or the office of the state attorney general, be able to justify its acceptance of the gift on the terms specified by the donor. Moreover, from a practical perspective, the charity must be able to defend its award as a legitimate execution of its charitable mission in order to attract future donations from prospective donors. So why not allow a charitable contribution deduction to the taxpayer in the hypothetical, notwithstanding the inherent quid pro quo?

The answer best lies in the subsidy theory. Because the transfer secures for the taxpayer-transferor a private material benefit equal to the amount of funds transferred to the charity, the traditional

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372. *See supra* notes 42-54 and accompanying text. Because the hypothetical assumes an identity between the taxpayer-transferor and the secondary beneficiary, allowing a charitable contribution deduction would not result in erosion of the tax base, as long as the award from the charitable transferee is included in the taxpayer’s income as a realized accretion to wealth over which the taxpayer exercises dominion. *See Comm’r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955). Under current law, however, the initial transfer would not be deductible. Accordingly, the award itself should not be included in the taxpayer’s income. In other words, because the taxpayer and secondary beneficiary are identical, the transaction should be treated as a wash. Such a wash may not occur if the taxpayer and secondary beneficiary are not identical. For example, assume that in the previous hypothetical, the taxpayer designated his daughter (a practicing attorney) as the secondary beneficiary. If the daughter’s income tax bracket is lower than that of the taxpayer, allowing the taxpayer a charitable contribution deduction and including the award in the daughter’s income would result in lower revenues for the federal government.

373. Obviously, the transfer would also likely confer a non-material benefit upon the transferor in the form of the honor of receiving the public service award. This possibility merely reinforces the notion that no deduction is necessary to encourage the transfer.
subsidy theory does not suggest the need to encourage the transfer with a deduction. In other words, we could expect the taxpayer in our hypothetical to offer the designated transfer to charity even without the incentive of a charitable contribution deduction (as long as he is not required to include the award in income), for the value of the award is no less than the amount of his transfer. Accordingly, society will not lose the benefit of the organization's promotion of pro bono representation.

B. Systemic Considerations

Section III.A of this Article discussed whether, and to what extent, certain case-specific factors should be relevant in determining the deductibility of earmarked contributions. In this subsection of the Article, I evaluate how various "systemic" factors bear upon the normative question of whether, and to what extent, earmarked transfers to charity should be deductible as charitable contributions. Each factor embodies norms (or deviations therefrom) that earmarked transfers may or may not advance. The extent to which such transfers are likely to advance (or violate) such norms is the subject of this discussion.

1. Encouraging Pluralism: The Voice of the Small Donor

As noted above, one asserted benefit of the charitable sector (and perhaps the nonprofit sector in general) is that it promotes pluralism. The argument that the nonprofit sector promotes pluralism is in many respects just a non-technical way of saying that nonprofits are likely to provide goods and services that would not be provided by government or for-profit firms (or in a manner that such entities would not provide). As previously discussed, there are economic justifications in support of the nonprofit sector (and charities in particular) when the production of a good or service falls short of the socially optimal ideal on account of the dual failures of government and private enterprise. However, the notion that pluralism is itself a valued norm, and should be encouraged, appears to be broader than this economics justification. To value pluralism is to value the rich diversity of opinions and tastes that typify the many subcultures of our society, quite apart from whether promoting this diversity can be justified under an economic analysis. Is there any reason to believe that allowing a charitable contribution deduction for earmarked transfers to charity will promote pluralism? I believe such a reason exists.

In the real world, the donor of large sums to charity commonly exercises a prominent voice in the operations of the charity, at least to the extent impacted by his or her donation.\textsuperscript{374} This observation should

\textsuperscript{374} See McNulty, \textit{supra} note 7, at 250 ("A related concern is that wealthy
not be shocking. Indeed, in critiquing Professor Andrews' defense of
the charitable contribution deduction, Professor Mark Kelman
observes that donors of large sums commonly receive great deference
from charitable donees. One form of deference is respecting the
donor's opinion of how the donated funds should be used by the
donee. Sometimes, a large donor is given a compelling voice over
charitable operations through placement on the governing board of
the charity. But less formal means of deferring to the donor's wishes
are available, and probably quite common. Consider a prospective
donor who transfers $1 million for an endowed chair in tax law at
State Law School. What is the likelihood that State Law School
will hire a professor of whom the donor does not approve? In reality, the
probability is low. State Law School will likely be quite deferential to
the donor's preferences. To hire a professor of whom the donor of
a large sum does not approve not only virtually ensures that the law
school will never see another dime from that donor when there is
probably "more where that came from," but also increases the
likelihood that the institution will earn a reputation for not
"cooperating" with generous stakeholders, thereby undermining
future efforts to raise funds.

This practical power of wealthy donors does nothing to preclude the
deductibility of their contributions under current law. As discussed
above, although some courts look to the charity's control of donated
funds (as does the IRS), the test of control is one of legal rights, not
"real world" economic pressures. Moreover, as discussed below, a
system which encourages accountability by charitable transferees to
donors has considerable theoretical appeal. But if a legitimate goal of
the charitable sector is pluralism (as an independent value, or as
means for advancing other values, such as efficiency), a problem
remains. The problem is not necessarily that charitable organizations
grant large donors a voice in their affairs, but that they grant so little
voice to small donors.

In addition to the law's tolerance of extensive practical control over
donated funds by donors of large sums, the law further perpetuates
the disparity of "voice" between wealthy donors and those of modest
means in the context of gifts designated to benefit a particular
individual through the treatment of private foundations. Consider a

contributors have the power to direct contributions through the charities to
beneficiaries of their choice and that the form of the present tax allowance enhances
that power.

375. See Kelman, supra note 201, at 856-58.

376. This does not necessarily mean that the donor will effectively (though
informally) select the professor to be hired. However, the donor may well be given
such deference that he or she exercises what is tantamount to veto power. If the
donor strongly objects to the candidate favored by State Law School, it will likely
either hire the donor's favorite candidate, or resume the search for a mutually
satisfactory candidate.
taxpayer with plenty of money to hire good legal counsel to help her incorporate a private foundation described in Code section 501(c)(3), and obtain recognition of the private foundation's tax-exempt status from the IRS. The taxpayer transfers a handsome sum to the private foundation and obtains a charitable contribution deduction for the gift. The taxpayer is named as one of the three members of the private foundation's board of directors, and the board is self-perpetuating (i.e., the board members elect their successors). Of course, the articles of incorporation of the private foundation, which were drafted by the taxpayer's legal counsel with great sensitivity to the taxpayer's wishes, name two other people as directors, hand-picked by and highly deferential to the taxpayer. If the private foundation—through its board of directors dominated by the taxpayer—desires to make a grant to an individual, and the grant furthers a charitable purpose of the foundation (for example, the grantee is poor and in need of temporary shelter), can the private foundation do so under current law? Yes, indeed it can. What an individual cannot do directly under current law, she can do indirectly through a private foundation—if she has the financial means to justify the formation and operation of a private foundation, and to hire legal counsel who can advise her how to do so.

Of course, private foundations are not utilized by those who lack financial resources sufficient to justify their formation and operation. Private foundations are utilized primarily by those who are fairly financially secure. Thus, the best that a person of moderate means could hope for under current law is "deference" from charities. However, contrast the deference given the donors of large sums with that which one would expect to be given the donors of small sums. While a donor who makes a small gift may well have a preference for how that gift will be used, unless the gift is formally restricted, there is a lower probability that the charitable transferee will follow the advice of the small donor, or even seek it. A charitable transferee has a less compelling financial reason to defer to the wishes of small donors, unless they can act collectively. Allowing a deduction for earmarked contributions, however, gives small donors with little financial leverage a greater potential for a meaningful voice. The only way that the charitable transferee will receive the donation is if it accepts the

377. See I.R.C. § 509(a) (1994) (defining private foundation). A private foundation is essentially a charitable organization that is neither a "traditional" operating charity (such as a school, hospital, or church) nor an organization broadly funded by the general public. A private foundation typically furthers charity by making charitable grants.

378. In general, nothing prevents a private foundation from making a grant to an individual. If the grant is for travel, study, or similar purposes, the foundation must (prior to making the grant) adopt certain procedures and obtain approval of such procedures from the IRS, and must limit the grant for activities specified in the Code. See I.R.C. § 4945(d)(3) & (g).
gift on its own terms. Doing so requires the charity to consider the preferences of the small donor. It is one thing for a charity to disregard the advice of a small donor after receiving the donation in hand, where the only downside is the possibility that the offended small donor will not give again (i.e., a possible future small donation may be lost). It is quite another thing for a charity to turn down a small donation that is ready to be dropped at the charity’s doorstep, if only the charity agrees that the donor’s restricted use will indeed further charitable operations.

Granted, a small earmarked contribution will not suffice to endow a university chair, and therefore it is unlikely that the preference expressed by the small donor in such a case will promote pluralism. But in other contexts—such as when a social welfare agency receives an earmarked contribution for helping a flood victim, or for assisting a poor family with mounting medical bills—there is a greater probability that the charitable transferee will give serious consideration to the worthiness of the secondary beneficiary. In such cases, by increasing the voice of small donors, allowing a deduction for earmarked charitable contributions tends to promote pluralism. Indeed, once a charitable transferee agrees that a designated secondary beneficiary is a worthy recipient of a benefit financed with the designated transfer, the charity may decide to devote unrestricted funds to benefit the secondary beneficiary. In this manner, the voice of the small donor is amplified, and pluralism is further promoted.379

2. Efficiency Gains and Losses

Will permitting a charitable contribution deduction for earmarked contributions promote or undermine economic efficiency? At the outset, I must confess that I cannot credibly purport to answer this question definitively. However, I am convinced that there are persuasive reasons that a deduction for such contributions tends to promote economic efficiency, and that arguments against the deduction on efficiency grounds are not without difficulties. While I cannot prove that a deduction for earmarked contributions is efficient, I believe I can make a plausible case that such a deduction is economically efficient, or at least is not necessarily economically inefficient.

379. Admittedly, there is some risk that the donors of large sums—who consist in part of affluent individuals and large corporations—will achieve an even greater voice than that which they currently enjoy if they can deduct contributions restricted to benefit a named secondary beneficiary. However, because such donors already have such a significant voice in the affairs of charitable donees, it is likely that the net result would be to give donors of small sums a relatively greater voice than that which they now possess. If so, allowing a deduction for earmarked transfers to charity will still tend to promote pluralism.
As a threshold matter, I must explain why a taxpayer’s making of earmarked contributions is not inherently inconsistent with the commonly accepted economics justification for the existence of the nonprofit sector advanced by Professor Hansmann: contract failure. As discussed above,\textsuperscript{380} contract failure exists because transferors of funds are unable to ensure that their transferred funds are actually used to benefit members of the targeted class of beneficiaries. This inability to monitor the desired “bang for the buck” may be attributable to the separation of the donor and the ultimate beneficiary (i.e., donors cannot determine whether their donations for hunger relief have actually reached starving Ethiopian children), the impossibility of measuring one’s contribution to the production of a public good, or the difficulty in judging the quality of service or goods provided by a charitable entity. Does the making of an earmarked contribution necessarily “solve” these instances of contract failure, thereby removing the justification for the provision of the benefit by charitable transferees in the first place?

In answering this question, we must first understand which instances of contract failure are germane to the present inquiry. For reasons discussed below,\textsuperscript{381} there are good reasons to deny a deduction for earmarked transfers to charity that secure the secondary beneficiary’s consumption of private goods and services for which she normally would be expected to pay a market price. Thus, in the case of the typical commercial nonprofit (like a school or hospital), the only instance with which we need concern ourselves is that involving a taxpayer’s payment of a good or service on behalf of someone whom the service-provider would not normally charge—such as an indigent (in the case of a hospital that customarily provides charity care). In such a situation, the taxpayer’s earmarked contribution to secure medical care for the indigent secondary beneficiary is a transaction plagued just as much by “contract failure” as the taxpayer’s payment of medical care for herself. Indeed, the potential contract failure is probably even greater in the case of the payment on behalf of the indigent, for the taxpayer herself does not have first-hand knowledge of some symptoms of illness experienced by the patient (i.e., the taxpayer cannot personally feel the patient’s pain or relief therefrom).

In the case of charities providing classic public goods, earmarked contributions would likely not even arise, and would have no unique effect even if they did arise. By definition, public goods are available for consumption by all consumers. An earmarked contribution to a charity providing a public good will benefit the secondary beneficiary to the same degree as a non-earmarked contribution. Whatever contract failure applies to contributions to charities that produce

\textsuperscript{380} See supra notes 251-254 and accompanying text.

\textsuperscript{381} See infra Part III.B.3.b.
public goods does so without regard to whether the contributions are earmarked.

The most problematic form of contract failure in the context of earmarked contributions is that involving the separation of the donor and the secondary beneficiary. In Professor Hansmann's example of contributions to CARE, where the donors are separated from ultimate beneficiaries by an ocean,\textsuperscript{382} earmarked contributions are characterized by the same major contract failure that characterize non-earmarked contributions: the taxpayer has little way of ensuring that the particular child she has chosen to feed will receive the benefit of her donation. The economics justification for the provision of hunger relief across the seas applies equally to those entities that receive earmarked contributions and those that do not.

But what about local charities, where donors live in close proximity to the people served by the charity? In such cases, it is true that contract failure is surely not as severe as in the case of donations to ameliorate hunger overseas. A taxpayer can to some degree monitor the effectiveness of local charities in meeting human needs. Moreover, the ability to monitor local human welfare charities is enhanced through earmarked contributions. Does this ability to monitor charitable transferees reduce contract failure to such a degree that it renders the existence of the charitable sector superfluous? I do not believe so.

First, it is highly unlikely that the ability to deduct earmarked contributions will result in all contributions being earmarked. Many donors simply do not have sufficient knowledge of the members of charitable classes served by charitable donees so as to designate them by name. Secondly, even many of those who earmark contributions will likely rely on charities to provide benefits to secondary beneficiaries without significant oversight. It will be more expedient for many donors simply to designate the secondary beneficiaries, and then rely upon the charities to honor the designation. No doubt, some donors will indeed monitor whether their designations have been honored. But this is not a reason to reject the deductibility of earmarked contributions on efficiency grounds. Rather, it may well be a reason to favor them. If charities believe that some donors will be monitoring them, they are more likely to comply with the donors' designations.

Of course, compliance with the designations of donors is efficient only if we assume that the exercise of "donor voice" itself promotes efficiency. That is the heart of the present inquiry. What are the plausible efficiency gains from earmarked contributions?

One conceivable efficiency gain from earmarked contributions is a reduction in the costs of gathering information concerning worthy

\textsuperscript{382} See Hansmann, The Role, supra note 251, at 846-47.
ultimate beneficiaries of charitable operations. Of the many charitable uses of funds, charities must decide which causes are the most deserving and in need of support. Charities providing benefits to particular individuals must gather information and evaluate potential recipients of benefits in order to determine how best to distribute scarce resources. A donor who offers an earmarked contribution serves the potentially helpful service of identifying a worthy and needy recipient of charitable funds. Indeed, in many cases, it is likely that the donor will have become aware of the secondary beneficiary's need in the course of everyday discourse, with little extra expenditure of time and money. Allowing donors to deduct earmarked contributions is a way to encourage the efficient "passing on" of information from donors to charities concerning ultimately worthy causes. True, donors could convey such information to charities without making a deductible contribution thereto. But there are two major advantages to allowing the deduction. First, it encourages the charities to consider the donor's suggestion seriously; the gift cannot be accepted in good faith unless the charity has decided upon the merits of the restriction. Secondly, when a donor parts with her money (as opposed to offering nothing but advice), we have credible evidence that the donor is a true believer in the worthiness of her cause. She "puts her money where her mouth is."

Another efficiency gain of earmarked contributions is the maximization of donors' "result utility." As discussed above in the context of the donative theory of exemption advanced by Professors Hall and Colombo, the result utility derived by the donor lies not in her personal participation in giving, but in her perception that the amount contributed will help society. Result utility mirrors the actual social value in accomplishing the activity supported by the donation. By encouraging earmarked contributions through the tax subsidy of a charitable contribution deduction, we tend to maximize donors' result utility, and thereby maximize the social value in accomplishing designated charitable purposes.

Another way of expressing this point is that a charitable contribution deduction for earmarked transfers tends to encourage donations from individuals who otherwise would not give to charity.

383. One could counter with the argument that the whole process may be inefficient because it forces charities to consider secondary beneficiaries that have no merit, itself a costly prospect. However, many donors who offer earmarked grants could be expected to have gathered a fair amount of information (often at a low cost, as noted above) to convey to charities, and to present the information to charities in a manner that is easily apprehended. Doing so maximizes the probability that the charity will accept the gift. While evaluating such information involves costs, they are likely not as extensive as the costs to charity of the entire process of gathering information, organizing it, and then evaluating it.

384. See supra text accompanying notes 301-312.

because they believe that their transfers will not have a meaningful impact. As professor Gergen has observed, people are less likely to subsidize a good produced by a social welfare agency when they feel that their prospective contribution is tiny relative to the enormous needs of society, and therefore will not make any real difference. However, a donor who is allowed to earmark her contribution has the satisfaction of knowing that her contribution will be used to benefit an individual whom the donor believes is worthy. The donor is more likely to see her contribution as making a difference. Moreover, encouraging this type of a gift with a tax subsidy potentially enhances the impact of a single donor, insofar as the value of a deduction allows her to contribute a greater amount than she otherwise would have been able (or even inclined) to contribute (i.e., in the absence of a deduction).

For example, consider a taxpayer in a 30% income tax bracket who has $50,000 of gross income for the taxable year. The taxpayer is willing to part with $100 of his funds on an after-tax basis in order to further charity meaningfully. In other words, our taxpayer is willing to be out-of-pocket in an amount equal to $15,000 (the amount of his federal income taxes (30% of $50,000) if no charitable transfers are deductible) plus $100 in transfers to charity, or a total of $15,100 in out-of-pocket expenditures, leaving him with $34,900 ($50,000 - $15,100). Also assume that the taxpayer’s transfer to charity (say, a homeless shelter) would indeed be socially desirable. However, if no charitable contribution deduction is available for earmarked gifts, the taxpayer may well not make any contribution to a homeless shelter because he just does not feel that his transfer will make a significant difference in any single person's life. Now consider a second scenario, which assumes that the law permits a charitable contribution deduction for earmarked contributions. Encouraged by the prospect of “making a difference,” the taxpayer makes a deductible transfer to a homeless shelter and earmarks a named homeless person as the secondary beneficiary of the transfer (as a recipient of meals provided by the shelter for one full month, for example). If the taxpayer can deduct the value of the earmarked transfer, the taxpayer can contribute about $143 to the shelter and remain in his desired after-tax position: his income tax bill will be 30% of ($50,000-$143), or about $14,957, to which we add $143 for his transfer of cash to the homeless shelter, for total out-of-pocket expenditures of $15,100. That leaves our taxpayer with $34,900, his desired amount after making expenditures for taxes and charity. More importantly, with

386. Cf. McNulty, supra note 7, at 236 (arguing that a social good is promoted when freerider problems are reduced on account of the appropriation of some benefit by donors, such as the knowledge by a donor of a private gift that the gift will benefit someone she knows in a manner visible to the donor).

387. See Gergen, supra note 187, at 1448.
the deduction for earmarked contributions, a charitable organization now has an additional $143 to conduct its operations, which it otherwise would not have received.

In the previous illustration, the deduction for earmarked contributions was efficient because it induced the taxpayer to transfer funds that he otherwise would not have transferred, and, by stipulation, in a socially desirable quantum. However, perhaps my example misleadingly assumes only two scenarios. Perhaps we have a third scenario, in which our taxpayer is willing to make a personal gift to a homeless person in the amount of $100. Such a gift would cost the taxpayer $100 both before and after taxes, because the gift is nondeductible for federal income tax purposes. After paying taxes of $15,000 (30% of $50,000), and making a gift of $100 to the homeless person, the taxpayer is left with $34,900, his desired amount after making expenditures for taxes and charity. As this example suggests, one may argue that a subsidy for earmarked contributions is inefficient, because in the absence of a deduction therefor, donors would simply give the secondary beneficiaries nondeductible personal gifts. Thus, we must ask if there is any reason to favor a deduction for earmarked contributions over a system in which we simply let a taxpayer make a nondeductible personal gift.

One advantage of providing a deduction for the earmarked contribution is the oversight function performed by the charity itself. The charity can ensure that the value appropriated by the homeless person is in the form of food (or shelter), not substances harmful to the person (such as alcohol or other drugs). Encouraging contributions to charitable transferees thereby improves the chances that members of the charitable classes served by the charities are truly helped.

Another advantage is the "signaling" function of

388. I recognize that a personal gift can be made in kind (i.e., I can buy a hamburger for a homeless person or, like the Good Samaritan, pay for his lodging at a hotel). However, it is probable that a charitable donee, the routine activities of which include the provision of benefits in kind on a large scale, can provide such benefits more efficiently than can most individual taxpayers. Admittedly, this point does not mean that charities actually operate as efficiently as they could. See infra text accompanying notes 403-414 for a discussion of this issue. However, if charities would operate more efficiently with greater donor involvement, it is probable that making gifts to charities often would be more efficient than making personal gifts in kind to individuals. See generally McNulty, supra note 7, at 236 (stating that charities may or may not be more efficient than individuals in furthering charitable goals).

389. One could counter that this argument fails to explain why we should not simply let donors make nondeductible earmarked grants to charities. After all, a nondeductible earmarked grant still places funds squarely in the hands of charities, which thereafter can make certain that secondary beneficiaries receive only appropriate forms of benefits. One response to this counter-argument is that a deduction may be necessary to encourage the optimal level of charitable giving. Another response is that many charities are probably discouraged by their legal counsel from accepting earmarked grants. Why so? They are (in many cases) nondeductible under current law. As such, the charity that receives an earmarked
earmarked transfers. If a taxpayer makes a personal gift to a disaster victim, while that victim may be aided to some degree, she may still have a significant remaining unmet need. As argued above, allowing a deduction for earmarked contributions encourages taxpayers to convey useful information to charities, which may be able to provide even greater support for those in need. Finally, relative to the amount of the nondeductible gift, allowing a deduction for the earmarked contribution allows the taxpayer to make a larger pre-tax transfer for the ultimate benefit of the secondary beneficiary at the same after-tax cost of the transfer. In our previous example, the deduction for the earmarked gift resulted in $43 of additional funds (relative to the amount of the nondeductible personal gift) being dedicated to charitable purposes.

Another plausible argument that a deduction for earmarked contributions may encourage a taxpayer to give more to charity involves the donor who believes that a prospective charitable donee will (or may) mismanage unrestricted funds. Such mismanagement may take the form of misfeasance (such as paying excessive compensation), or the mere devotion of funds to uses that the donor does not consider worthy of support. At least in some cases, monitoring whether a charity complies with the donor’s designated use is easier than determining whether a charity has “wasted” assets through mismanagement. This perceived benefit of facilitating the accountability of charities to those who monitor their advancement of charitable purposes may be just the incentive that some donors need to transfer funds to charity.

So what is the most important efficiency loss that a deduction for earmarked contributions may create? It is probably an oversupply of benefits to named secondary beneficiaries. In other words, the major risk is that a taxpayer (or taxpayers as a group) are likely to donate a sum of earmarked contributions in excess of the socially optimal level. This loss would occur when the taxpayer’s choice of a secondary beneficiary is misguided, as when the secondary beneficiary is less deserving of support than others whom the charity desires to...
benefit. This loss also would occur when the taxpayer's choice of the secondary beneficiary is sound, but the amount of the donation is in excess of the socially optimal level. How do we begin to analyze the magnitude of this risk of efficiency loss?

The best that I can do presently is to focus attention on some major assumptions that underlie the analysis of this potential efficiency loss. If we assume that charities are trustworthy, that they make efficient decisions regarding the use of donated funds (notwithstanding what donors' perceptions may be), it is far from clear that allowing a deduction for earmarked contributions is a bad idea. Clearly, if the donor offers an earmarked contribution that is indeed socially optimal, we could expect a wholly “trustworthy” charitable donee to accept the gift. Further, under the assumption of trustworthy charitable donees, if a prospective donor designates an unworthy secondary beneficiary, the prospective charitable donee generally can be trusted to refuse the gift. The major risk arises when the prospective donor specifies a “worthy” recipient, but one whom the charity considers “less worthy” than another whom could be helped by the prospective donation. In that situation, how will the parties—both the prospective donor and the donee—behave? Answering this question obviously requires more assumptions.

If we assume that donors are stubborn, arrogant taxpayers who will not give to charity unless they “get their way” when specifying a restricted use, then a prospective donee might be inclined to go ahead and accept the designated gift on the theory that helping a worthy secondary beneficiary (who is not “the worthiest” potential secondary beneficiary) is better than helping nobody at all. But is this result necessarily inefficient, relative to the world of giving under current law? It is inefficient only if we assume that those “stubborn, arrogant taxpayers” would have made unrestricted gifts to the charitable transferee in the absence of a deduction for earmarked contributions, and that such donors’ contributions are the only source of funds that

392. Cf. Hall & Colombo, The Donative Theory, supra note 222, at 1461 (“The aberrational, idiosyncratic desires of a single individual may not reflect the desires of any significant portion of society and thus may not be worthy of a public subsidy.”).

393. Cf. Evelyn Brody, Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms, 40 N.Y.L. Sch. L. Rev. 457, 470 (1996) (“Because donors often do not consume the services they donate, donor control can lead to inefficient overproduction of what particular donors want to support.”); Gergen, supra note 187, at 1425 (observing the risk of misallocation of resources when donors make restricted gifts).

394. If we assume that charitable organizations generally cannot be trusted to make good decisions (even when subject to existing enforcement mechanisms), then current law should be significantly reformed. As discussed below, there are persuasive reasons to believe that charitable organizations engage in sub-optimal behavior. However, it is doubtful that managers of most charities engage in the most egregious form of misbehavior (the private appropriation of charitable funds) to any great degree. See infra text accompanying notes 396-402.
may benefit the "worthiest" secondary beneficiaries. Such assumptions are at least problematic, particularly in view of the prior assumption that such taxpayers believe that only they can best determine worthy charitable uses. We would rightly question whether such taxpayers would have made unrestricted charitable gifts under current law.

If we assume that donors will listen to the reasoning of prospective "trustworthy" charitable donees who believe that an earmarked grant would not best further charitable purposes, it would not be at all unreasonable to expect that such donors would simply offer other earmarked transfers—ones which earmark funds for the benefit of the "worthiest" secondary beneficiaries identified by charitable donees. Such a process could be expected to produce a socially desirable level of benefits to secondary beneficiaries (although the transaction costs associated with communications between donors and charitable transferees would likely be higher than in the case of unrestricted gifts).

Perhaps this analysis is far too simplified. One could argue that the greatest risk of loss in efficiency from allowing a deduction for earmarked grants is simply that a charitable transferee, in this situation and this alone, will substitute its "optimal decisions" for donors' "sub-optimal decisions." Under this argument, charities can generally be trusted to devote funds to socially optimal uses, as long as they are left to their own decision-making processes. Stated another way, charities are indeed trustworthy, but only when they are free of the influence of donors. The risk is that charities will abdicate their decision-making function to donors, to the detriment of society. Because this precise argument presents its own nuances, I take it up separately in the next section of this Article.

3. Abdication of the Decision-Making Function of Charities

a. In General

Whether a deduction for earmarked contributions is unjustified because it uniquely tends to result in the abdication of a charitable organization's decision-making function is a complex issue. Recall the basic argument: a deduction for an earmarked contribution will encourage the substitution of a charitable organization's "optimal decisions" for the "sub-optimal decisions" of donors. I will refer to this as the "abdication" argument. In analyzing the abdication argument, I wish to identify explicitly this argument's assumptions, analyze such assumptions, and place the argument in the proper context of the present inquiry. I shall undertake the last of these objectives first (and briefly).
In the limited context of what this Article tackles—the deductibility of earmarked transfers to charity—the abdication argument is not in itself sufficient to compel the disallowance of the deduction. If the premises of the argument are true, then the deductibility of all types of charitable contributions subject to donor-initiated restrictions should be questioned. But under current law, most restricted gifts are plainly deductible. Admittedly, this observation, standing alone, does not necessarily mean that earmarked contributions should be deductible. After all, if deductions for expenditures A and B are equally unjustified, that we allow a deduction for B does not necessarily mean that we should allow a deduction for A. However, other objections to the abdication argument may be raised.

In so doing, we now should identify the major assumptions of the abdication argument. The first assumption of the abdication argument is that charities, left to themselves, make good (i.e., socially beneficial, or perhaps even socially optimal) decisions regarding the use of donated funds. The second assumption is that as a class, donors who designate secondary beneficiaries make poorer (i.e., less socially desirable) decisions than independent charitable organizations regarding the use of donated funds. The third assumption is that charities which normally make good choices concerning the use of donated funds will defer to the inferior choices of donors (i.e., charities will make poorer choices) if donors can deduct their earmarked transfers to charity. Each assumption merits critical reflection.

As to the first assumption of the abdication argument, current law provides several checks to prevent the most egregious forms of mismanagement. The prohibition against private inurement of a charitable organization's net earnings, the requirement that a charitable organization be organized exclusively and operated primarily to further an exempt purpose, the excise tax on "excess benefit transactions" engaged in by public charities, and various excise taxes imposed on private foundations (and private persons having a special relationship therewith) all serve to curtail many types of misfeasance. The IRS is the "enforcer" of these limitations.

395. One could collapse the first two assumptions into one: charities, left to themselves, make better decisions than donors as a class. However, expressing the assumptions in three-fold form is analytically useful because it so plainly invites a critical examination of the behavior of charities. The following discussion is useful regardless of the form in which the abdication argument is expressed.
399. See I.R.C. § 4958.
400. See, e.g., id. § 4941 (imposing excise taxes on acts of self-dealing between a private foundation and a disqualified person); id. § 4945 (imposing excise taxes on taxable expenditures of private foundations).
Several of these limitations are just versions of the "nondistribution constraint" imposed upon nonprofit corporations under state law. The enforcers of the nondistribution constraint are the state attorneys general (whose ability to closely monitor nonprofits in practice has proven quite limited). While the enforcement of these limitations is not perfect, the severity of the penalties for non-compliance (particularly after the enactment of Code section 4958) provides some meaningful degree of assurance that most charitable organizations will not siphon funds away from charitable operations.

However, this working conclusion does not alone establish the truth of the first assumption of the abdication argument. As Professors Brody and Ben-Ner have observed, the nondistribution constraint merely precludes an organization from distributing net profits; it certainly does not ensure that the organization utilizes funds in a socially optimal manner. As Professor Ben-Ner has stated,

[The absence of a profit motive does not imply the existence of a specific alternative goal. Nonprofit organizations may pursue goals related to various attributes of a service (its quality, diversity, frequency of provision, price, or the identity of its beneficiaries) in ways that fail to meet the demands of some demand-side stakeholders. The nondistribution-of-profit constraint... leaves too much room for managers to make programmatic decisions that may not agree with the economic demand of those who are dissatisfied with market provision.]

Professor Brody lists several reasons that a nonprofit organization may fail to operate in a socially optimal manner. At bottom is the fundamental problem that nonprofit entities are "agents without principals." The governing boards of such entities have fiduciary duties, but there is no group completely analogous to the shareholders of a for-profit firm to whom management must answer. As such, the

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401. The term "nondistribution constraint" was coined by Professor Hansmann. See Hansmann, The Role, supra note 251, at 838. It simply means that a nonprofit corporation is prohibited by state law from distributing profits to private parties. Id.

402. See Brody, supra note 393, at 467 n.32 (citing authorities); Hansmann, The Role, supra note 251, at 837-74.

403. See Brody, supra note 393, at 463-66.


405. "Demand-side stakeholders" are those who have some stake in the price, quantity, quality, and other features of that which a nonprofit organization provides. They include consumers of a nonprofit organization's goods and services and donors. See id. at 749-50.

406. Id. at 752-53.

407. See Brody, supra note 393, at 463-64 (citing the inability of a nonprofit organization to judge accurately its quality of service, internal agency costs, and the propensity for corporate waste resulting from the absence of a profit-maximizing agenda).

408. Id. at 465.
Particularly troubling is the implication of contract failure as it relates to accountability. As Professor Brody insightfully writes,

"[T]he law grants plenary authority to the nonprofit board of directors to manage the affairs of a nonprofit corporation. Those who govern a nonprofit firm can exercise discretion to maximize different goals. Because of the presumed information asymmetry between the nonprofit and the patrons, the nondistribution constraint alone cannot assure the patron that his donation... will achieve his intent. If the public cannot tell what is happening inside the nonprofit, the patron cannot know whether the nonprofit is using his or her money to maximize the quality of the charity’s services, to reduce their cost to the public, to augment pecuniary and nonpecuniary compensation of the charity’s workers, or even to save for the benefit of future patrons."

The observations of Professors Brody and Ben-Ner should give us pause as we consider the first assumption of the abdication argument—that charities, left alone, make socially beneficial (or even socially optimal) decisions regarding the use of donated funds. Because a charitable donee typically lacks accountability to defined principals, we have little assurance that a charitable donee maximizes charity. Granted, this lack of accountability means only that charitable organizations have an opportunity to use donated funds in a manner that fails to produce the greatest potential societal benefit; the lack of accountability does not mean that charities actually fail to maximize charity, or fail to approximate doing so. However, there is some reason to believe that charities do tend to pursue goals extraneous to the production of the greatest social good. Professor Brody has noted the variety of goals that managers of nonprofit organizations seek to maximize, according to various economists, social scientists, and management experts. Many of these goals differ from maximizing the impact of a charity’s stated mission. Equally troubling is the prospect that nonprofit organizations tend to devalue productive efficiency. Professor Brody argues that nonprofit organizations operate with a higher degree of "slack" than that present in business corporations (which, at least in theory, are subject to shareholder demands to maximize profits). This organizational slack results from such internal goals as "avoiding conflict, reducing

409. See id. at 465-67. Professor Brody also argues that for-profit firms suffer from a lack of accountability because of the separation of ownership and control of large corporations. See id. at 467.

410. Brody, supra note 393, at 466. Professor Brody writes in a manner reminiscent of Professor Ben-Ner’s earlier scholarship. Cf. Ben-Ner, supra note 404, at 753.

411. See id. at 491-92.

412. Id. at 507. This observation is not intended to suggest that proprietary firms single-mindedly pursue the goal of profit maximization in reality. There is good reason to doubt that they do. See id. at 494-505.
tension, valuing ‘fairness,’ and making the nonprofit a more pleasant place to work.” For these reasons, the first assumption of the abdication argument is problematic. True, a charitable organization, left to itself, can be expected to produce “some good” for society, and often to an important extent. However, because a charitable organization also is likely to pursue inefficient goals, we have good reason to believe that it will make sub-optimal decisions. What we do not know is the extent of social loss resulting from the sub-optimal behavior of charities.

One may also properly question the second assumption of the abdication argument: that donors who designate secondary beneficiaries make poorer (i.e., less socially desirable) decisions than independent charitable organizations regarding the use of donated funds. As an initial matter, insofar as donors probably do not care as much about the internal goals of charities (discussed above) that tend to reduce efficiency, we may properly question whether a donor’s restriction of funds for the benefit of a named secondary beneficiary is likely to be less optimal than whatever use the charity would have made of such funds in the absence of the donor’s designation. Although earmarked contributions may produce other inefficiencies, at least they tend to reduce those internal inefficiencies discussed by Professor Brody. Further, as argued above, in many cases donors who offer an earmarked contribution may have superior information about the secondary beneficiary’s worthiness. In such cases, a donor’s judgment of the societal benefit of supporting the secondary beneficiary may well be superior to that of the charity. Perhaps more fundamentally, it is far from clear that the judgment of a person who is so convinced of the worthiness of a named secondary beneficiary that she is willing to expend her own funds to support her is less credible than the judgment of one who supports secondary beneficiaries with other people’s money.

More generally, as we complete our brief analysis of the second assumption of the abdication argument and begin to consider the third assumption thereof, we should examine the broader question of whether giving donors (as a group) a greater “voice” in the affairs of charity is an appropriate way to increase the accountability of these “agents without principals” (as Professor Brody calls nonprofit organizations). How one answers this question probably reflects one’s vision of the role of donors and other stakeholders in the oversight of

413. Id. at 507 (footnote omitted).
414. The clearest case is a designated gift of cash, to be transferred to a secondary beneficiary. In that case, the charitable donee will be bound to use the cash as designated by the donor. In other contexts, such as when a donor earmarks a contribution for the benefit of a secondary beneficiary who is to receive a benefit in kind, there is greater opportunity for the charity to waste the gift (e.g., by paying too much for food to be provided a homeless person).
charitable enterprise. On the one hand, as Professor Brody has observed, the separation of donors’ “supply” from beneficiaries’ “demand” may result in an inefficient supply of a good or service funded by donors. 415 In other words, donors may supply only what they want to supply, not what members of charitable classes need. On the other hand, as Professor Ben-Ner argues, one may view the whole class of charitable donors (of time and money) and purchasers of a charitable organization’s goods and services as the appropriate group of “controllers” of the charity, insofar as they “demand” the provision of the goods and services they fund and are most analogous to “owners.” 416 Under this vision, control by donor-stakeholders (and other patrons) “provides the only assurance that the firm will operate according to their economic demand.” 417

To defend (or reject) Professor Ben-Ner’s vision of the role of donors in overseeing the affairs of charitable entities is far beyond the scope of this paper. All I offer here is conceptual agreement with his argument that charities would likely operate in a manner closer approximating the social ideal if they were more accountable to a broad group of donors. Donors lack some of the incentives to establish and pursue inefficient goals. If many donors are involved in the oversight of charities, they will likely bring a diversity of perspective and experience that can be of great value. Donors are likely to give more to charity when convinced that their contributions will be expended in a manner that they see fit. Donors involved in decision-making will probably facilitate the exchange of useful information amongst themselves and senior officers of charitable organizations.

These observations should sound familiar, of course. They are some of the reasons that support a deduction for earmarked contributions. To be sure, allowing a deduction for earmarked gifts to charity is an extremely small measure compared to the type of reform that would comprehensively implement Professor Ben-Ner’s vision of nonprofit governance by stakeholders. My point for the moment is only that my proposal for deducting earmarked gifts to charity is a minor step in the direction of implementing more comprehensive and effective measures to involve a broad class of donors in the oversight of nonprofits so as to increase the accountability of charitable agents without principals.

The preceding arguments do not, standing alone, disprove the second assumption of the abdication argument (i.e., that donors make poorer decisions than “independent” charities), although they do call into question the truth of the assumption in the limited context of

415. See Brody, supra note 393, at 470, 512.
416. See Ben-Ner, supra note 404, at 753-61.
417. Id. at 753.
earmarked contributions. Further, and more generally, the preceding arguments suggest that even if donors as a class are usually less competent in determining the use of charitable funds than the management of charitable organizations, society may still be much better off in uniting donors and charities in the charitable decision-making process. In other words, an enterprise in which donors and charitable managers make decisions together may well be superior to an enterprise with a decision-making process that is independent of donor participation.

This thought brings us face-to-face with the third assumption of the abdication argument—that charities will defer to the choices of donors if donors can deduct their earmarked transfers to charity. First, in the context of earmarked contributions, deference to donors may often be entirely acceptable, even desirable. Such is the case, for example, when the donor has superior knowledge of the worthiness of a secondary beneficiary, or when in the absence of a restriction the charity would waste the donation. But such is not always the case. Sometimes, the donor may simply be misguided. In such situations, how significant is the risk that charities will unjustifiably defer to the wishes of donors?

I can offer here only some reasoned speculation and observations. For the reasons discussed above,418 most donors (at least those who otherwise would be inclined to make unrestricted gifts to charity) probably can be trusted to listen to the concerns expressed by a charity when considering whether to accept a deductible earmarked gift. If we assume that donors will listen to the reasoning of prospective charitable donees who believe that an earmarked grant would not optimally advance charitable purposes, we may anticipate that such donors could be persuaded to offer a different earmarked transfer, which comports with the charitable donee's assessment of the "worthiest" secondary beneficiary. It is true that this process of communicating between prospective donor and prospective donee creates transaction costs. But I believe that the benefits of this process may justify the costs. Facilitating such communication between donors and donees is one way of moving the current system towards the vision of Professor Ben-Ner, a system in which donors exercise accountability over the decisions of the managers of charities. The process that I would expect to ensue from allowing a deduction for earmarked contributions will likely (if only modestly) increase donor involvement in charitable decision-making, to the betterment of society. Charitable organizations would need to justify alternatives presented to donors, a process which requires more critical assessment of desired uses of funds. In this process, donors have the opportunity to justify their initial designations to charity. An environment of

418. See supra text accompanying note 394.
greater cooperation and interaction between donors and charitable donees could well arise.\textsuperscript{419}

b. \textit{The Case of Commercial Nonprofits}

There is an important instance in which we may properly question whether a deduction for an earmarked contribution is appropriate: where the taxpayer's transfer to charity, which is a commercial nonprofit, secures market-priced goods and services for consumption by the secondary beneficiary. The charitable transferee in such cases often has only modest (or no) interest in the identity of the secondary beneficiary, and may not view him as uniquely "worthy" or "needy" of the benefit that he receives. Consider a taxpayer's payment of the tuition of an unrelated pre-teen child. As long as the child meets the admission standards of the school (which, we may even assume, are relatively high), a reasonable working assumption is that the school generally has little interest in determining whether the child is "worthier" of his education than any other child who meets admission standards. This assumption is certainly reasonable when the policy of the school is to award no scholarships or grants (so as to attract extraordinary talent, or to benefit the poor). The furtherance of the charity's mission lies in the nature of services rendered (the promotion of education), not in the identity of the persons who consume the services rendered. Accordingly, a charitable transferee may be perfectly willing to accept an earmarked transfer securing a benefit for the secondary beneficiary, regardless of whether providing an education to the secondary beneficiary results in more or less value to society than providing the benefit to someone else.\textsuperscript{420}

Because the charitable transferee in such circumstances need not affirmatively determine that the secondary beneficiary is a particularly worthy recipient of the benefit provided by the charity, we have insufficient reason to believe that the taxpayer's payment securing such benefit should be encouraged through the charitable contribution deduction. Another way of expressing this conclusion is to say that in these circumstances, the charitable transferee is not simply abdicating its responsibility to decide upon the worthiness of a

\textsuperscript{419} I concede that this analysis assumes that charities will indeed approach donors with alternative suggestions if offered earmarked gifts that the charities consider sub-optimal. I do not think this assumption is unrealistic. True, the charity risks offending a prospective donor. On the other hand, approaching a prospective donor with such a suggestion presents an opportunity for the charity to demonstrate just how well the charity has thought through the potential uses of its funds, and to demonstrate how seriously the charity views its mission. Such communications may actually foster donor-donee relations and goodwill, or at least not hinder them.

\textsuperscript{420} This analysis does assume that the school is not able to attract, or for some legitimate reason does not seek to attract, a high percentage of those whom some believe to be the "worthiest" (i.e., most intelligent, most athletic, most artistic, most disadvantaged, etc.) potential students.
secondary beneficiary: the charity has no such responsibility to abdicate in the first instance. Consequently, we lack adequate grounds for concluding that the taxpayer's payment benefits a "worthy" (as opposed to a merely "eligible") secondary beneficiary. All we know for certain is that the taxpayer's payment has a redistributive effect.

One qualification of the previous analysis is that a payment which secures a good or service of a commercial (and charitable) nonprofit organization by a secondary beneficiary (who is not a member of the taxpayer's household) probably should still be deductible if credible evidence establishes that, absent the earmarked transfer, the charitable transferee nonetheless would have provided such good or service to the secondary beneficiary without charge (assuming adequate funds to do so) because of the secondary beneficiary's inability to pay (particularly if the secondary beneficiary is destitute). In such cases, the charity furthers its exempt purposes not only by providing a particular good or service (such as education or hospital care), but also by benefiting the poor. A taxpayer who makes an earmarked contribution for the benefit of a secondary beneficiary who would have received the charity's services at no charge and in any event on account of his poverty is plainly advancing a charitable purpose of the charitable transferee. Moreover, if the financial condition of the secondary beneficiary and the policy of the charitable transferee to provide free care to such a beneficiary can be demonstrated, we have adequate assurance that the secondary beneficiary is "worthy" of support.

4. Encouraging Altruism

As discussed above, Professor Atkinson has argued in favor of income tax exemption for organizations that embody altruism. Professor Atkinson does not offer a comprehensive justification for advancing altruism as a desirable norm, nor will I do so here. I simply desire to note that, just as a charitable contribution deduction in general tends to promote altruism, so does a deduction for earmarked contributions to charity. To Professor Atkinson, the hallmark of altruism is the absence of a material quid pro quo. As limited by the normative analysis in this Article, the deduction for an earmarked contribution to charity that I advocate would involve no material quid pro quo. If altruism is a desirable norm to be advanced through the tax system, a deduction for earmarked contributions to charity appears justified.

421. See supra text accompanying notes 264-276.

422. One could also argue that altruism would be advanced through a deduction for personal gifts, at least when made to non-relatives and persons who are not members of the taxpayer's household. Whether personal gifts should be deductible is
5. The "Perk of Picking" Secondary Beneficiaries Under Income Tax Theory

One could argue that earmarked transfers to charity should not be deductible because when a donor designates her gift to charity for the benefit of a secondary beneficiary, she necessarily receives a significant benefit that transferors of "blind" donations do not receive: the satisfaction of knowing that her transfer will assist a secondary beneficiary whom the donor considers worthy of beneficence. However, I believe that other scholars have capably undermined this train of thought. First, as a matter of income tax theory and policy, one may observe that such notion is inconsistent with the position of Professor Andrews (who argues that taxable consumption does not include the nonmaterial pleasures of giving), and is at least in considerable tension with the "welfare reduction" theory (which reasons that a taxpayer making a charitable contribution is less well-off than he was before the transfer; under that approach, the same conclusion is true regardless of whether the donation is earmarked). Moreover, were we to reject these theories in favor of the view of Professor Koppelman that the real basis for taxing income is accretion (and the "power to consume"), there is no good reason under that theory for treating earmarked transfers to charity less favorably than non-earmarked transfers; both transfers are equally unworthy of a deduction because the transferor in both cases had the power to consume the amounts transferred prior to the transfer. If current law implicitly rejects Professor Koppelman's theory as to non-designated transfers to charity, I see no principled reason to invoke the theory so as to deny deductions for earmarked contributions to charity. Doing so is arbitrary.

Likewise, I do not believe that a sufficient distinction exists between earmarked and non-earmarked transfers to charity under broad concepts of "private preclusive appropriation" as consumption. In critiquing the view of Professor Andrews that charitable contributions do not constitute "private preclusive appropriation" of divisible goods and services (Professor Andrews' concept of taxable private consumption), Professor Kelman has argued that "tied grants" (contributions restricted for a specific charitable use, such as scholarship grants) meet the Andrews criteria for consumption; they "appropriate" the specific services to be funded with the grants.\(^\text{423}\) For example, a scholarship grant appropriates educational services (albeit, for someone other than the donor).\(^\text{424}\) Although Professor Kelman argues that unrestricted grants may be appropriative for various other

\(^{423}\) See Kelman, supra note 201, at 849-50.

\(^{424}\) See id.
reasons, his logic leads to the conclusion that a great deal of charitable contributions are appropriative. Any time a donation is made to a charitable grantee, whatever services that particular donee provides (be they educational services, the relief of poverty, the rehabilitation of drug addicts, etc.) are "appropriated" for someone (or some group of persons) (except, perhaps, in the case of pure public goods producing non-localized benefits). Accordingly, if the distinction between appropriative and non-appropriative charitable contributions is our guiding light, I see no compelling reason to "draw the line" so as to deny a deduction only for earmarked contributions. 426

6. Erosion of the Tax Base and Horizontal Equity

As discussed previously, it could be argued that a deduction for earmarked contributions is inefficient, because in the absence of a deduction therefor, donors would simply give the secondary beneficiaries nondeductible personal gifts. 427 Another way of expressing this argument is that the deduction would erode the income tax base. Although, as discussed above, there are numerous efficiency-based responses to this argument, there is also an important response grounded in horizontal equity, which may be illustrated as follows: a taxpayer with $300,000 of annual income who donates $100,000 to charity as an unrestricted gift is in virtually the same position as a taxpayer with equal income who donates an equal sum to the same charity as an earmarked contribution. If we are to tax similarly situated taxpayers similarly, we should grant the latter taxpayer a deduction for her gift if we grant the former taxpayer a deduction for his gift.

The most rational basis for distinguishing the two taxpayers in the previous illustration is that the latter taxpayer, unlike the former, receives the "perk of picking" the secondary beneficiary. However, the argument that a "designating" donor receives a species of utility that a "blind" donor does not receive is fundamentally unpersuasive when one considers the countless forms of utility that tax-advantaged donors already routinely receive (some of which derive from making unrestricted gifts). As discussed above, Professors Gergen, Hall, and Colombo have all acknowledged the (often significant) utility that donors receive in connection with charitable giving. Yet under current law, many forms of utility received by a transferor as a result

425. See id. at 850-51.
426. It is no objection to say that earmarked contributions are uniquely "appropriative" simply because they benefit a single individual. A charitable contribution is deductible under current law if the donor specifies that donated funds must be used to benefit one person (unbeknownst to the donor) whom the charitable donee selects.
427. See supra text accompanying notes 388-390 (responding to this argument).
of a donation result in no disallowance (nor even a reduction) of the charitable contribution deduction. The law would be quite peculiar indeed were it to discriminate amongst taxpayers on the basis of what type of non-pecuniary, non-material benefits that they receive upon making a charitable contribution.

To illustrate, there is no obvious reason that we should tax transfers generating utility merely from the knowledge that a donation will benefit a particular needy individual less favorably than transfers generating utility in the form of enhanced social standing from subsidizing the cost of a building bearing the donor’s fine family name. In the case of similarly situated taxpayers making an equal dollar contribution and deriving the same quantum of utility from giving, denying a deduction in the former case while allowing a deduction in the latter violates horizontal equity. Moreover, we cannot say for certain that the amount of one taxpayer’s utility generated from the ability to designate the secondary beneficiary is necessarily greater than the amount of another taxpayer’s gift-related utility taking other forms (such as community goodwill, the relief of a burdened conscience, the desire to impress friends and neighbors, etc.). Accordingly, focusing on the expected donor utility derived from designating the secondary beneficiary generally should not result in a denial of a deduction under notions of horizontal equity.

7. Consistency with Income Tax Treatment of Personal Gifts

The previous analysis of this Article suggests that a deduction for earmarked transfers to charity is appropriate in many circumstances under Code section 170. A skeptical reader may object that while a deduction for earmarked transfers to charity is justifiable under Code section 170, the deduction also must pass muster under the policy considerations that compel the nondeductibility of gifts made between individual taxpayers. In other words, can the preceding analysis be reconciled with the denial of a deduction for personal gifts under current law? Although a comprehensive analysis of the proper tax treatment of personal gifts is beyond the scope of this Article, I can offer the following brief explanation of why the proposed deduction for earmarked transfers to charity under Code section 170 can readily be viewed as consistent with the income tax treatment of personal gifts, *if Code section 170 remains constant.*

Two major schools of thought justify the nondeductibility of personal gifts. According to adherents of the first, the donor who makes a personal gift is not entitled to a deduction because prior to the gift, she had the power to consume assets, and this power to consume is the essence of income.  

position is that the donor had the "ability to pay" taxes prior to the
gift, and therefore the amount of the gift should remain in her tax base.\textsuperscript{429} Of course, as discussed above\textsuperscript{431} taken to its logical
conclusion, this school of thought would deny a deduction for any
contribution to charity—whether or not the contribution is
earmarked—because a charitable donor of one dollar has the same
power to consume (or ability to pay taxes) as the donor of a personal
gift of one dollar prior to making the gratuitous transfer. Thus, to
invoke this first policy explanation for the tax treatment of personal
gifts so as to deny a charitable contribution deduction for earmarked
transfers to charity on the one hand, but to allow the deduction for
non-earmarked charitable transfers on the other, would be entirely
incongruous. Under the assumption that Code section 170 in general
is desirable, we must admit that a charitable donor’s pre-contribution
“power to consume” sums contributed to charity is, for various policy
reasons (such as those extensively discussed above), an insufficient
reason for including the donation in her income tax base. When we so
admit, we find that this first explanation for the nondeductibility of
personal gifts is no reason to disallow a deduction for earmarked
transfers to charity.

Nor is the deduction advocated in this Article inconsistent with the
other major school of thought justifying the nondeductibility of
personal gifts. As previously observed, Professor Andrews has
rationalized the current taxation of personal gifts under the
assumption that interpersonal gifts occur primarily between members
of the same household, and taxing the portion of such household’s
income attributable to the gift at the income tax rate to which the
donor’s income is subject is sensible.\textsuperscript{431} This Article does not advocate
a deduction for any earmarked transfer to charity when the secondary
beneficiary is the taxpayer or a member of her household.
Accordingly, under this second school of thought, a properly framed
deduction under Code section 170 for an earmarked transfer to
charity is just as appropriate as that available to a taxpayer who makes
an undesignated charitable gift.

IV. CONCLUSION

Current federal income tax law unjustifiably disallows a charitable
contribution deduction for several types of transfers to charitable
organizations from taxpayers who, like the Good Samaritan, desire to
assist a specified individual. Under prevailing judicial and
administrative interpretations of Code section 170, the circumstances

\textsuperscript{429} E.g., Joseph M. Dodge, Beyond Estate and Gift Tax Reform: Including Gifts
\textsuperscript{430} See supra text accompanying notes 202-214.
\textsuperscript{431} See supra note 196.
in which a taxpayer may deduct earmarked contributions to charity are limited. Generally, current law correctly disallows a charitable contribution deduction for earmarked transfers in which the taxpayer or a person closely related thereto is designated by the taxpayer as the secondary beneficiary. Existing law properly allows a deduction under Code section 170 for transfers in which a taxpayer simply expresses a non-binding preference that her donation be used to benefit an unrelated secondary beneficiary. However, most cases and revenue rulings mistakenly advance the rule that a deduction must be denied a taxpayer if she, upon her own initiative (rather than in response to an appeal by a charitable donee), restricts the use of donated funds by the charitable donee so as to benefit a named person selected by the taxpayer. Existing precedent obfuscates the analysis of the circumstances in which earmarked contributions should be deductible by advancing an undefined (and largely unhelpful) “control” test, an overly broad “donor intent” test, and an irrelevant and counter-productive “but for” test.

Considering existing theories of the proper tax base in computing personal income, pervasive norms of tax policy, and other policy norms, goals, and principles, this Article has demonstrated that the deduction for earmarked contributions to charity should be expanded. I offer the following framework for determining when an earmarked contribution should be deductible: In general, a taxpayer should be entitled to deduct any earmarked transfer to a charitable organization which both receives delivery of the transferred money or property and accepts the contribution in its own right (rather than as an agent or as a trustee of a private trust). There should be two exceptions to this proposed rule. First, no deduction should be allowed for any earmarked transfer pursuant to which the taxpayer or a member of her household is designated by the taxpayer as the secondary beneficiary. This aspect of the framework attempts to account for the impropriety of a deduction for a transfer that is, in essence, part of a quid pro quo exchange. Secondly, a taxpayer should receive no charitable contribution deduction for any transfer to a charity operating as a commercial nonprofit, if such transfer secures market-priced goods and services for consumption by the secondary beneficiary. An exception to this exception should exist if it is established that, absent the earmarked transfer, the charitable transferee nonetheless would have provided such good or service to the secondary beneficiary without charge (assuming adequate funds to do so) because of the secondary beneficiary’s inability to pay for the good or service.

Although my proposed framework for determining the deductibility of earmarked transfers to charitable organizations differs in approach from that of most authorities directly on point, I believe that most of the results of cases can be justified under my framework. I also
believe that this framework can be implemented judicially. For the reasons discussed above, I do not totally abandon the "donor intent" test and the "donee control" test. However, I do strictly confine those tests to require no more than that which is absolutely essential to preserve the integrity of Code section 170. Because the proposed framework can exist harmoniously with the results of most cases, courts should feel free to adopt it, albeit as a development or refinement in the law governing earmarked transfers to charity. Likewise, my proposed framework could be adopted by the IRS, although doing so would mark a shift in policy for the agency.432

I reiterate the caveat with which I introduced the previous section of this Article. My proposed framework assumes the existence of the charitable contribution deduction of Code section 170 (as currently written) for non-earmarked transfers and the federal income tax exemption for charitable organizations granted by current law. Should the Code and state laws governing nonprofit organizations undergo major reformation, my proposed framework might well be rendered moot, or even undesirable.

Absent from this discussion is a thorough consideration of how the common law of charitable trusts and charitable gifts bears upon the analysis. A comprehensive policy analysis of current law’s treatment of non-charitable gratuitous transfers is also in order. A thoughtful discussion of these issues may be necessary before my proposed framework is accepted by the courts.

There remains a need to adopt more comprehensive reform so as to increase cooperation between charities and their stakeholders. Such cooperation is likely to improve the efficiency of charities in many respects. The challenge is to design reforms that will preserve, and even enhance, the many virtues that are said to characterize the charitable sector. My framework is but a small step in that direction.

432. The position of the IRS is, in my opinion, too hostile to taxpayers claiming a deduction for earmarked contributions to charity.