Volume 74
Issue 2 *Dickinson Law Review - Volume 74, 1969-1970*

1-1-1970

Tax Reform Act: Denial of Charitable Deduction for the Use of Property

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TAX REFORM ACT: DENIAL OF CHARITABLE DEDUCTION FOR THE USE OF PROPERTY

INTRODUCTION

The Tax Reform Act of 1969[1] passed by Congress on December 11 and signed into law by the President on December 30, 1969, provides as follows in the charitable contributions section:

> (3) Denial of deduction in case of certain contributions of partial interests in property.—In the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall be allowed under this section only to the extent that the value of the interest contributed would be allowable as a deduction under this section if such interest had been transferred in trust. For purposes of this subparagraph, a contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in such property.[2]

This new provision eliminates charitable deductions for gifts of the use of property for limited periods and, thereby, settles the disagreement between the Internal Revenue Service and the courts[3] which, though infrequently litigated, is important to charitable donors. This Comment will trace the legislative and case history of the problem surrounding the giving of charitable deductions for a gift of the use of property for limited periods. It will then examine the effect of the Tax Reform Act on gifts of use of property, particularly contributions of rent-free office space.

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1. Pub. L. No. 91-172, 83 Stat. — (Dec. 30, 1969).

2. *Id.* § 201(a). Deduction is not allowed for a charitable gift of the remainder interest in a trust unless it is a charitable remainder annuity trust (specifies in dollars the amount to be paid to the beneficiary annually) or a charitable remainder unitrust (specifies the beneficiary's annual income based on a fixed percent of the net fair market value of the trust's assets). *Id.* §§ 201(e), (h), (i). Deduction is not allowed for the income interest of a trust with a noncharitable remainder unless the grantor is taxable on that income or unless all interests in the trust are given to the charity. Charitable deduction for an income interest in the trust is also not allowed unless the income beneficiary receives a guaranteed annuity or a fixed percentage annually of the fair market value of the trust property. *Id.* § 201(a); See. H.R. REP. No. 413, 91st Cong., 1st Sess. 58-62 (1969).

3. *Compare* Threlfall v. United States, 302 F. Supp. 1114 (W.D. Wis. 1969) *with* I.T. 3918, 1948-2 CUM. BULL. 33.

LEGISLATIVE HISTORY

In 1917 Congress amended the Revenue Act of 1916[4] by adding contributions to charities to the list of income tax deductions:

> Ninth. Contributions, or gifts actually made within the year to corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children or animals, no part of the net income of which inures to the benefit of any private stockholder or individual. . . .[5]

This section was not materially changed until 1938 when the word "payment" was inserted: "(o) Charitable and Other Contributions. —In the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of. . . ."[6]

The Internal Revenue Service has argued that insertion of the word "payment" excludes deductions for the use of property under a leasehold interest since there can be no "payment" made of the property.[7] The Service's argument, however, does not agree with the reason given in the House Report of 1938 for amending the 1917 revenue bill:[8]

> Under the various Revenue Acts the deduction for contributions is allowed for the taxable year in which the contribution is made . . . . In the interest of certainty in the administration of the revenue laws, it is desirable to dispel this confusion by enacting a clear and uniform statutory rule to govern this situation.
>
> The bill provides that the deduction for contributions or gifts for charitable and other purposes shall be allowed only for the taxable year in which the contribution is actually paid. The allowance of the deduction in the year when actually paid will provide a clearer rule without hardship to the taxpayer and will eliminate the uncertainty in the administration of the deduction.[9]

The 1938 amendment was one to reduce administrative difficulties in determining the year of deduction; it did not alter the type of gifts included under the charitable contribution section.[10]

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4. Act of Sept. 8, 1916, ch. 463, § 1201(2), 39 Stat. 756.
5. Act of Oct. 3, 1917, ch. 63, § 1201(2), 40 Stat. 300, 330.
6. Act of May 28, 1938, ch. 289, § 23(o), 52 Stat. 447, 463 [hereinafter referred to in the text as 1939 Code].
7. I.T. 3918, 1948-2 CUM. BULL. 33. See discussion at note 46 and accompanying text *infra*.
8. H.R. REP. No. 1860, 75th Cong., 3rd Sess. (1938), [hereinafter also referred to in the text as 1938 House Report], 1939-1 CUM. BULL. 728.
9. *Id.* at 741-742.
10. See Threlfall v. United States, 302 F. Supp. 1114 (W.D. Wis. 1969).

The 1938 Report also stated the basic policy in favor of deductions for charitable contributions:

> The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare.[11]

The legislative statement of policy contained in the 1938 Report is as valid today as it was in 1938. Encouragement of charitable contributions, a policy also advanced by the courts,[12] is necessary today to relieve the government of some of the burdens of providing for the welfare of its citizens, and charitable deductions from income tax are a most persuasive form of encouragement.

In the Internal Revenue Code of 1954[13] various sections[14] of the 1939 Code were consolidated into section 170, and an additional deduction of up to ten percent of adjusted gross income over and above the existing deduction limit of twenty percent was allowed for contribution made to certain enumerated charitable organizations.[15] In reporting on the passage of section 170, the House Ways and Means Committee said, "It is to be noted that such charitable contributions must be paid *to* the organization and not *for the use of* the organization."[16] While Congress added special conditions to the amendments in the 1954 Code, as in the restriction on the additional ten percent allowed deduction for charitable contributions, it did not change the meaningful sections of previous acts included in the 1954 Internal Revenue Code; the phrase "to or for the use of" was retained in the definition of charitable contributions and continued to apply to the general twenty percent deduction. This 1954 House Report, therefore, is not helpful in interpreting the meaning of the charitable deductions sections which have been in force virtually unchanged since 1939. The determination of which donations constitute contributions or gifts

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11. H.R. REP. No. 1860, 75th Cong., 3rd Sess. (1938), 1939-1 CUM. BULL. 728, 742.

12. United States v. Pleasants, 305 U.S. 357 (1939); Helvering v. Bliss, 293 U.S. 144 (1934).

13. 26 U.S.C. § 170 (1964) [hereinafter also referred to in the text as 1954 Code].

14. H.R. REP. No. 1337, 83rd Cong., 2nd Sess. (1954), 3 U.S. CODE CONG. & AD. NEWS 4019:

> Section 170 of the bill consolidates section 23(o) of the 1939 Code, relating to charitable contributions by individuals; section 23(q) of the 1939 Code, relating to charitable contributions by corporations; and section 120 of the 1939 Code, relating to the unlimited deduction of charitable contributions by individuals.

Id. at 4189.

15. 26 U.S.C. § 170(b)(1)(A) (1964).

16. H.R. REP. No. 1337, 83rd Cong., 2nd Sess. (1954) [hereinafter also referred to in the text as 1954 House Report], 3 U.S. CODE CONG. & AD. NEWS 4019, 4190 (emphasis by the Committee).

"to or for the use of" an organization has been left largely to interpretation by the Internal Revenue Service and the courts.

The relevant sections of the 1954 Code are:

> (a) Allowance of deduction.—
>
> (1) General rule.—There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. . . .
>
> . . . .
>
> (c) Charitable contribution defined.—For purposes of this section, the term "charitable contribution" means a contribution or gift *to or for the use of*—[17]

"To or for the Use of" Interpreted

The Internal Revenue Service and the courts have not always agreed on the interpretation of the charitable deductions section.[18] Though infrequently litigated, there has been, as previously indicated, a divergence of opinion concerning deductions for allowing a charity the use of property. For example, consider the following situation: *A* owns an office or apartment building and a charitable organization[19] asks him to donate office space for its use for a

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17. Int. Rev. Code of 1954, § 170(a), (c), 26 U.S.C. § 170(a), (c) (1964) (emphasis added). This language is retained in the Tax Reform Act of 1969, § 201(a), (c).

18. *See* note 3 *supra*.

19. Organizations qualifying under the Internal Revenue Code of 1954 are as follows:

> (1) A State, a Territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.
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> (2) A corporation, trust, or community chest, fund, or foundation—
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> (A) created or organized in the United States, any State or Territory, the District of Columbia, or any possession of the United States;
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> (B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals;
>
> (C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and
>
> (D) no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation.
>
> . . . .
>
> (3) A post or organization of war veterans, or an auxiliary unit or society of, or trust or foundation for, any such post or organization—
>
> (A) organized in the United States or any of its possessions, and
>
> (B) no part of the net earnings of which inures to the benefit of any private shareholder or individual.
>
> (4) In the case of a contribution or gift by an individual, a

limited period of time; *A* has empty space in his building and agrees to lease it to the charity. The question that arises is whether the fair rental value of that space is deductible from his income tax as a charitable contribution.

In *Threlfall v. United States*[20] the United States District Court in Wisconsin decided the issue in favor of the taxpayer. The court relied mainly on three cases: *Priscilla M. Sullivan*,[21] *Mattie Fair*,[22] and *Passailaigue v. United States*.[23]

Freehold Interests

In *Priscilla M. Sullivan*[24] the taxpayer in 1942 conveyed[25] a house in fee without consideration to the American National Red Cross which was to hold the property until the war ended or until the local Red Cross chapter ceased to use it as a headquarters, whichever occurred first. The taxpayer claimed a deduction based on the rental value of the house for each year of use. The Tax Court held that the taxpayer conveyed a determinable fee with the right of reverter in the taxpayer which is an irrevocable interest in the property. The property interest was according to the Tax Court of indefinite duration and could not be terminated by the taxpayer. The contribution was, therefore, a completed gift in 1942, and the allowable deduction was the fair market value of the property in that year. Here, because the conveyance was in fee, the court could find a single completed gift and avoid the question of mere "use" of property apart from ownership. The court stated:

> When the transfer was completed, it [the Red Cross] became the owner of the property subject to a right of

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domestic fraternal society, order, or association, operating under the lodge system, but only if such contribution or gift is to be used exclusively for religious, chartiable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

(5) A cemetery company owned and operated exclusively for the benefit of its members, or any corporation chartered solely for burial puroses as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, if such company or corporation is not operated for profit and no part of the net earnings of such company or corporation inures to the benefit of any private shareholder or individual.

For purposes of this section the term "charitable contribution" also means an amount treated under subsection (d) as paid for the use of an organization described in paragraph (2), (3), or (4).

INT. REV. CODE of 1954, § 170(c), 26 U.S.C. § 170(c) (1964); INT. REV. CODE of 1954, § 170(d) continues in pertinent part as follows: "(d) Amounts paid to maintain certain students as members of taxpayer's household.—" 26 U.S.C. § 170(d) (1964).

20. 302 F. Supp. 1114 (W.D. Wis. 1969).

21. 16 T.C. 228 (1951).

22. 27 T.C. 866 (1957).

23. 224 F. Supp. 682 (M.D. Ga. 1963).

24. 16 T.C. 228 (1951).

25. The property was conveyed to an attorney who reconveyed it to the American National Red Cross.

> reverter in the petitioner in accordance with the terms of the deed. Thus, petitioner was no longer liable for real estate taxes with respect to the property, and in fact paid none after March 30, 1942.[26]

In *Mattie Fair*[27] the taxpayer owned a two story building. In 1948 she conveyed to the Fair Foundation, a charitable organization, the right to build, own and maintain five additional stories; she also conveyed an easement for the right to use part of her building for a lobby, stairways, and elevators. The taxpayer was under no duty to maintain the supporting building, and in the event it was destroyed, she had the option to rebuild. If taxpayer rebuilt, the Foundation also had the right to rebuild. The ownership of taxpayer's property and the ownership of the property granted to the Foundation was to be separate and distinct.

The taxpayer claimed a charitable deduction based on an evaluation of the conveyed rights made by the Tyler (Texas) Real Estate Board. The Commissioner of Internal Revenue took the position that the rights conveyed did not constitute property in that no interest in the ground was conveyed. The Tax Court agreed with the taxpayer and allowed the deduction. The Tax Court said, "Property is the sum of rights and powers incident to ownership"[28] and the right to use air space is frequently the most valuable right in land. The Tax Court noted further that the taxpayer had conveyed a present irrevocable interest in the property.

Leasehold Interests

In *Passailaigue v. United States*[29] the District Court of the Middle District of Georgia dealt directly with a leasehold interest donated to a charitable organization. In 1959 taxpayer leased to Youth Craft Shop, Inc., a charitable organization, a parcel of land under an oral lease and later under a written lease.[30] Youth Craft

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26. 16 T.C. 228, 231 (1951).
27. 27 T.C. 866 (1957).
28. *Id.* at 872. The evaluation included the cost of the portion of the building used for entrance, lobby, elevator and storage as well as the value of the portion of the lot used for the building entrance lobby, elevator and storage. *Id.* at 870.
29. 224 F. Supp. 682 (M.D. Ga. 1963).
30. The lease stated:
Landlord has given to Tenant and Tenant has accepted from Landlord as a gift the use and rental of the premises located in the City of Columbus. . . .
. . . .
Tenant shall not pay to Landlord any sum for the use, occupancy and rental of said premises, it being the intention of the parties

paid no rent; the lease was to run indefinitely until taxpayer gave fifteen days written notice of termination. In 1959 and 1960 taxpayer deducted the fair rental value of the property as charitable contributions. The Commissioner assessed deficiencies against him; the deficiencies were paid, and a claim for refund was filed.

The Commissioner contended that since Passailaigue did not part with title to the property, no gift was made. Instead, according to the Commissioner's contention, the taxpayer granted only a privilege for the use and enjoyment of the property. The Internal Revenue Service relied upon its own construction[31] of the 1939 Code that:

> [P]ermission to use and occupy property granted to an organization described in section 23(o) of the Code does not represent a *payment* made to or for the use of the organization within the meaning of that section. Such an arrangement does not constitute a gift of property. It is merely the granting of a privilege for which no charge is made.[32]

The taxpayer contended he transferred a valuable property right with a determinable value.

Upholding the taxpayer's contention, the court observed that in *Mattie Fair*[33] and *Priscilla M. Sullivan*[34] the grants were made for an indeterminable period; the building could have burned or the war could have ended immediately. In this case the charitable organization could at least rely on fifteen days use. The court viewed the important question as not whether the right *might* be terminated but whether the right *was* terminated.[35] Youth Craft had exclusive use of the property for two years.

Expanding on the views of the Tax Court in *Priscilla M. Sullivan*[36] the court held:

> [I]t [Property] is also the sum of all the rights and powers incident to ownership of the physical thing. It is the tangible and the intangible. Property is composed of constituent elements and of these elements the right to *use* the physical thing to the exclusion of others is the most essential and beneficial.[37]

Without the right to use the property according to the court the owner has little more than naked legal title.[38] The substance of

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to this contract that Landlord hereby gives the use, occupancy and rental of said property to Tenant. . . .

Id. at 687.

31. I.T. 3918, 1948-2 CUM. BUL.. 33.
32. *Id.* at 34 (emphasis by the Internal Revenue Service).
33. 27 T.C. 866 (1957).
34. 16 T.C. 228 (1951).
35. Passailaigue v. United States, 224 F. Supp. 682, 686 (M.D. Ga. 1963).
36. 16 T.C. 228 (1951).
37. Passailaigue v. United States, 224 F. Supp. 682, 686 (M.D. Ga. 1963).
38. *Id.* at 686.

what the transfer accomplishes is more important than its form, and in *Priscilla M. Sullivan*[39] and *Mattie Fair*[40] taxpayers both transferred the right to use property despite the difference in form.

The Georgia District Court looked beyond the conveyance formalities used in *Mattie Fair*[41] and *Priscilla M. Sullivan*[42] which the Internal Revenue Service contended were distinguishable on the facts. It found a valuable property interest had been given to a charitable organization as a gift; the value of that gift, the fair rental value of the property, was properly deducted as a charitable contribution.

Recently the Western District Court of Wisconsin followed the decision in *Passailaigue v. United States*.[43] In *Threlfall v. United States*[44] the taxpayer at the request of the United Cerebral Palsy Foundation agreed to allow that organization the use of office space in a building he owned. He donated the office space for an original period of two and one-half months; the Foundation occupied the space for three and one-half months. Threlfall claimed a charitable deduction of the rental value of the space used.

The Internal Revenue Service contended that the donation of the office space was similar to the contribution of services for which no deduction is allowed[45] and that contribution of the use and occupancy of the property was not "payment to or for the use of" the organization.[46]

The court discussed the legislative policy of encouraging charitable contributions and, therefore, held that section 170 of the 1954 Code should be liberally construed to include the instant leasehold. Addressing itself to the Internal Revenue Service's contention that *Priscilla M. Sullivan*[47] and *Mattie Fair*[48] involved freehold rather than leasehold interests, the court held:

> I conclude that for the purposes of Section 170 there is no significant distinction between a donation of a freehold interest and a donation of a leasehold interest. It

39. 16 T.C. 228 (1951).
40. 27 T.C. 866 (1957).
41. *Id.*
42. 16 T.C. 228 (1951).
43. 224 F. Supp. 682 (M.D. Ga. 1963).
44. 302 F. Supp. 1114 (W.D. Wis. 1969).
45. Orr v. United States, 343 F.2d 553 (5th Cir. 1965) (taxpayer serving on boards and committees of Methodist Church); Rev. Rul. 67-236, 1967-2 CUM. BULL. 103 (radio station providing free broadcast time for religious and public affairs programs); Rev. Rul. 57-462, 1957-2 CUM. BULL. 157 (newspaper donating space to a charitable organization).
46. I.T. 3918, 1948-2 CUM. BULL. 33.
47. 16 T.C. 228 (1951).
48. 27 T.C. 866 (1957).

> appears, therefore, that *Passaillaigue* [*sic*] *v. United States*, *supra*, was correctly decided and should be followed here. Accordingly, I conclude that the granting of permission by plaintiff to the Foundation to use space in plaintiff's building transferred a property interest to the Foundation and constituted a "charitable contribution" within the meaning of Section 170(a)(1).[49]

The court also stated "payment" was a term added to the 1939 Revenue Code for the purpose of eliminating uncertainty in administering charitable deductions by providing for the time of deduction.[50]

The Georgia and Wisconsin courts rejected the Commissioner's contention that the donation of the office space under a lease constituted a service rather than a deductible gift. The Internal Revenue Service's position that the value of services rendered to a charitable organization is not deductible has not been challenged by the courts.[51] Unreimbursed expenses directly connected with and solely attributable to the performance of the volunteer service are, however, deductible.[52] For example, a nurse's aide working gratuitously for the American Red Cross at a local hospital may not deduct the value of her services. However, she may deduct her unreimbursed expenses for transportation to and from the hospital, for cost and maintenance of Red Cross uniforms and for cost of gloves and shoes worn exclusively with the uniform. She may not deduct the cost of lunches while performing her services unless the service required her to be away from home overnight.[53] These payments are considered to be payments for the use of the charitable organization. Similarly, a taxpayer using his car and airplane partly for charitable purposes may deduct unreimbursed expenses for gas and oil, pilot's fees and license registration fees but not for depreciation, insurance and repair fees.[54]

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49. Threlfall v. United States, 302 F. Supp. 1114, 1118 (W.D. Wis. 1969).
50. *Id.*
51. *See* authorities cited note 43 *supra*.
52. Orr v. United States, 343 F.2d 553 (5th Cir. 1965) (expenses for gas, oil, pilot's fees and license registration fees for use of car and airplane for charitable purposes); Henry Cartan, 30 T.C. 308 (1958) (expenses incurred on trips to Chicago for Red Cross chapter); Rev. Rul. 69-473, 1969 INT. REV. BULL. No. 36, at 8 (deduction for expenses incurred participating in a program to assist unmarried pregnant women); Rev. Rul. 58-279, 1958-1 CUM. BULL. 145 (expenses for operation, maintenance and repair of car and airplane used in service for Civil Air Patrol); Rev. Rul. 58-240, 1958-1 CUM. BULL. 141 (expenses incurred in attending church convention as a delegate and in attending American Legion convention as a delegate); Rev. Rul. 56-509, 1956-2 CUM. BULL. 129 (expenses incurred by civil defense volunteers traveling to attend meetings and to watch atomic bomb tests); Rev. Rul. 56-508, 1956-2 CUM. BULL. 129 (expenses incurred for transportation and uniforms by nurse's aide for American Red Cross); Rev. Rul. 55-4, 1955-1 CUM. BULL. 291 (expenses incurred for travel, meals and lodging by officer of association).
53. Rev. Rul. 56-508, 1956-2 CUM. BULL. 126.
54. Orr v. United States, 343 F.2d 553 (5th Cir. 1965).

The courts have had no difficulty distinguishing between performance of a service and gift of a leasehold interest. The donee of the leased property acquires according to the courts exclusive control and possession of it, but the courts say this important element of possession and control is absent in voluntary service cases.[55] The important element of possession and control makes the contribution one of property rather than service; it also renders meaningless the distinction between the freehold and leasehold interests which the Commissioner contended distinguished the fact situations in *Passailaigue v. United States*[56] and *Threlfall v. United States*[57] from the *Priscilla M. Sullivan*[58] and *Mattie Fair*[59] cases. In both the latter cases the donors would regain possession and title to the property. Though in form a freehold interest was conveyed, in substance the same interest was conveyed under the leases. The gifts were of property and fell within the meaning of section 170.[60]

The court in *Passailaigue v. United States*[61] recognized that a valuable property interest, though less than a freehold, had been contributed to Youth Craft for its use. The value of that gift was readily ascertainable. As early as 1930 the Board of Tax Appeals noted:

> The statute does not specify that only certain kinds of gifts are deductible. The only limitation found in the statute is as to the class of "donees" and in an amount not to exceed 15 per centum of the taxpayer's net income. . . .[62]

As shown in the legislative history of section 170(a)(1) and 170(c) of the 1954 Code, no substantive change was made by the technical language changes these sections made to the Code. Congress amended the Internal Revenue Code since 1921 to deal specifically with situations involving trusts[63] and tangible personal property[64] but never amended it to preclude deductions for the gift of a leasehold interest by an individual. The Internal Revenue Service allowed deductions for restrictive easements[65] and undivided present

55. Threlfall v. United States, 302 F. Supp. 1114 (W.D. Wis. 1969).
56. 224 F. Supp. 682 (M.D. Ga. 1963).
57. 302 F. Supp. 1114 (W.D. Wis. 1969).
58. 16 T.C. 228 (1951).
59. 27 T.C. 866 (1957).
60. See Treas. Reg. § 1.170-1(c) (1966).
61. 224 F. Supp. 682 (M.D. Ga. 1963).
62. J.T. Fargason, 21 B.T.A. 1032, 1037 (1930).
63. INT. REV. CODE of 1954, § 642(c), 26 U.S.C. § 642(c) (1964).
64. INT. REV. CODE of 1954, § 170(f), 26 U.S.C. § 170(f) (1964), *amending* 26 U.S.C. § 170 (1954).
65. Rev. Rul. 64-205, 1964-2 CUM. BULL. 62.

interests in property[66] leased to the state when donated to the state for exclusively public purposes. Donations to a governmental unit for exclusively public purposes should, however, be given no greater rights to deduction than the rights received for the same type of donations given to other charitable organizations, since a governmental unit is only one of the organizations described in the charitable deductions section of the Code.[67] Thus, until the Tax Reform Act was passed the courts allowed a deduction for the gift of a leasehold interest in property to a charitable organization.

Tax Reform Act

Under the Tax Reform Act of 1969,[68] the conflict between the courts and the Internal Revenue Service concerning the gift of office space for use by a charitable organization is resolved. The Act makes such a gift nondeductible. The House Ways and Means Committee Report states:

> *Explanation of provision*—Your committee's bill, in effect, provides that a charitable deduction is not to be allowed for contributions to charity of less than the taxpayer's entire interest in property, such as the right to use property for a period of time. The taxpayer, however, will be able to continue to exclude from his income the value of the right to use the property contributed to the charity—representing the equivalent of the rental income from such property.[69]

The House Ways and Means Committee was disturbed by what it termed a double deduction under the existing Code. The taxpayer could deduct the fair rental value of the property as a charitable contribution and was not required to report the rental value as income. The Committee said:

> For example, if the individual owns an office building, he may donate the use of 10 percent of its rental space to a charity for 1 year. As a result, he may report for tax purposes 90 percent of the income which he otherwise would have had if the building were fully rented, and may claim a charitable deduction (amounting to 10 percent of the rental value of the building) which offsets his reduced rental income. He, therefore, may exclude 10 percent of the amount which would have been included in his income if the property had been rented to a noncharitable party.[70]

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66. Rev. Rul. 57-511, 1957-2 Cub. Bull. 158.
67. *See* Int. Rev. Code of 1954, § 170(c), 26 U.S.C. § 170(c) (1964), quoted in note 17 *supra*. For a list of these charitable organizations, see Cumulative List of Organizations Described in Section 170(c) of the Internal Revenue Code of 1954, Internal Revenue Service, Pub. No. 78, Dec. 31, 1968; Supplement to Publication No. 78, Supp. No. 1969-4, Jan.-Aug., 1969; 1969 Int. Rev. Bull. No. 47, at 35; 1969 Int. Rev. Bull. No. 39, at 14.
68. Pub. L. No. 91-172, 83 Stat. — (Dec. 30, 1969).
69. H.R. Rep. No. 413, 91st Cong., 1st Sess. 57, 58 (1969).
70. *Id.* at 57.

Inherent in the double deduction argument is the theory of constructive recognition of the rental value in the gross income of the contributor. The Internal Revenue Service urged the constructive recognition of income position in *Threlfall v. United States*,[71] but the court held that the purpose of the charitable deduction was to encourage charitable contributions and that the taxpayer need not constructively recognize gross income for the amount of rental income sacrificed.[72]

Discouraging charitable contributions of office space may work hardship on charitable organizations by making it difficult to obtain office space rent free. If a prospective donor has unoccupied space in his building, he has two choices: keeping the space vacant or donating it to a charitable organization for its use. Before the Tax Reform Act, if the space remained vacant, there was no income to report or constructively recognize and no charitable deductions; if the space were occupied by a charity, by court decision, there was no constructive recognition of income, but a charitable deduction of the fair rental value was allowed. Under the Reform Act, the income tax consequences are the same whether the space remains vacant or whether it is donated to a charity, the taxpayer need not constructively recognize income but he is not allowed a charitable deduction. The taxpayer, therefore, gains nothing by donating the space to a charity under the new system. It may be to the taxpayer's advantage, however, to keep the space vacant in anticipation of a rent paying tenant. He, therefore, is not induced to allow the charity to use the space and may not want to foreclose his opportunity to rent it immediately to a paying tenant. If so, the charity, needing office space, will have to use some of its charitable funds to pay rent, thus diverting those funds from the charitable purposes of the organization.

If the prospective contributor donates money to the charity to be used to pay rent for office space, the contribution is deductible, but the contributor has already included this money in his gross income. While the contributor may be unwilling or unable to make a money donation, he may be willing to allow the organization the use of his unoccupied space for several months if given a financial incentive to do so. The gift would be as meaningful to the charity as a deductible money gift.

Conclusion

In as much as constructive recognition of income would dis-

71. 302 F. Supp. 1114 (W.D. Wis. 1969).
72. *Id.* at 1121.

courage charitable contributions, the Tax Reform Act which has the same net effect tends to remove incentives for donating office space to a charity. The House Ways and Means Committee Report on the Reform Act states: "In order to strengthen the incentive effect of the charitable contributions deduction for taxpayers generally, your committee has increased the present 30-percent limitation to 50 percent. . . ."[73] Disallowing deductions for the gift of the use of property contradicts this expressed desire to encourage charitable giving. The contribution of rent-free office space to a charitable organization should be encouraged by the government. Charities should be helped, not hindered, in their attempts to find offices, and for this reason the former policy of deductibility advanced by the courts should be restored.

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73. H.R. REP. No. 413, 91st Cong., 1st Sess. 51 (1969).