

2023

Relighting the Charitable Deduction: A Proposed Public Benefit Exception

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Gutting, Kristin Balding (2023) "Relighting the Charitable Deduction: A Proposed Public Benefit Exception," *Florida Tax Review*: Vol. 12, Article 6.

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FLORIDA TAX REVIEW

Volume 12

2012

Number 6

RELIGHTING THE CHARITABLE DEDUCTION: A PROPOSED PUBLIC BENEFIT EXCEPTION

*Kristin Balding Gutting**

Let no man's ghost say his training ever let him down.¹

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1. *Firematic Quotes and Prayers*, PA FIRE, <http://www.eriepafire.com/quotes.html> (last visited Sept. 18, 2011).

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I. INTRODUCTION

Throughout the country, firefighters risk their lives on a daily basis to keep the public safe. It is, therefore, imperative they receive the best possible training. One invaluable training method is live burn training, in which a structure is set on fire providing firefighters with “a level of realism that is unsurpassed.”² Fire departments, both career and volunteer, as well as numerous municipal departments conduct various training exercises, including roof ventilation, domestic violence exercises, simulated meth lab explosions, room-to-room fire practice, firefighter survival techniques, arson investigation training, rescue techniques, and/or firefighter down techniques, through the donation of homes that are finally burned to the ground as part of live burn training.³

For over thirty-five years, relying on a United States Tax Court case,⁴ many believed a taxpayer could claim a charitable deduction for the donation of the taxpayer’s home to the local municipality for live burn training, while still retaining ownership of the underlying land (live burn donation).⁵ In 2004, however, the Internal Revenue Service (the Service)

2. *National Fire Fighter Near-Miss Reporting System: Live Burn Training*, FIRE ENGINEERING, <http://www.fireengineering.com/articles/2011/01/near-miss-live-burn.html> (last visited Aug. 3, 2011). See also *infra* note 179 and accompanying text.

3. Robert Sullivan, *Training Fire a Valuable Tool for RFD*, PALADIUM-ITEM (Richmond, IN), Mar. 16, 2011, available at 2011 WLNR 5157123 [hereinafter Sullivan, *Training Fire*].

4. *Scharf v. Commissioner*, 32 T.C.M. (CCH) 1247 (1973), *action on dec.*, 1974-36031 (Mar. 20, 1974).

5. See, e.g., Sheldon I. Banoff & Richard M. Lipton, *Tax Deductions for Clunker Homes, Without Congressional Bailouts*, 112 J. TAX’N 63, 63 (2010) (“Experience tells us that charitable deductions for [live burn donations] have been claimed for decades.”); Bernard Leibtag, *Tax Aspects of Contributing a House to a Fire Department*, 39 TAX ADVISER 723 (2008) (“Taxpayers can obtain

established a task force, charged with the sole purpose of extinguishing live burn donations, and requested that local municipalities not cooperate with taxpayers in executing the requisite paperwork in claiming a charitable deduction for a live burn donation.⁶ In 2009, the deductibility of a live burn donation was thrust into the public spotlight as the media publicized the Service's attack on the charitable deduction claimed by Kirk Herbstreit, an ESPN commentator and former Ohio State quarterback, for the donation of

a charitable contribution deduction for the fair market value of property (i.e., land improvements) donated to a fire department to be burned down.”); Bruce W. McClain & Paul J. Lee, *Structuring Charitable Gifts of Property in Lieu of Demolition or Condemnation*, TAXES: THE TAX MAG., Oct. 2000, at 31 (“[A] taxpayer who plans to have a home demolished . . . might instead make a contribution of the property to the local city fire department to be burned for live fire practice. . . . result[ing] in a tax deduction . . .”); Gregory A. Thompson & Karen S. Muraskin, *Charitable Contribution Deductions – An Alternative to Capitalization of Demolition Costs*, 24 TAX ADVISER 421 (1994) (“As a planning alternative, taxpayers should consider making a charitable contribution of the structure to a local fire department for use in training drills.”); *Discussion: Donation of House to Fire Department*, TAX ALMANAC, http://www.taxalmanac.org/index/php/Discussion:Donation_of_House_to_Fire_Department (last visited Mar. 3, 2011) (discussion board). *But see* Paul Caron, *IRS Denies Deduction for Homes Donated to Fire Department and Burned Down*, TAXPROF BLOG (Sept. 26, 2009), http://taxprof.typepad.com/taxprof_blog/2009/09/irs-challenges.html [hereinafter Caron, TAXPROF BLOG].

Steven Willis, a professor at the University of Florida who studies income tax law, said a charitable deduction can be no greater than the value of whatever was donated, and a house given to a fire department has negative value, since the owner was going to have to pay somebody to get rid of it.

Id.

6. Sheldon I. Banoff & Richard M. Lipton, *More on Tax Deductions for Clunker Homes*, 112 J. TAX’N 189, 190 (2010); *Combustible tax deductions: Will this charitable contribution go up in smoke?*, ACCOUNTINGWEB (July 27, 2009), <http://www.accountingweb.com/topic/tax/combustible-tax-deductions-will-charitable-contribution-go-smoke> (“[I]n 2004, which was the year of their donation, the IRS began taking a different view of these donations.”).

his home to the local fire department.⁷ Soon after, in 2010, the live burn donation was back in the headlines as it was exposed that Oregon

7. Caron, TAXPROF BLOG, *supra* note 5 (“The story has been picked up by over 100 media outlets and newspapers, including ABC, Atlanta Journal Constitution, CBS, Chicago Tribune, Cleveland Plain Dealer, CNBC, Forbes, Houston Chronicle, Los Angeles Times, Miami Herald, New York Times, Newsday, NPR, Philadelphia Inquirer, San Diego Union-Tribune, Seattle Times, and Washington Times.”). See, e.g., Meghan Barr, *Burning down the house? IRS nixes tax deductions*, NEWSDAY.COM, (Sept. 25, 2009), <http://www.newsday.com/business/burning-down-the-house-irs-nixes-tax-deductions-1.1476952> [hereinafter Barr, *IRS nixes tax deductions*], reprinted in *Burning down the house? IRS nixes tax deductions*, SAN DIEGO UNION-TRIB., (Sept. 25, 2009, 1:32 PM), <http://www.signonsandiego.com/news/2009/sep/25/us-burning-down-house-092509/>; *IRS: No Tax deduction for burning down house*, CNBC.COM (Sept. 25, 2009, 4:02 PM), <http://www.cnbc.com/id/33023329>; *Burning down the house? IRS nixes tax deductions*, AJC.COM (Sept. 25, 2009 5:11 PM), <http://www.ajc.com/news/nationworld/burning-down-the-house-146954.html>; *IRS nixes tax deductions*, WASH. TIMES (Sept. 26, 2009), <http://washingtontimes.com/news/2009/sep/26/irs-nixes-tax-deductions/>; *IRS feeling burned by house deductions*, SEATTLE TIMES (Sept. 26, 2009, 8:35 PM), http://seattletimes.nwsourse.com/html/nationworld/2009943541_apusburningdownthehouse.html; *Burning Down the House? IRS Nixes Tax Deductions*, CBSNEWS (Sept. 25, 2009), <http://www.cbsnews.com/stories/2009/09/09/25/ap/national/main5340252.shtml>; *Burning Down the House? IRS Nixes Tax Deductions*, ABC NEWS (Sept. 25, 2009), <http://abcnews.go.com/US/wireStory?id=8674343>; *Burning down the house? IRS nixes tax deductions*, MIAMI HERALD (Sept. 25, 2009), <http://www.miamiherald.com/news/nation/AP/story/1251852.html>; *Burning down the house? IRS nixes tax deductions*, PHILLY.COM (Sept. 25, 2009), http://www.printthis.clickability.com/pt/cpt?action=cpt&title=Burning...925_ap_burningdownthehouseirsniestaxdeductions.html&partnerID=193672; *Burning Down the House: IRS nixes tax deductions for those who donate their homes to fire dept*, L.A. TIMES (Sept. 25, 2009, 2:09 PM), <http://latimes.com/news/nationworld/nation/wire/sns-ap-us-burning-down-the-house,0,2553997>; *Burning Down the House? IRS nixes tax deductions*, NAT’L PUB. RADIO (Sept. 25, 2009), <http://www.npr.org/templates/story/story.php?storyId=113212594>; *Burning down the house? IRS nixes tax deductions*, CLEVELAND.COM (Sept. 25, 2009, 3:30 PM), <http://www.cleveland.com/newsflash/index.ssf?/base/national-23/1253911593255590.xml&storylist=cleveland>; *Burning down the house? IRS nixes tax deductions*, FORBES.COM (Sept. 25, 2009, 3:31 PM), http://www.forbes.com/feeds/ap/2009/09/25/business-financial-impact-us-burning-down-the-house_6933091; *Burning down the house: IRS nixes tax deductions for those who donate their homes to fire dept*, CHI. TRIB. (Sept. 25, 2009, 4:09 PM), <http://www.chicagotribune.com/news/nationworld/sns-ap-us-burning-down-the-house,0,5359520.story>; *Burning Down the House? IRS Nixes Tax Deductions*, N.Y. TIMES (Sept. 25, 2009, 4:50 PM), http://www.nytimes.com/aponline/2009/09/25/us/AP-US-Burning-Down-The-House.html?_r=1; *A home donation flare-up, It’s a win-win situation — firefighters get practice, residents clear property — but IRS says it doesn’t earn any deduction*, HOUS. CHRON. (Sept. 26, 2009, 7:55 AM), <http://chron.com/disp/story.mpl/nation/6638041.html>.

gubernatorial candidate, Chris Dudley, claimed a deduction on his 2004 federal income tax return for a live burn donation so he could build a new residence on the land.⁸ Consequently, in recent years, there has been much confusion and debate on whether live burn donations qualify for charitable deductions.

In *Rolfs v. Commissioner*,⁹ the United States Tax Court recently overruled its earlier opinion¹⁰ holding a live burn donation was a quid pro quo transaction because the taxpayers received demolition services in exchange for the live burn donation.¹¹ In early 2012, the United States Court of Appeals for the Seventh Circuit affirmed the Tax Court's decision.¹² Because the live burn donation is a quid pro quo transaction, the taxpayers must pass a two-part quid pro quo test originally laid out by the United States Supreme Court in *United States v. American Bar Endowment*.¹³ Under the quid pro quo test, a taxpayer must demonstrate (1) the fair market value of the payment to the charitable organization exceeded the fair market value of the benefit received by the taxpayer and (2) if there is an excess payment, the taxpayer intended such portion of the payment to be a gift.¹⁴ In applying the first prong of the quid pro quo test, the Tax Court held the demolition benefit received by the Rolfs outweighed the fair market value of the live burn donation, as the home had a restricted use.¹⁵ Accordingly, the charitable deduction for the Rolfs' live burn donation was disallowed.¹⁶ Because the Tax Court determined there was no excess contribution, the court did not examine the intent prong of the quid pro quo test.

8. Jack Bogdanski, *Dudley pushed another envelope on taxes*, JACK BOG'S BLOG (Oct. 6, 2010), http://bojack.org/2010/10/dudley_pushed_another_envelope.html (stating that the deduction was \$350,000).

9. 135 T.C. 471 (2010), *aff'd* 668 F.3d 888 (7th Cir. 2012).

10. Scharf v. Commissioner, 32 T.C.M. (CCH) 1247 (1973), *action on dec.* 1974-36031 (Mar. 10, 1974).

11. Rolfs v. Commissioner, 135 T.C. at 486, *aff'd* 668 F.3d 888, 888 (7th Cir. 2012).

12. Rolfs v. Commissioner, 668 F.3d 888, 888 (7th Cir. 2012) (The Seventh Circuit held, in part, that "[t]o support the deduction, the Rolfs needed to show a value for their donation that exceeded the substantial benefit they received in return. The Tax Court found that they had not done so. We agree and therefore affirm."). Essentially, the Seventh Circuit affirmed the Tax Court's holding that the live burn donation was not deductible. Thus, this Article will primarily focus on the Tax Court's opinion.

13. *United States v. Am. Bar Endowment*, 477 U.S. 105 (1986). In 1997, the *American Bar Endowment* two-part test was incorporated into Treasury Regulation section 1.170A-1(h).

14. *Id.* at 117.

15. *Rolfs*, 135 T.C. at 494.

16. *Id.*

Under the current state of the law, the Tax Court and the Seventh Circuit were correct in subjecting the donation to the quid pro quo test as the taxpayer did receive a benefit in return for the donation to the local fire department. After a careful review of the *Rolfs* opinion, however, neither the Tax Court nor the Seventh Circuit held that a charitable deduction was disallowed for all live burn donations. Arguably, if a taxpayer demonstrates and substantiates that the value of the structure donated is higher than the demolition benefit received, the taxpayer could successfully deduct the excess amount.¹⁷ Both, Tax Court's and the Seventh Circuit's holdings, however, effectively extinguished the live burn donation by adopting a valuation approach that makes it nearly impossible for a taxpayer to claim a charitable deduction for a live burn donation.¹⁸ In determining the value of the live burn donation, the Tax Court found the home to be of minimal value due to underlying restrictions and conditions of the donation.¹⁹ The Tax Court focused mainly on the impact of the severance of the house from the underlying land and determined such fact made the live burn donation "virtually worthless."²⁰ After considering the condition of the house and the restrictions placed thereupon, the Tax Court held the fair market value was de minimis as no one would purchase the house for more than a nominal amount.²¹ Accordingly, the Tax Court determined the fair market value of the house was an amount between \$100 and \$1,000, which is necessary to ensure sufficient consideration exists for a sales contract to be enforceable.²²

17. For example, if the taxpayer demonstrated that the fair market value of the live burn donation was \$100,000 and the demolition benefit received was \$10,000, then the taxpayer would be able to claim a \$90,000 charitable contribution. This assumes, however, that the taxpayer was able to demonstrate that he intended to make a gift of the excess amount of \$90,000 to the fire department. Additionally, the live burn donation would also have to survive the Service's other two arguments asserted in *Rolfs*: (1) the charitable deduction should be disallowed for the live burn donation as the taxpayers "transferred to the VFD less than their entire interest in the lake house" and (2) the "lake house as donated to the VFD was worthless." *Rolfs*, 135 T.C. at 481. See also *infra* notes 233–234 and accompanying text (discussing the Service's alternative arguments).

18. *Rolfs*, 668 F.3d 888, (emphasis added) ("[P]roper consideration of the economic effect of the condition that the house be destroyed reduces the fair market value of the gift so much that *no net value is ever likely to be available for a deduction*, and certainly not here.")

19. *Rolfs*, 135 T.C. at 493.

20. *Id.* at 494.

21. *Id.* at 479, 495.

22. *Id.* While beyond the scope of this article, the Tax Court arguably incorrectly valued the live burn donation. Clearly, the house material alone was worth more than the \$100 to \$1,000 value that the Tax Court assigned to the Live Burn Donation. For arguments that the Tax Court improperly valued the Live burn

The Seventh Circuit affirmed the Tax Court's approach, but added that "[n]one of the value of the house, as a house, was actually given away," "[t]he taxpayers . . . gave away only the right to come onto their property and demolish their house."²³ Thus, under the either approach, it is hard to imagine a live burn donation where the value would be greater than the demolition benefit received.

While it appears that the Service has won the fight in the Courts, this article proposes the live burn donation not be extinguished. Instead, Congress should consider exceptions to the application of the quid pro quo test when the benefit of the donation to the public substantially outweighs the benefit received by the taxpayer (the public benefit exception). Ultimately, this will encourage donations that otherwise would be underfunded, as is the case in live burn donations.

In reaching this conclusion, Part II of this article provides a brief overview of the charitable deduction, including a discussion of its purpose and legislative history.²⁴ Part III explores the evolution of and current exceptions to the quid pro quo test, which concludes the quid pro quo test is the most workable approach in determining whether a quid pro quo contribution to a charitable organization is deductible.²⁵ Part IV provides a brief overview of live burn training and the development of the law regarding the live burn donation.²⁶ Part V argues that in certain circumstances exceptions should be made to the quid pro quo test — the public benefit exception — and discusses the public benefit exception using the live burn donation as the lens to examine the application of the proposed exception.²⁷ In conclusion, Part V proposes an amendment to the charitable deduction, thereby allowing a charitable deduction for live burn donations, while recognizing the need for limitations given the perceived abuse and

donation *see* Willis W. Hagen II, *The Tax Court's Capricious Nature in Ascertaining the Value of Donated Property*, 114 J. TAX'N 301 (2011) [hereinafter Hagen, *Capricious Nature*]; Brief and Required Short Appendix of Petitioners-Appellants, Theodore R. Rolfs, et al. at 15-30, *Rolfs v. Commissioner*, No. 11-2078 (7th Cir. July 26, 2011). Furthermore, the Seventh Circuit stated that "[p]erhaps the best 'comparable sales' comparison might have been the price paid by the fire department to rent a burn tower for the length of time the department conducted exercises in and around the lake house." Arguably, this was incorrect as the court overlooked the stark difference between tower training and live burn training. *See infra* Part IV.A (discussing the benefits of live burn training).

23. *Rolfs*, 668 F.3d 888.

24. *See infra* text at notes 30–45.

25. *See infra* text at notes 53–166.

26. *See infra* text at notes 177–254.

27. *See infra* text at notes 255–72.

valuation difficulties of the live burn donation.²⁸ Part VI provides closing remarks.²⁹

II. OVERVIEW OF THE CHARITABLE DEDUCTION

A. *The History and Purposes of the Charitable Deduction*

It was not until 1917, four years after the United States first income tax law,³⁰ that individual taxpayers were allowed to deduct “charitable contributions or gifts”³¹ to qualified charitable organizations (the charitable deduction).³² The congressional intent behind the charitable deduction was to

28. *See infra* text at notes 273–78.

29. *See infra* Part VI.

30. Tariff Act of 1913, ch. 16, 38 Stat. 114. *See also* Jacob L. Todres, *Internal Revenue Code Section 170: Does the Receipt by a Donor of An Intangible Religious Benefit Reduce the Amount of the Charitable Contribution Deduction? Only the Lord Knows for Sure*, 64 TENN. L. REV. 91, 97 (1996) [hereinafter *Todres, Intangible Religious Benefit*] (stating that “the omission was deliberate.”) For a detailed review of the history of Code section 170 *see generally* Vada Waters Lindsey, *The Charitable Contribution Deduction: A Historical Review and a Look To the Future*, 81 NEB. L. REV. 1056 (2003).

31. *See* 65 CONG. REC. 6728 (1917). (remarks of Senator Hollis). Senator Hollis stated that:

We are now talking about the income tax on individuals, however; and the point I wish to emphasize is this: By agreement of the committee we are now going to exempt from taxation gifts to charitable, educational, and scientific institutions not to exceed 15 per cent of the donor’s income.

Id. at 6730. *See also* *Seed v. Commissioner*, 57 T.C. 265, 275 (1971) (“[T]he term ‘charitable contributions’ as it is used generally in section 170 and the regulations is synonymous with the word ‘gift.’”). Hereinafter, the words “contribution” and “gift” when referencing the charitable deduction will be used interchangeably.

32. War Revenue Act of 1917, ch. 63, § 1201(2), 40 Stat. 300, 330. The original charitable deduction provision read as follows:

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, to an amount not in excess of fifteen per centum of the taxpayer’s taxable net income as computed without the benefit of this paragraph. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury.

ensure taxpayers would have money available to support charities, despite the necessary tax increase to fund World War I.³³ Generally, the government appropriates public funds to charitable organizations, as well as state and local governments which often provide funding to local fire departments. The charitable deduction, however, relieves the government of this financial burden.

[T]he 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.³⁴

Id. For a discussion of the history of the charitable deduction, see generally BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS ¶ 35.1 (2011) [hereinafter BITTKER & LOKKEN, FEDERAL TAXATION]; BORIS I. BITTKER, MARTIN J. MCMAHON, JR. & LAWRENCE A. ZELENAK, FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 25.01 (2002) [hereinafter MCMAHON & ZELENAK, INCOME TAXATION]. *But see* Todres, *Intangible Religious Benefit*, *supra* note 30, at 97 n.39 (stating that prior to the modern income tax law, there was a charitable deduction allowed for corporations under the pre-1913 corporate income tax).

33. 65 CONG. REC. 6728 (1917). (Remarks of Senator Hollis). Senator Hollis commented that:

Usually people contribute to charities and educational objects out of their surplus. After they have done everything else they want to do, after they have educated their children and traveled and spent their money on everything they really want or think they want, then, if they have something left over, they will contribute it to a college or to the Red Cross or for some scientific purposes. Now, when war comes and we impose these very heavy taxes on incomes that will be the first place where the wealthy men will be tempted to economize, namely, in donations to charity. They will say, "Charity begins at home."

Id.

34. H.R. REP. NO. 75-1860, at 19 (1938), reprinted in 1939-1 C.B. 728, 742. See also MCMAHON & ZELENAK, INCOME TAX, *supra* note 32 quoting Regan v. Tax'n with Representation of Wash., 461 U.S. 540, 544 (1983) ("More recently, the Supreme Court has remarked that '[d]eductible contributions are similar to cash grants [from the government to the charity] of the amount of a portion of the individual's contributions.'"); *Brinley v. Commissioner*, 782 F.2d 1326, 1336 (5th Cir. 1986) (Hill, J., dissenting) (providing that the charitable deduction is meant to help "aid in the accomplishment of many social goals which our federal and local governments otherwise cannot or will not accomplish"). For arguments against the original purpose of the charitable deduction see MCMAHON & ZELENAK, INCOME TAX, *supra* note 32. McMahon and Zelenak propose a better rationale for the charitable deduction stating that:

Thus, through the enactment of the charitable deduction, which is codified in Code section 170,³⁵ Congress sought to encourage taxpayers to provide private support for a wide range of activities and organizations that aid in the accomplishment of social objectives that otherwise would not or could not be sustained by the federal and local governments. Essentially, this allows the American people to decide which charity to support, whether public or private, while allowing the federal government to subsidize a portion of such charitable enterprise.

B. The Mechanics of the Charitable Deduction

Over the years, the charitable deduction has been subject to endless scrutiny, given its frequent use as a vehicle for tax abuse.³⁶ Consequently, the charitable deduction, which originally started out as two sentences in 1917,³⁷ has morphed into a maze of complexity. This congressional incentive to donate a portion of one's income to charity is subject to significant exceptions and limitations, some of which are statutorily proscribed while others are judicially and administratively created.³⁸ For purposes of this article, however, the key language is still the same — a taxpayer is allowed the charitable deduction for a “contribution or gift to or for the use of” a qualified organization.³⁹

If money one gives to charity is the equivalent of money one never had, in terms of its effect on one's ability to pay tax, then allowing a deduction for charitable contributions makes perfect sense. The premise of this argument is debatable, both because the taxpayer had the choice whether or not to give money to charity, and because the taxpayer may bask in the warm glow of having made a contribution. If the premise is accepted, however, § 170 logically follows.

Id.

35. Unless, otherwise indicated, all references to the Internal Revenue Code in this article are to the Internal Revenue Code of 1986, as amended.

36. Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 [hereinafter Pension Protection Act of 2006].

37. *See supra* note 32 (providing the original charitable deduction language).

38. For an in-depth discussion of I.R.C. § 170 *see generally* BITTKER & LOKKEN, FEDERAL TAXATION, *supra* note 32, ¶ 35.1; MCMAHON & ZELENAK, INCOME TAX, *supra* note 32, ¶ 25.01.

39. *See* I.R.C. § 170(a) (“There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year.”); I.R.C. § 170(c) (“For purposes of this section, the term ‘charitable contribution’ means a contribution or gift to or for the use of....”).

Generally, for a taxpayer to claim the charitable deduction,⁴⁰ the donation must (1) be made to or for the use of a qualified recipient,⁴¹ (2) be a “contribution or gift” rather than a payment for goods or services,⁴² and (3) meet the relevant substantiation requirements.⁴³ Additionally, the taxpayer must navigate through a complex web of rules that provide income-based percentage limitations on the dollar amount a taxpayer can deduct based on both the type of property donated and the type of qualified organization receiving the property.⁴⁴ However, while the charitable deduction is a vast

40. I.R.C. § 63 (providing that the charitable deduction is a below-the-line itemized deduction).

41. I.R.C. § 170(c)(1) (providing that the charitable deduction is allowed for a charitable donation to or for the use of wide-ranging list of entities). I.R.C. § 170(c)(1), as it pertains to this article, states that the charitable contribution can be “made to or for the use of (1) A State, 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.” *Id.* See also Rev. Rul. 71-47, 1971-1 C.B. 92 (discussing that fire volunteer departments are qualified charities); *Search for Charities, Online Version of Publication 78*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/app/pub-78/> (last visited Sept. 5, 2011) (a web-searchable list of organizations that are “eligible to receive tax-deductible charitable contributions”).

42. See *infra* Part III (discussing the definition of “contribution or gift”).

43. In order for a taxpayer to claim the charitable deduction, some form of written receipt has always been required. However, due to the increase in fraudulent claims of the charitable deduction, Congress enacted stricter substantiation standards. See Pension Protection Act of 2006, *supra* note 36. Now, every donation of cash requires that the taxpayer maintain a bank record or a written statement from the charitable organization, which includes the name of the charitable organization, the date of the charitable contribution, and the amount of the charitable contribution. I.R.C. § 170(f)(17). However, when the contribution is in a form other than money, additional levels of substantiation are required depending on the value of the non-monetary donation. See *infra* notes 217–19 and accompanying text (discussing the relevant substantiation requirements).

44. Reg. § 1.170A-1(c)(1). In determining the amount of the charitable deduction that a taxpayer can claim in a given year for the taxpayer’s charitable donation, the taxpayer first must determine the value of the charitable contribution. Generally, the value of the charitable contribution is equal to its fair market value. Thus, the amount of the deduction for cash charitable contributions is straight forward; the amount of cash donated to the charitable organization. Charitable contributions made with property other than money, however, are much more challenging. Generally, the amount of non-monetary contributions is the fair market value of the property at the time of the contribution. Reg. § 1.170A-1(c)(2) (providing that for charitable contribution purposes, fair market value is defined as the “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts”). Special rules, however, exist which

and complex deduction, the core of the current deduction, insofar as this article is concerned, is the definition of “contribution or gift” and the quid pro quo test that flows therefrom. Accordingly, this article will focus on the meaning of the term “contribution or gift” in the context of the quid pro quo test.⁴⁵

III. THE QUID PRO QUO TEST

A taxpayer’s eligibility to claim a charitable deduction requires the charitable donation be a “contribution or gift.”⁴⁶ In 1954, Congress described “gifts” as payments “made with no expectation of a financial return commensurate with the amount of the gift.”⁴⁷ Thirty years later, the Supreme Court, in *American Bar Endowment*, stated “the *sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration.”⁴⁸ The words “contribution or gift,” according to the Supreme Court, are “intended to differentiate between unrequited payments to qualified recipients and payments made to such recipients in return for goods or services.”⁴⁹ Accordingly, the contribution cannot be a payment for goods

reduce the value of some charitable contributions, such as contributions of certain types of appreciated property. I.R.C. § 170(e). For example, in the case of appreciated property, the amount of such charitable contributions is reduced by any gain from a hypothetical sale which would not have been long-term capital gain. I.R.C. § 170(e)(1)(A) (resulting in the taxpayer typically valuing the charitable contribution equals to the property’s adjusted basis). However, the amount of the charitable deduction is not unlimited. I.R.C. § 170(b) (providing limits on the overall amount that a taxpayer can deduct). The limitations are very complex, as the limitation applicable to the charitable contribution is based on the type of taxpayer, the type of the property contributed, and the type of the charitable organization. Generally, an individual taxpayer is allowed to deduct the aggregate amount of his annual contributions to a public charity, including a governmental unit, to the extent such contributions do not exceed fifty percent of his contribution base. I.R.C. § 170(b)(1)(A)(v). I.R.C. § 170(b)(1)(G) (defining “contribution base” as a taxpayer’s adjusted gross income for the taxable year without regard to any net operating loss carrybacks under Code section 172.) *But see* I.R.C. § 170(b)(1)(B) (providing a thirty percent ceiling rule for certain donations to private charities); I.R.C. § 170(b)(1)(C) (providing that certain capital gain property is subject to additional limitations). A more in-depth examination of these limitations is beyond the scope of this article.

45. *See infra* Part III (discussing the evolution of the quid pro quo test).

46. I.R.C. § 170(c).

47. S.REP. NO. 83-1622, at 196 (1954); H.R.REP. NO. 83-1337, at A44 (1954)

48. *United States v. Am. Bar Endowment*, 477 U.S. 105, 118 (1986).

49. *Hernandez v. Commissioner*, 490 U.S. 680, 690 (1989).

or services.⁵⁰ Ultimately, the quid pro quo test was developed for determining whether any portion of a payment that was part of a quid pro quo transaction (i.e., when a taxpayer receives a financial benefit in return, whether it be in the form of goods or services) was a “contribution or gift.”⁵¹ For various reasons, Congress and the Service, however, have enacted and promulgated exceptions to the application of quid pro quo test.⁵²

A. *The Evolution of the Quid Pro Quo Test*

For many years, courts have struggled with articulating a standard for determining whether a payment to a charity qualifies as “contribution or gift” within the context of the charitable deduction, thereby resulting in three different tests: (1) the intent of the donor approach, (2) the substantial benefit received approach, and (3) the benefit received test.⁵³ Under the intent of the donor approach, the allowance of the charitable deduction depends on the subjective intent of the donor, allowing a deduction only if the donor’s motivation for the payment was a “detached and disinterested generosity . . . out of affection, respect, admiration, charity or like impulse.”⁵⁴ However, under the substantial benefit received approach, the donor’s motivation is irrelevant. Instead, the charitable deduction is allowed only if the payment is made without the taxpayer receiving or expecting any substantial benefit in return for such payment.⁵⁵ Finally, under the benefit received approach, the court considered whether the donor received a benefit in return for his payment.⁵⁶ Assuming the donor receives a benefit, the donor is only allowed a deduction for the amount which the payment exceeds the value of the benefit he received.⁵⁷

In 1986, in *American Bar Endowment*, the Supreme Court provided guidance on the proper approach to use in determining whether a donation to

50. I.R.C. § 170(c).

51. See *infra* Part III.A (discussing the evolution of the quid pro quo test).

52. See *infra* Part III.B (discussing the exceptions to the quid pro quo test).

53. See generally Todres, *Intangible Religious Benefit*, *supra* note 30, at 101–14; Joseph V. Sliskovich, *Charitable Contributions or Gifts: A Contemporaneous Look Back to the Future*, 57 U. MO. KAN. CITY L. REV. 437, 457–80 (1989) [hereinafter Sliskovich, *Charitable Contributions or Gifts*]; James W. Colliton, *The Meaning of “Contribution or Gift” for Charitable Contribution Deduction Purposes*, 41 OHIO ST. L.J. 973, 973–73 (1980) [hereinafter Colliton, *Meaning of Contribution*]; Richard D. Hobbet, *Charitable Contributions — How Charitable Must They Be?*, 11 SETON HALL L. REV. 1 (1980) [hereinafter Hobbet, *Charitable Contributions*].

54. *DeJong v. Commissioner*, 309 F.2d 373, 379 (9th Cir. 1962).

55. *Singer Co. v. United States*, 196 Ct. Cl. 90, 106 (1971).

56. *Oppewal v. Commissioner*, 468 F.2d 1000, 1001–02 (1st Cir. 1972).

57. *Id.*

a charity qualified as a “contribution or gift.”⁵⁸ The Court adopted the quid pro quo test, a two-part test in which the taxpayer must demonstrate (1) the fair market value of the payment to the charitable organization exceeded the fair market value of the benefit the taxpayer received in return and (2) if there is an excess payment, the taxpayer intended the excess payment to be a gift.⁵⁹ Soon after, in *Hernandez v. Commissioner*,⁶⁰ the Court reexamined the quid pro quo transaction issue in the context of religious benefits and provided insight into the application of the quid pro quo test.⁶¹ Eleven years later, in 1997, the Service promulgated regulations to determine the deductibility of a quid pro quo donation, thereby codifying the quid pro quo test.⁶²

1. *The Pre-Quid Pro Quo Test Approaches*

a. *The Intent of the Donor Approach*

The first attempt of a federal appeals court to define “contribution or gift” within the context of the charitable deduction was in 1962, by the United States Court of Appeals for the Ninth Circuit in *DeJong v. Commissioner*.⁶³ The Ninth Circuit was confronted with deciding whether a donation to a non-profit religious-based school, the Society for Christian Instruction (the Society), which was attended by the donors’ two children, qualified for the charitable deduction.⁶⁴ The Society was a tuition-free school funded through various means, including the solicitation of donations from the students’ parents.⁶⁵ “Approximately [seventy] percent of the [Society’s]

58. *United States v. Am. Bar Endowment*, 477 U.S. 105, 117 (1986).

59. *Id.*

60. 490 U.S. 680 (1989).

61. *Id.* at 690.

62. Reg. § 1.170A-1(h).

63. 309 F.2d 373 (9th Cir. 1962). *See id.* at 377 (citing *Commissioner v. Duberstein*, 363 U.S. 278, 284 (1960)) (“The meaning of the term ‘gift’ as applied to particular transfers has always been a matter of contention. Specific and illuminating legislative history on the point does not appear to exist. Analogies and inferences drawn from other revenue provisions, such as the estate and gift taxes, are dubious.”).

64. *Id.* at 375 (“The sole question presented to us is whether . . . the \$400.00 paid by [the donor] to the Society was in the nature of a tuition fee paid for the education which the Society was expected to furnish the petitioner’s children, and therefore not deductible as a charitable contribution.”).

65. *Id.*

In the late summer or early fall of each year, enrollment committees appointed by the board of trustees of the Society meet with parents of prospective students. At these meetings the parents

total income [was] derived from contributions from parents of enrolled students,” as all parents contributed to the Society.⁶⁶ Even if a student’s parents did not financially contribute to the Society, the student was still allowed to attend.⁶⁷

The court began its analysis by recognizing the terms “contribution” and “gift” have been used interchangeably.⁶⁸ Unfortunately, without any analysis regarding the purpose of the charitable deduction, the court adopted the definition given by the Supreme Court, in *Commissioner v. Duberstein*,⁶⁹ to the term “gift” within the meaning of Code section 102.⁷⁰ The *Duberstein* Court defined the term “gift” as “detached and disinterested generosity⁷¹ . . . out of affection, respect, admiration, charity or like impulses.”⁷² Furthermore, the Court stated the subjective intent of the transferor is the most significant factor in determining whether a transfer is a “gift.”⁷³ In relying on *Duberstein*, the Ninth Circuit recognized:

The value of a gift may be excluded from gross income only if the gift proceeds from a “detached and disinterested generosity” or “out of affection, admiration, charity or like impulses,” and must be included if the claimed gift proceeds

are given “a broad picture of what the cost will be in the operating budget for the coming year” and they are asked to contribute to the best of their ability and to try to carry as much “of the load as they feel they can.” When a parent is known to be “pretty well-to-do” it is suggested that he contribute the full amount of the estimated cost per student for the coming year times the number of students he is enrolling. All of the parents interviewed are given an enrollment card to sign and are asked to indicate thereon the number of students they wish to enroll and the amount of the contribution they intend to make toward the operation of the school or schools. With the exception of a few parents who have reservations against signing a card of this nature, signed cards are received from all parents.

Id.

66. *DeJong*, 309 F.2d at 375. (“[A]ll parents of prospective students do pledge a certain amount of money, although in some cases that amount is “very nominal.””).

67. *Id.* (“All facilities of the schools are available to all students irrespective of the amounts pledged or contributed by their parents.”).

68. *Id.* at 376

69. 363 U.S. 278 (1960).

70. *DeJong*, 309 F.2d at 379.

71. *Duberstein*, 363 U.S. at 285.

72. *Id.*

73. *Id.*

primarily from “the constraining force of any moral or legal duty,” or from “the incentive of anticipated benefit of an economic nature.”⁷⁴

Ultimately, the Ninth Circuit adopted the intent of the donor approach articulated in *Duberstein*, for determining whether a payment was a “contribution or gift” within the meaning of the charitable deduction by “conclud[ing] that such criteria are clearly applicable to a charitable deduction under § 170.”⁷⁵ Accordingly, the court in *DeJong* held that \$400⁷⁶ of the \$1,075 donation “was in the nature of tuition fees for the education which the Society was expected to furnish to [the donor’s] children,” and thus “[t]he payment of such sum is not a charitable gift.”⁷⁷ The charitable deduction was allowed for the remaining \$675.

The intent of the donor approach is difficult to apply because it requires a subjective look into the mind of a donor to determine whether the payment is “detached and disinterested generosity.”⁷⁸ The court’s opinion

74. *DeJong*, 309 F.2d at 379. For other courts adopting the intent of the donor approach see for example *Dowell v. United States*, 553 F.2d 1233 (10th Cir. 1977); *Burwell v. Commissioner*, 89 T.C. 580 (1987); *McLaughlin v. Commissioner*, 51 T.C. 233 (1968). See also *Winters v. Commissioner*, 468 F.2d 778 (2d Cir. 1972) (in determining that a charitable deduction was not allowed, the court decided not to chose between the intent of the donor approach and the benefit received approach; and, instead, tested the payment under both approaches).

75. *DeJong*, 309 F.2d at 379. See also *Hobbet, Charitable Contributions*, *supra* note 53 (“As, precedent, however, *DeJong* was clouded in that the [Service] has clearly presented the issue to the court on the basis of an objective determination.”). But see *United States v. Transamerica Corp.*, 392 F.2d 522, 524 (9th Cir. 1968) (refusing to apply the intent of the donor approach in determining if a charitable deduction was allowed for a payment by a corporation to a charitable organization).

76. *DeJong*, 309 F.2d at 379 (stipulating that \$400 was the approximate cost of an education for two children at the Society).

77. *Id.* See also *Channing v. United States*, 4 F. Supp. 33 (D. Mass 1933), *aff’d*, 67 F.2d 986 (1st Cir. 1933) (holding that the payment of a child’s school tuition is a family expense, not a charitable contribution to the educating institution).

78. See Douglas A. Kahn & Jeffrey H. Kahn, “*Gifts, Gifts, and Gifts*” - *the Income Tax Definition and Treatment of Private and Charitable “Gifts” and A Principled Policy Justification for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441, 503–12 (2003) [hereinafter Kahn & Kahn, “*Gifts, Gifts, and Gifts*”] (“Despite a number of decisions to the contrary, it appears reasonably certain that the *Duberstein* standard of ‘detached and disinterested generosity’ does not and should not apply to the determination of whether a transfer to a charity is a gift.”). The application of the “detached and disinterested generosity” standard also has a long standing history of being problematic in its application to I.R.C. § 102. See *Oppewal v. Commissioner*, 468 F.2d 1000, 1002 (1st Cir. 1972); Steven J. Willis &

lacked an explanation regarding its application of the “detached and disinterested generosity” standard. Although the Ninth Circuit did not discuss this division of the contribution amount, in order to make the analysis and conclusion consistent with *Duberstein*,⁷⁹ the only rational interpretation is that the court viewed the donation as being two separate transactions.⁸⁰ The first transaction, the nondeductible \$400, was viewed by the court as a payment to the Society for the tuition, which lacked the requisite “detached and disinterested generosity” motive as the taxpayers anticipated the return benefit of their childrens’ education. The second transaction, being a charitable donation of the remaining \$675, which the court deemed deductible, must have been motivated by “detached and disinterested generosity.”⁸¹ The court arguably allowed the \$675 deduction for the amount of the payment exceeding the value of the educational benefit received by the taxpayer because a person would only pay more for a good or service out of “detached and disinterested generosity.” This approach is similar to the quid pro quo test later adopted by the Supreme Court because under the quid pro quo test only the amount of the payment exceeding the amount of the benefit received is deductible and then only to the extent it was intended to be a gift.

Michael S. Hawley, *I.R.C. Section 247(b) and Duberstein Resurface: The Emperor Still Has No Clothes*, 25 ARIZ. L. REV. 907, 921 (1984) (explaining courts’ inconsistent results when applying the *Duberstein* test and attributing the inconsistency to the test’s uncompromising “all-or-nothing” requirement). *But see* Hobbet, *Charitable Contributions*, *supra* note 53, at 13–30 (discussing that the best standard to determine if a payment is a “contribution or gift” is the intent of the donor approach).

79. *See also* Collman v. Commissioner, 511 F.2d 1263 (9th Cir. 1975) (treating the donation of land to a government agency as two transactions and thus holding it was only partially deductible as the amount of the charitable deduction was reduced by the value of the construction work performed by the county for the donor). *But see* for the inconsistent application of the transaction splitting approach, Allen v. United States, 541 F.2d 786 (9th Cir. 1976) (treating the donation of land to a county in order to secure the necessary permission to build a housing development as one transaction and allowing a deduction for the full value of land donated); Stubbs v. United States, 428 F.2d 885 (9th Cir. 1970) (disallowing in its entirety the charitable deduction for the donation of land, even though the value of the donation exceeded the value of the benefit the donor received in return). In *Allen* and *Stubbs*, the Ninth Circuit applied a modified version of the intent of the donor approach stating that the approach was to “expose the true nature of the transaction.” *Allen*, 541 F.2d at 788; *Stubbs*, 428 F.2d at 887.

80. Colliton, *Meaning of Contribution*, *supra* note 53, at 983 (“It is difficult to escape the feeling that the court first decided that \$675 more was given to the Society than the value of the education received in return and that, therefore, the transfer of \$675 was made because of “detached and disinterested generosity.””).

81. *DeJong*, 309 F.2d at 379 (providing that the Service has already conceded the issue that the excess payment amount of \$675 was deductible).

b. *The Substantial Benefit Received Approach*

In 1971, nine years after *DeJong*, in *Singer Co. v. United States*,⁸² the United States Court of Claims established an alternative approach to the intent of the donor approach. In *Singer*, the Singer Company sold its sewing machines to schools and other charities at a rate⁸³ below fair market value.⁸⁴ Accordingly, the Claims Court considered whether the Singer Company, a manufacture of sewing machines, was entitled to the charitable deduction for “contributions made in the form of discounted sales of its . . . sewing machines.”⁸⁵ In doing so, the court explored the definition of the term “contribution or gift.”⁸⁶ Recognizing the flaws of the intent of the donor approach, the court began its analysis by stating “[i]f we were to accept [*DeJong*’s] definition of gift . . . it would then be necessary for us to look to the subjective intent of the plaintiff when awarding discounts to organizations. This would not be an impossible task, but it would indeed be a very difficult one.”⁸⁷ Accordingly, the court proposed an alternative objective approach based on the benefit received by the donor.

[I]f the benefits received, or expected to be received, are substantial, and meaning by that, benefits greater than those that inure to the general public from transfers for charitable purposes (which benefits are merely *incidental* to the transfer), then in such case we feel the transferor has received, or expects to receive, a *quid pro quo* sufficient to remove the transfer from the realm of [the charitable deduction]. With this standard, we feel that the subjective approach of “disinterested generosity” need not be wrestled with.⁸⁸

82. 196 Ct. Cl. 90 (1971). See also I.R.S. Chief Couns. Adv. 2004-35-001 (Aug. 27, 2004) (stating that *Singer* is “[a] leading authority” in the area of charitable intent).

83. *Singer Co.*, 196 Ct. Cl. at 94 (providing that the discounts ranged from twenty-five percent for “[c]hurches and charitable organizations (other than governments, schools, hospitals, and Red Cross)” to forty-five percent for “[g]overnments, schools, hospitals, and Red Cross”).

84. *Id.* (stating that the sales “were made at break even prices and resulted in no over-all immediate net profit or loss to [the Singer Company]”).

85. *Id.* at 93.

86. *Id.* at 97 (stipulating that the sales were bargain sales).

87. *Id.* at 99–100.

88. *Singer Co.*, 196 Ct. Cl. at 106. See also *id.* at 104 (noting that “[o]ne of the most persuasive arguments plaintiff makes in the case against ‘disinterested generosity’ is that those provisions which allow exclusions from gross income are matters of ‘legislative grace’ and subject to narrow construction.”). But see *Hobbet*,

In applying the substantial benefit received approach, however, the court appeared to divert to a subjective intent approach. The court looked to, and determined that, the Singer Company's "predominant purpose" for providing the discounted machines to the schools was to obtain goodwill and to increase the possibility of future sales.⁸⁹ The predominant purpose analysis resulted in the court holding that the discounted sales to the school provided potential benefits that "were substantial enough to supply the plaintiff with a *quid pro quo* for the discount which, in turn, effectively destroyed the discounts' charitable nature."⁹⁰ Although the court never placed a value on the expected return benefit, in order for the substantial benefit received approach to disallow the deduction, the court determined the expected return benefit of goodwill and future sales to the Singer Company was greater than the benefit to the general public receiving discounted sewing machines.

Alternatively, once again the court, diverting to a subjective intent approach, found the purpose of the discounted sales to charities other than schools "was to assist the recipient organizations in the performance of the charitable, religious or public services that they were currently providing. The incidental effect of this policy was the development and maintenance of a favorable public image [(goodwill)] for plaintiff in the eyes of those organizations and their members."⁹¹ The court held "that the benefits derived from such discounts were merely incidental to the making of the transfer and not substantial enough to destroy the charitable contribution characterization."⁹² Clearly, the court determined that the benefit to the charities receiving a discount on sewing machines was greater than the expected return benefit of goodwill and future sales to the Singer Company.

After careful examination of *Singer*, the true question under the substantial benefit received approach is not the intent of the donor, but instead, whether a substantial benefit was received. While the court stated the

Charitable Contributions, *supra* note 53, at 6 (calling the *Singer* approach a "hybrid objective-subjective analysis").

89. *Singer Co.*, 196 Ct. Cl. at 108 (stating that the purpose of the discounts was to "encourag[e] those institutions to interest and train young women in the art of machine sewing; thereby enlarging the future potential market by developing prospective purchasers of home sewing machines and, more particularly, Singer machines-the brand on which the future buyers learned to sew") (emphasis omitted).

90. *Id.* at 93.

91. *Id.* at 108.

92. *Id.* at 93 (1972); *see also id.* at 109 ("Such a finding, together with our agreement therewith, makes it difficult to see how the plaintiff could derive substantial benefits from such discounts in the way of increased sales."). *But see* Colliton, *Meaning of Contribution*, *supra* note 53, at 989-90 (providing an alternative viewpoint that the *Singer* holding was inconsistent with the substantial benefit received approach).

intent of the donor approach was a difficult approach to administer,⁹³ the substantial benefit received approach is also flawed in both the court's quasi-subjective application of the test, as discussed above, and the test itself. In determining whether a substantial benefit was received, the court proposed a balancing test between the benefit to the general public and the direct benefit to the taxpayer. Assuming the benefit to the public was greater than the return benefit to the taxpayer, the return benefit to the taxpayer was merely incidental and a deduction for the full amount of the payment to the charitable organization was allowed. While the substantial benefit received approach conforms to the purpose of the charitable deduction, acting as a subsidy to those organizations the government feels provides a community benefit, it creates difficulty for the courts in determining a value of the benefit to the charitable organization. Additionally, it potentially allows the taxpayer a deduction for an amount, which encompasses in part, a payment for goods or services.⁹⁴

c. The Benefit Received Approach

In 1967, five years after *DeJong*, in *Crosby Valve & Gage Co. v. Commissioner*,⁹⁵ the United States Court of Appeals for the First Circuit expressed dissatisfaction with the intent of the donor approach.⁹⁶ The court, however, did not provide an alternative test. Instead, the court agreed with the ultimate holding of the United States Tax Court below, but made a point of disagreeing with the Tax Court's use of *DeJong's* intent of the donor approach.⁹⁷ The court stated:

93. See *supra* note 87 and accompanying text.

94. For example, under the substantial benefit received approach, if a taxpayer makes a \$100 payment to a charitable organization and in return receives a benefit valued at \$10, but under the balancing test, the court views that benefit to the general public to be greater than those that the taxpayer received, the benefit would be considered an incidental benefit. As a result, the taxpayer would be able to deduct the full amount of the payment, \$100.

95. 380 F.2d 146 (1st Cir. 1967).

96. *Id.* at 146 (the issue before the court was whether "a business corporation, wholly owned by a charitable foundation, [is] entitled to a charitable deduction for property (in this case equity in bonds) turned over without consideration to its parent[.]").

97. *Id.* at 146.

The Tax Court held that the transfers to the foundation were not deductible. It placed primary emphasis on its syllogism that (1) "charitable contribution" is synonymous with "gift;" (2) a gift proceeds from a "detached and disinterested generosity;" and (3) since the transfers in this case were the result of the foundation's control over the corporation they were motivated by legal duty to

Were the [charitable deduction] 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.⁹⁸

Five years later, in *Oppewal v. Commissioner*,⁹⁹ the First Circuit formulated an alternative test. In *Oppewal*, under facts very similar to *DeJong*, the court was confronted with deciding whether a donation to a non-profit religious-based school, the Whitinsville Society for Christian Instruction (the Whitinsville Society), which was attended by the donors’ two children, qualified for the charitable deduction.¹⁰⁰ As in *DeJong*, the court ultimately held the amount of the payment in excess of the cost of the educational benefit the donors received for their children was deductible.¹⁰¹

its sole stockholder, and not by disinterested generosity. 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.

Id.

98. *Id.* at 146–47.

99. 468 F.2d 1000 (1st Cir. 1972).

100. *Id.* at 1001.

101. *Id.* at 1002.

Applying that test here, the conclusion is inescapable that six hundred and forty dollars of taxpayers’ payment to the Society was non-deductible tuition. The taxpayers’ two children obtained a year of education in the Society’s religiously-oriented school, as desired by taxpayers. The cost to the Society of providing that service was at least six hundred and forty dollars. In effect, if not in form or by design, taxpayers paid this cost.

Id.

In reaching this conclusion, the court developed an objective test for determining when a payment is a “contribution or gift.”¹⁰² The court stated:

The more fundamental objective test is — however the payment was designated, and whatever motives the taxpayers had in making it, was it, to any substantial extent, offset by the cost of services rendered to taxpayers in the nature of tuition? If so, the payment, to the extent of the offset, should be regarded as tuition for, in substance, it served the same function as tuition.¹⁰³

Under the benefit received approach, the court simply looked to see whether a donor received a benefit without regard for his motivation at the time of the payment. Assuming a benefit was received, the donor could not claim the charitable deduction for the full amount of the payment, but rather the donor could only deduct the amount by which the payment exceeded the value of the benefit received. The benefit received approach was thus the easiest to administer of all three approaches, as it eliminated the need for the court to inquire into the subjective intent of the taxpayer or to value the benefit received by the public. Moreover, unlike the substantial benefit received approach, it reduces the amount of the charitable deduction by the value of the benefit received.¹⁰⁴

102. *Id.* (“The objective test taxpayers would apply is whether there was certainty as to the beneficiaries of their payment.”).

103. *Oppewal v. Commissioner*, 468 F.2d 1000, 1002 (1st Cir. 1972).

Under this test, the fact that the taxpayers might have made the payment even had their children not been enrolled in the Society’s school, or that the Society would have enrolled the children even had no payment been made, or that taxpayers’ children would have received an education of the same academic quality (although not religiously oriented) in a public school without additional expense to taxpayers, become irrelevant considerations.

Id. at 1002 n.2.

104. For example, under the benefit received approach, if a taxpayer makes a \$100 payment to a charitable organization and in return receives a benefit valued at \$10, the taxpayer would be able to deduct only \$90, the difference between the amount of the payment and the benefit received.

2. *The Quid Pro Quo Test*

a. *The Supreme Court Weighs In*

United States v. American Bar Endowment.¹⁰⁵ In 1986, over twenty years after the confusion began as to the meaning of “contribution or gift,” the Supreme Court provided guidance.¹⁰⁶ The American Bar Endowment (the Endowment), which was the fundraising branch of the American Bar Association, sold various group insurance policies to its members to raise funds for charity.¹⁰⁷ The Endowment purchased a group policy for its members from an insurance company at a negotiated premium. Because the insurance company’s actual cost of providing coverage to the group was lower than the premium paid by the Endowment, the insurance company paid a dividend to the Endowment.¹⁰⁸ The Endowment, however, required its members participating in the group insurance program to permit the Endowment to retain all of the dividends paid by the insurance company because such funds were critical to its fundraising efforts. Despite its ability to negotiate a lower premium for its members, the Endowment competitively priced its policies with other insurance policies offered to the public and its members thereby allowing the Endowment “to generate large dividends to be used for its charitable purposes.”¹⁰⁹ Accordingly, the Endowment advised its insured members that their respective share of the dividends, less any administrative costs incurred by the Endowment, constituted a charitable deduction for such member. It was this after-tax cost to its members that resulted in the Endowment group insurance program being less than the cost of an identical commercial policy. Accordingly, the Supreme Court was faced with the issue as to “whether the [Endowment’s] members [could]

105. 477 U.S. 105 (1986). For a more in-depth review of the facts in *American Bar Endowment* see Sliskovich, *Charitable Contributions or Gifts*, *supra* note 53, at 480–87.

106. See Colliton, *Meaning of Contribution*, *supra* note 53, at 998. [B]oth the courts and the Internal Revenue Service have adopted three different lines of reasoning in deciding charitable contribution deduction cases. Circuit courts have adopted one or another of the tests. The Tax Court has been inconsistent as to what test to use. Moreover, the Internal Revenue Service has enthusiastically adopted all three tests. The law, therefore, [was] in a state of great confusion.

Id.

107. *Am. Bar Endowment*, 477 U.S. at 107 (noting that approximately twenty percent of the Endowment’s members purchased the insurance).

108. *Id.* at 108.

109. *Id.*

claim a charitable deduction for the portion of their premium payments that exceed[ed] the actual cost to the organization of providing insurance.”¹¹⁰

In examining the meaning of “contribution or gift,” the Court stated if a donor expects a substantial benefit in return for their payment to a charity, the general rule is it cannot be a “contribution or gift.”¹¹¹ Assuming the donor, however, only receives an incidental benefit, “[w]here the size of the payment is clearly out of proportion to the benefit received,” the charitable deduction should not be denied in its entirety.¹¹² Consequently, a donor may claim the charitable deduction equal to the excess of the payment to the charitable organization over the value of the benefit the donor received in return because the payment had a “dual character.”¹¹³ But the deduction is allowed only if the donor can demonstrate he intended to contribute “money or property in excess of the value of any benefit he received in return.”¹¹⁴

In applying this two-part quid pro quo test, the Court determined the Endowment members’ cost for participating in the group insurance program was not more than what they could have paid for a similar group policy. The Endowment’s “members [were] never faced with the hard choice of supporting a worthwhile charitable endeavor or reducing their own insurance costs.”¹¹⁵ Accordingly, the Endowment members failed to demonstrate that they paid more for the Endowment insurance policy than it was worth or that they intended to pay in excess in order to benefit the Endowment. Therefore, the Court held that the members were not allowed a charitable deduction because the Court could not construe that there was a charitable motive behind the Endowment members’ purchases of the insurance policies.

The quid pro quo test can be viewed as combining all three prior approaches and their underlying flaws. Thus, after *American Bar Endowment*, the confusion regarding the meaning of “contribution or gift” did not completely disappear. First, the Court stated if the benefit received is substantial, then no charitable deduction should be allowed. Assuming, however, the benefit is merely incidental, the two-prong quid pro quo test should be applied. Yet, the Court did not explicitly provide a manner for determining whether the benefit received was incidental or substantial. The Court, however, cited to *Singer* for the notion that if a substantial benefit was

110. *Id.* at 106–07.

111. *Id.* at 116–17.

112. *Am. Bar Endowment*, 477 U.S. at 117.

113. *Id.* (citing Rev. Rul. 67-246, 1967-2 C.B. 104) (formulating a two-part test in determining that the price of a ticket to a charity ball deductible to extent it exceeds the market value of admission); Rev. Rul. 68-432, 1968-2 C.B. 104, 105 (noting the possibility that a payment to a charitable organization may have “dual character”).

114. *Am. Bar Endowment*, 477 U.S. at 118.

115. *Id.* at 116.

received, the contribution was not deductible. Logically, the Court effectively adopted *Singer's* balancing test requiring a court to determine whether the “benefits [received are] greater than those that inure to the general public from transfers for charitable purposes. . . .”¹¹⁶

Secondly, the Court did not expressly discuss the *DeJong* intent of the donor approach, which required a “detached and disinterested” motive. Instead, the Court reached its holding, in part, based on the members’ lack of intent to make a payment to the Endowment in excess of the benefit the members received. The Court stated a taxpayer “must at a minimum demonstrate that he purposely contributed money or property in excess of the value of any benefit he received in return.”¹¹⁷ The Court reasoned that since the Endowment member did not know “he could [have] purchase[d] comparable insurance for less money,” the member could not have “intentionally [given] away more than he received.”¹¹⁸ “[T]he [Court’s] emphasis appears to be on a more sterile measurement of ‘intent’ or ‘purpose.’”¹¹⁹ Therefore, the Court seems to have changed the intent element into a more administrable knowledge standard. However, the Court’s focus on knowledge can also be viewed as applying a “detached and disinterested” standard. If a person intentionally makes a payment greater than the value of the benefit he receives, arguably, this excess payment is “detached and disinterested.”¹²⁰ Thus, confusion still exists.

*Hernandez v. Commissioner.*¹²¹ Almost three years later, in *Hernandez*, the Court was confronted with applying the quid pro quo test in the religious context. In *Hernandez*, the taxpayers paid the Church of

116. See *Singer Co. v. United States*, 196 Ct. Cl. 90 (1971); see also *supra* Part III.A.1.b. (discussing *Singer*).

117. *Am. Bar Endowment*, 477 U.S. at 118.

118. *Id.* See also Kahn & Kahn, “*Gifts, Gifts, and Gifts*,” *supra* note 78, at 503–05.

119. Sliskovich, *Charitable Contributions or Gifts*, *supra* note 53, at 486.

120. See, e.g., *id.*

However, as developed by the Court, the notion of intentional or purposeful transfer of excess value necessarily embraces the sort of unselfish beneficence generally associated with charity and generosity. Indeed, it is difficult to imagine a situation in which a transfer of excess value (with no anticipation or expectation of any measurable or identifiable return benefit), intentionally made to an organization ostensibly performing a charitable function, would not reflect “generosity” in the colloquial sense, as well as for purposes of section 170.

Id.

121. 490 U.S. 680 (1989). For a more in-depth view of *Hernandez* see Todres, *Intangible Religious Benefit*, *supra* note 30.

Scientology (the Church) for various “auditing”¹²² and “training”¹²³ sessions. The Church believed “any time a person receives something he must pay something back.”¹²⁴ Accordingly, the Church charged fixed prices for the auditing and training sessions based on the length and sophistication of the auditing or training.¹²⁵ The Church offered a five percent discount for advance payments.¹²⁶ Moreover, the Church refunded any person’s “unused portion of prepaid auditing or training fees, less an administrative charge.”¹²⁷ The Court stated payments for auditing and/or training were the “quintessential *quid pro quo* exchange.”¹²⁸ Therefore, the payments were not a “contribution or gift” because “[e]ach of these practices reveals the inherently reciprocal nature of the exchange.”¹²⁹

Additionally, since the Court found no support that Congress intended to distinguish religious benefits from other benefits in the application of the *quid pro quo* test, the Court disagreed with the taxpayer’s assertion that the *quid pro quo* test does not apply if the benefit is purely religious.¹³⁰ The Court also found that a purely religious benefits exclusion “might raise problems of entanglement between church and state” because

122. *Hernandez*, 490 U.S. at 684-85. The Court described auditing as: [I]nvolv[ing] a one-to-one encounter between a participant (known as a “preclear”) and a Church official (known as an “auditor”). An electronic device, the E-meter, helps the auditor identify the preclear’s areas of spiritual difficulty by measuring skin responses during a question and answer session. Although auditing sessions are conducted one on one, the content of each session is not individually tailored. The preclear gains spiritual awareness by progressing through sequential levels of auditing, provided in short blocks of time known as “intensives.”

Id.

123. *Id.* at 685 (“Participants in these sessions study the tenets of Scientology and seek to attain the qualifications necessary to serve as auditors. Training courses, like auditing sessions, are provided in sequential levels. Scientologists are taught that spiritual gains result from participation in such courses.”).

124. *Id.*

125. *Id.*

126. *Hernandez*, 490 U.S. at 686.

127. *Id.*

128. *Id.* at 691.

129. *Id.* at 692. The Court also held that denying the charitable deduction violated neither the Establishment Clause nor the Free Exercise Clause of the First Amendment. *Id.* at 695–98, 700–03.

130. *Hernandez*, 490 U.S. at 693.

the Service and the judiciary would be forced to distinguish “‘religious’ services from ‘secular’ ones.”¹³¹

The taxpayers also asserted selective prosecution, arguing the denial of the charitable deduction for payments to the Church for auditing or training was inconsistent with the Service’s “longstanding practice of permitting taxpayers to deduct payments made to other religious institutions in connection with certain religious practices.”¹³² Due to a lack of an evidentiary record in the lower court, however, the Court stated it could not decide this issue:

[The Service’s] application of the “contribution or gift” standard may be right or wrong with respect to these other faiths, or it may be right with respect to some religious practices and wrong with respect to others. It may also be that some of these payments are appropriately classified as partially deductible “dual payments.” . . . Only upon a proper factual record could we make these determinations. Absent such a record, we must reject petitioners’ administrative consistency argument.¹³³

Thus, in *Hernandez*, the Court did not clarify all the confusion looming with regards to the quid pro quo test. However, the Court clarified the second-prong of the quid pro quo test by requiring the examination of intent based on an objective standard. Essentially, the Court considered “the external features of the transaction in question” and rejected “conduct[ing] imprecise inquiries into the motivations of individual taxpayers.”¹³⁴ The Court then went on to discuss *American Bar Endowment* and focused on the external factors demonstrating the donor had no knowledge he was paying in excess for the insurance policy.¹³⁵ Thus, under the quid pro quo test, the

131. *Id.* at 694.

132. *Id.*

133. *Id.* at 702–03; *see also id.* at 704 (O’Connor, J., dissenting).

The Court today acquiesces in the decision of the [Service] to manufacture a singular exception to its 70-year practice of allowing fixed payments indistinguishable from those made by petitioners to be deducted as charitable contributions. Because the IRS cannot constitutionally be allowed to select which religions will receive the benefit of its past rulings, I respectfully dissent.

Hernandez, 490 U.S. at 704.

134. *Id.* at 690–91 (“In ascertaining whether a given payment was made with ‘the expectation of any *quid pro quo*,’ . . . the IRS has customarily examined the external features of the transaction in question . . . obviating the need for the IRS to conduct imprecise inquiries into the motivations of individual taxpayers.”).

135. *Id.* at 691.

second prong is arguably met by merely showing the donor knew he made a payment in excess of the benefit received.¹³⁶

The Court also held that the benefit received included religious services.¹³⁷ In 1993, however, the Service issued Revenue Ruling 93-73,¹³⁸ which simply read “Revenue Ruling 78-189, 1978-1 C.B. 68, is obsolete.”¹³⁹ Revenue Ruling 93-73 caused much confusion, since it purportedly overruled *Hernandez*,¹⁴⁰ as Revenue Ruling 78-189¹⁴¹ provided a charitable deduction was not allowed for the payment to the Church for auditing or training.¹⁴² Thus, such payments are now deductible.¹⁴³

b. The Service Speaks Out — Treasury Regulation Section 1.170A-1(h)

In December of 1996, ten years after the Supreme Court weighed-in, the Service promulgated a regulation adopting the quid pro quo test for determining whether the charitable deduction is allowed for a payment made as part of a quid pro quo transaction (the quid pro quo regulation).¹⁴⁴ The quid pro quo regulation provides a facts and circumstances test, in which:

136. See also *id.* at 690 (noting that *American Bar Endowment* cited *Singer*, but adding that this citation was because *Singer* “embraced this [external factor] analysis.”). But see *supra* note 115 and accompanying text (providing an alternative viewpoint as to the reason *American Bar Endowment* cited *Singer*).

137. *Hernandez*, 490 U.S. at 691.

138. 1993-2 C.B. 75.

139. *Id.*

140. See generally Gregg D. Polsky, *Can Treasury Overrule the Supreme Court?*, 84 B.U. L. REV. 185, 244 (2004) (stating that Revenue Ruling 93-73 is invalid, as it overrules *Hernandez*); Alison H. Eaton, Comment, *Can the IRS Overrule the Supreme Court?*, 45 EMORY L.J. 987, 991 (1996) [hereinafter Eaton, *IRS Overrule*] (arguing that “the IRS exceeded its authority, and therefore, Revenue Ruling 93-73 is invalid.”).

141. 1978-1 C.B. 68.

142. *Id.*

143. Eaton, *IRS Overrule*, *supra* note 140, at 1012–13 (discussing that Revenue Ruling 93-73 was issued within weeks after a settlement was reached with the Church involving the exempt status of the Church). See also Elizabeth MacDonald, *Scientologists and IRS Settle for \$12.5 Million*, WALL ST. J., Dec. 30, 1997, at A12 (discussing the unauthorized disclosure of the settlement agreement and stating that “[t]he settlement, which lets Scientologists deduct on their individual tax returns “auditing” fees as donations, supersedes the [Service’s] earlier rule denying such deductions — a position that was backed by the U.S. Supreme Court.”).

144. T.D. 8690, 1997-1 C.B. 68 (providing that the quid pro quo regulation “incorporates the two-part test adopted by the Supreme Court in [*American Bar Endowment*]”); Reg. § 1.170A-1(h).

No part of a payment that a taxpayer makes to or for the use of an organization . . . that is in consideration for . . . goods or services . . . is a contribution or gift . . . unless the taxpayer --

(i) Intends to make a payment in an amount that exceeds the fair market value of the goods or services; and

(ii) Makes a payment in an amount that exceeds the fair market value of the goods or services.¹⁴⁵

As in *American Bar Endowment*, the amount of the charitable deduction is limited to the amount in which the fair market value of the payment to a charitable organization exceeds the fair market value of the goods or services received by the taxpayer.¹⁴⁶ A charitable organization is deemed to provide goods or services in return for a payment if, at the time of the payment, the donor receives or “expects to receive” goods or services in return for the payment, whether in the year of payment or thereafter.¹⁴⁷ The Preamble to the quid pro quo regulation provides insight into what is meant

145. Reg. § 1.170A-1(h); see T.D. 8690, 1997-1 C.B. 68. The Preamble states that the quid pro quo regulation provides that:

A deduction is not allowed for a payment to charity in consideration for goods or services except to the extent the amount of the payment exceeds the fair market value of the goods or services. In addition, a deduction is not allowed unless the taxpayer intends to make a payment in excess of the fair market value of the goods or services.

Id.

146. Reg. § 1.170A-1(h)(2) (providing that the charitable deduction is limited to “the excess of — (A) The amount of any cash paid and the fair market value of any property (other than cash) transferred by the taxpayer to [a charitable] organization . . .; over (B) The fair market value of the goods or services the organization provides in return.”).

147. T.D. 8690, 1997-1 C.B. 68; Reg. § 1.170A-13(f)(6).

A donee organization provides goods or services in consideration for a taxpayer’s payment if, at the time the taxpayer makes the payment to the donee organization, the taxpayer receives or expects to receive goods or services in exchange for that payment. Goods or services a donee organization provides in consideration for a payment by a taxpayer include goods or services provided in a year other than the year in which the taxpayer makes the payment to the donee organization.

Id.

by the “expects to receive” goods or services standard, providing it is a facts and circumstance test and includes payments that are either made: (1) “in response to an express promise of a benefit,” (2) “with knowledge that the charitable donee has conferred a benefit on other donors making comparable contributions,” or (3) with the expectation, “at the time of his or her payment to charity, that there would be a *quid pro quo*, even though there was no explicit promise of one.”¹⁴⁸

The *quid pro quo* regulation, however, does not provide a standard for determining whether the donor intended to make a payment in excess of the benefit received. Because the Preamble states that the *quid pro quo* regulation is a codification of the *quid pro quo* test, it is reasonably concluded the intent required to claim a charitable deduction for the excess payment amount can be easily satisfied by showing the donor knew he paid in excess of the benefit received. In recent informal guidance, the Service defined the term “gift” for purposes of a charitable deduction stating it is “a transfer of money or property without receipt of adequate consideration, made with charitable intent.”¹⁴⁹ The guidance further stated “[a] transfer is not made with charitable intent if the transferor expects a direct or indirect return benefit commensurate with the amount of the transfer.”¹⁵⁰ Arguably, this guidance has adopted the knowledge standard.

Furthermore, the *quid pro quo* regulation does not discuss the rule that a charitable deduction shall be denied if a substantial benefit is received. Thus, the only logical conclusion is that a substantial benefit is one in which the *quid* is less than or equal to the *quo* (i.e., the payment to the charitable organization is less than or equal to the value of the benefit received).¹⁵¹ The

148. T.D. 8690, 1997-1 C.B. 68.

For example, if a charity has a history of sponsoring a dinner-dance for donors making substantial contributions, a donor making a substantial contribution may have an expectation of receiving an invitation to such an event. The expectation of a *quid pro quo* may exist even though the donor is not aware of the exact nature of the *quid pro quo* (e.g., a donation to a charity that sponsors a donor appreciation event of a different type every year).

Id.

149. I.R.S. Chief Couns. Adv. 2004-35-001 (Aug. 27, 2004).

150. *Id.*

151. *But see* Kahn & Kahn, “*Gifts, Gifts, and Gifts*,” *supra* note 78, at 515.

What, then, is the standard for determining whether a transfer to a charity is a gift? The standard rests on whether the transferor received a substantial benefit in return for, or as a consequence of, making the transfer. A benefit that accrues to the general public is not “substantial” for this purpose. A substantial benefit will not deny the transferor a deduction to the extent that the amount transferred to the charity exceeds the value of the benefit obtained,

quid pro quo regulation, however, provides certain goods or services, of an insubstantial value, received by the taxpayer are not to be considered in applying the quid pro quo test.¹⁵² Various other exceptions to the quid pro quo test also exist, which are discussed herein.

B. Exceptions to the Quid Pro Quo Test

When applying the quid pro quo test, various congressional and administrative exceptions do not require taxpayers to reduce their donation by a benefit received, but, instead, allow taxpayers to deduct the full amount of the payment to a charitable organization. For example, the Service has provided that certain items of insubstantial value and annual membership benefits are not considered when applying the quid pro quo test.¹⁵³ Thus, a token item bearing the charity's name or logo, such as a key chain or tee-shirt, given to a taxpayer in the context of a fundraising campaign is not considered when applying the quid pro quo test, so long as payment to the charitable organization is of, or exceeds, a certain amount (\$48.50 in 2011)¹⁵⁴ and the cost of the item does not exceed the yearly low-cost item amount (\$9.70 in 2011).¹⁵⁵ Additionally, the quid pro quo test does not consider any annual membership benefits offered to a taxpayer in exchange for a yearly \$75 payment or less consisting of either (1) any rights or privileges the donor can exercise frequently during the membership period, such as free or discounted admission to the organization's facility, and/or (2) admission to member-only events during the membership period, as long as

provided that the donation of the excess value was intentional (i.e., a dual payment).

Id.

152. Reg. § 1.170A-1(h)(3).

153. Reg. § 1.170A-1(h)(3) (providing that for purposes of the quid pro quo test "goods or services described in § 1.170A-13(f)(8)(i) or § 1.170A-13(f)(9)(i) are disregarded"); Reg. § 1.170A-13(f)(8)(i)(A) (refers to "[g]oods or services that have insubstantial value under the guidelines provided in Revenue Procedures 90-12, 1990-1 C.B. 471, 92-49, 1992-1 C.B. 987, and any successor documents" and certain "[a]nnual membership benefits offered to a taxpayer in exchange for a payment of \$75 or less per year"); Reg. § 1.170A-13(f)(9) (providing an additional exception for certain goods or services provided by a charitable organization to the employees of a corporation or the partners of a partnership in return for a donation from the corporation or partnership to the charitable organization).

154. The monetary values are indexed for inflation. *See* Rev. Proc. 2010-40, 2010-46 I.R.B. 663 (providing the indexed limitations for 2011).

155. *Id.* Additionally, in 2011, low-cost items include the fair market value of all benefits received for a contribution, if the benefits are not more than the lesser of two percent for the payment or \$97. *See id.* (citing Rev. Proc. 90-12, 1990-1 C.B. 471).

the charitable organization reasonably projects the cost per person is under a threshold amount (\$9.70 in 2011).¹⁵⁶ Most scholars and practitioners are comfortable with these administrative exceptions because the exceptions allow practical administration of the quid pro quo test, given the valuation difficulties and nominal value.

However, a more controversial exception¹⁵⁷ to the quid pro quo test is the congressionally mandated exception providing for a charitable deduction equal to eighty percent of a payment to a university or college in return for the right to purchase tickets for seating at an athletic event in the respective university's or college's athletic stadium (the season ticket exception).¹⁵⁸ Thus, for example, if a university requires a minimum

156. Reg. § 1.170A-1(h)(3); Reg. § 1.170A-13(f)(8)(i)(B); Rev. Proc. 2010-40, 2010-46 I.R.B. 663. For example, if a taxpayer purchases an annual zoo membership for \$75, which provides free parking, free admission, and a discount on items sold in the zoo's gift shop, such benefits would be disregarded in the application of the quid pro quo test. Additionally, if the minimum membership payment does not exceed \$75, the membership benefits are also excluded for those who contribute more than \$75. If the organization offers additional benefits to members paying more than \$75, such as a calendar for those contributing \$100, only the additional benefits are taken into account in applying the quid pro quo test.

157. See, e.g., MCMAHON & ZELENAK, INCOME TAXATION, *supra* note 32, ¶ 25.01[2] (calling Code section 170(l) “[a] notable exception to the *quid pro quo* bar, reflecting the exalted position accorded to college athletics”); Kahn & Kahn, “Gifts, Gifts, and Gifts,” *supra* note 78, at 515 (suggesting that the Congress actually reduced the deduction stating that “[i]f Congress wished to reduce a charitable gift for the receipt of benefits of that nature, as it did in the case of a contribution to a university for which the donor receives a right to purchase tickets to an athletic event, Congress can establish an arbitrary figure or percentage of the donation to be disallowed.”).

158. I.R.C. § 170(l). Code section 170(l) provides that a charitable deduction equal to eighty percent of the amount paid to or for the benefit of college or university if:

such amount would be allowable as a deduction under this section but for the fact that the taxpayer receives (directly or indirectly) as a result of paying such amount the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution. If any portion of a payment is for the purchase of such tickets, such portion and the remaining portion (if any) of such payment shall be treated as separate amounts for purposes of this subsection.

Id. See also Tech. Adv. Mem. 2000-04-001 (Jan. 28, 2000) (providing that Code section 170(l) applied even when the donation entitled the taxpayer to purchase skybox seating). For an in-depth history of the deductibility of payments for the right to purchase collegiate athletic season tickets see Nina R. Murphy, *Revenue Ruling 84-132: Sidelined, but Not Forgotten*, 19 U. RICH. L. REV. 301 (1985) [hereinafter Murphy, *Revenue Ruling*].

donation of \$10,000 to obtain the right to purchase season tickets to the university's football games (or sometimes the right to be placed in a lottery to potentially be able to purchase season tickets), the donor would be able to claim a charitable deduction for \$8,000.¹⁵⁹

The season ticket exception arose out of political pressure from universities and colleges fearing they would lose an additional source of revenue.¹⁶⁰ In July 1984, the Service issued Revenue Ruling 84-132,¹⁶¹ denying the deduction for a payment to a university scholarship program to obtain the right to purchase preferred seating for university home football games. Due to scrutiny from universities and colleges, one month later, Revenue Ruling 84-132 was withdrawn until a public hearing was held.¹⁶² In response to Revenue Ruling 84-132, the National Collegiate Athletic Association (NCAA) criticized Revenue Ruling 84-132 stating it would "lead to enormous confusion and ultimately to serious erosion in [universities' and colleges'] fund-raising capacities."¹⁶³ Subsequently, in early 1986, Revenue Ruling 84-132 was replaced by Revenue Ruling 86-63,¹⁶⁴ thereby allowing for a deduction equal to the difference between the payment and the value of the preferred seating. The donor, however, bore the burden of establishing the value of the preferred seating.¹⁶⁵ Universities and college were once again in uproar. Thus, in 1988, Congress promulgated the season ticket exception stating it was intended "to eliminate otherwise unavoidable valuation controversies."¹⁶⁶

159. It is not out of the realm that a university requires a \$10,000 minimum donation. In 2008, the University of Georgia required a \$10,651 minimum donation to obtain the right purchase season tickets. Also, the minimum donation at many schools varies depending on the location of the desired seat. Furthermore, the donation in some cases is more than the price of the season tickets.

160. Murphy, *Revenue Ruling*, *supra* note 158, at 301 n.7 (noting that, in a 1985 statement, the NCAA stated that, "the results of [a] survey of its member schools [concluded] that 77% of the schools responding had preferential seating as a benefit of membership.").

161. 1984-2 C.B. 55.

162. Announcement 84-101, 1984-45 I.R.B. 21 (stating that "based on News Release IR-84-111, dated October 19, 1984" that the Revenue Ruling 84-132 was "suspended pending a public session on the implications of Rev. Rul. 84-132 upon the varied athletic scholarship programs in existence throughout the country.").

163. *Toner Testifies at IRS Hearing on Contribution Ruling*, THE NCAA NEWS, Jan. 9, 1985, at 16 (citing Statement of John L. Toner, President, National Collegiate Athletic Association, to the Internal Revenue Service on the Implications of Revenue Ruling 84-132 (Jan. 7, 1985)).

164. 1986-1 C.B. 88.

165. *Id.*

166. H.R. REP. NO. 100-795, at 523-24 (1988).

IV. THE LIVE BURN DONATION

For decades, relying on the Tax Court's pre-*American Bar Endowment* decision in *Scharf v. Commissioner*,¹⁶⁷ many believed a taxpayer could claim a charitable deduction for a live burn donation.¹⁶⁸ In 2004, however, the Service began targeting live burn donations.¹⁶⁹ The debate over the deductibility of a live burn donation began to garner national recognition as the media publicized the Service's attack on the charitable deduction claimed by Kirk Herbstreit, an ESPN commentator and former Ohio State quarterback, for the contribution of his home to the local fire department.¹⁷⁰ Soon after, the fire surrounding live burn donations was ignited again, when it was revealed that Oregon gubernatorial candidate, Chris Dudley, took a large deduction on his 2004 federal income tax return for a live burn donation so he could build a new residence on the land.¹⁷¹ Recently, several cases involving live burn donations were filed in the Tax Court and the United States District Court for the Southern District of Ohio.¹⁷² But, it was not until 2010 that the courts finally provided their view on the live burn donation in light of *American Bar Endowment*.

167. 32 T.C.M. (CCH) 1247 (1973).

168. *See supra* note 5 and accompanying text.

169. *See supra* note 6 and accompanying text.

170. *See supra* note 7 and accompanying text.

171. *See supra* note 8 and accompanying text. It appears that Dudley's deduction was never challenged by the Service, since the deduction was discovered after the three year time period the Service typically has to make adjustments to a taxpayer's return. I.R.C. § 6501 (providing the statute of limitations for the Service to assess additional taxes to a taxpayer). For a discussion of how Dudley's live burn donation might have affected the outcome in the gubernatorial election *see generally Oregon: Democrat Wins Historic 3rd Term as Governor*, USA TODAY (Nov. 4, 2010, 12:19 PM), http://www.usatoday.com/news/politics/2010-11-02-or-full-election-results_N.htm (noting how Dudley's opposition used his house donation deduction against him in the 2010 Oregon Gubernatorial election); *Oregon 2010 Election Results*, OREGONLIVE.COM, <http://gov.oregonlive.com/election/> (last visited Nov. 20, 2011) (providing that Dudley received forty-eight percent of the vote; his opponent received forty-nine percent); Nigel Duara, *Dudley Gave House for Fire Training, Got Tax Break*, BLOOMBERG BUSN. WK. (Oct. 8, 2010, 8:58 AM), <http://www.businessweek.com/ap/financialnews/D9INHB3O2.htm> (discussing Oregon Democrats' accusation that Dudley took a fraudulent tax deduction).

172. *See Rolfs v. Commissioner*, 135 T.C. 471 (2010), *aff'd* 668 F.3d 888 (7th Cir. 2012). (*Rolfs* was filed on June 7, 2004); Petition, *Hendrix v. United States*, 106 A.F.T.R.2d (RIA) 2010-5373 (S.D. Ohio 2010) (No. 2:09-cv-132) (*Hendrix* was filed on February, 24, 2009); Petition, *Vassos v. Commissioner*, No. 2097-10 (T.C. Jan. 19, 2010) (*Vassos* was filed on January 19, 2010); Complaint, *Herbstreit v. United States*, No. 2:09-cv-216 (S.D. Ohio Mar. 19, 2009) (dismissed without prejudice July 15, 2009).

Consequently, in recent years, there has been much confusion and debate over whether live burn donations qualify for charitable deductions.

In early 2010, the United States District Court for the Southern District of Ohio, in *Hendrix v. United States*,¹⁷³ issued the first opinion in over thirty-five years disallowing a live burn donation. However, the court's opinion was not helpful because ultimately the court disallowed the live burn donation on a technicality — the lack of a qualified appraisal and “contemporaneous written acknowledgement.”¹⁷⁴ Then, nine months later, in *Rolfs*, the Tax Court, which was affirmed by the Seventh Circuit, overruled *Scharf* and held that a live burn donation was a quid pro quo transaction.¹⁷⁵ In applying the quid pro quo test, the Tax Court stated that the demolition benefit received in exchange for the live burn donation outweighed the fair market value of the house donated because the house had a restricted use.¹⁷⁶ Accordingly, the taxpayer was unable to claim a charitable deduction for its live burn donation. Prior to exploring the relevant case law regarding the deductibility of the live burn donation, a brief overview of the relevance of live burn training is necessary.

A. An Overview of Live Burn Training

“Live burn training is the best, most comprehensive, realistic training that firefighters can take part in, as burn towers with propane fires do not have the same effect or realistic or authenticity as burn training with donated structures.”¹⁷⁷ Throughout the country, both career and volunteer fire

173. 106 A.F.T.R.2d (RIA) 2010-5373 (S.D. Ohio 2010).

174. *See id.* at 2010-5373. *See also* Martin J. McMahon, Jr., Ira B. Shepard & Daniel L. Summons, *Recent Developments in Federal Income Taxation: The Year 2010*, 10 FLA. TAX. REV. 565, 701–02 (2011) (“Both their house and their claimed charitable contribution deduction went up in smoke. District Court denies deduction for about-to-be-demolished house to local fire department on ‘qualified appraisal’ and ‘contemporaneous written acknowledgment’ grounds, but ducks the issue of whether taxpayers could claim a deduction for this type of donation.”).

175. *Rolfs*, 135 T.C. at 487–89 *aff’d* 668 F.3d 888 (7th Cir. 2012).

176. *Id.* at 495.

177. Interview with Jeff M. Balding, Driver Eng’g, Springfield Fire Dep’t (Sept. 11, 2011) [hereinafter Balding Interview]. *See also Rolfs*, 135 T.C. at 475 (“Chief Wieczorek believed the firefighter training exercises conducted at the lake house were superior to the training exercises otherwise available to the [fire department].”); Bruce Vielmetti, *Decision Awaited on Denial of Tax Break for Burning House*, JSONLINE, (April 3, 2011), <http://www.jsonline.com/news/wisconsin/89850962.html> [hereinafter Vielmetti, *Decision Awaited*] (“[Live Burn Training is] the best training [firefighters] get all year. . . . Is it worth the write-off? Yes”); Thomas J. Burmeister, Jr., Comment, *Burnin’ Down the House – And Deducting It Too: Charitable Contributions of Building to Fire Departments* under

departments use donated houses to conduct various training exercises, including roof ventilation, domestic violence exercises, simulated meth lab explosions, room-to-room fire practice, firefighter survival techniques, arson investigation training, rescue techniques, and/or firefighter down techniques, resulting in the home being burned to the ground as part of live burn training.¹⁷⁸

We can do things in an actual house that we can't do at our training facility. One of the big things was putting a firefighter in a room as if he were trapped and then having

I.R.C. § 170, 94 MARQ. L. REV. 1013, 1046 (2011) [hereinafter Burmeister, *Burnin' Down the House*] (discussing the value of live burn training); Sullivan, *Training Fire*, *supra* note 3 (“The experience is invaluable”); Kriss Garcia & Reinhard Kauffmann, *Realistic Live-Burn Training You Can Afford*, FIRE ENGINEERING, <http://www.fireengineering.com/articles/print/volume-162/issue-5/features/realistic-live-burn-training-you-can-afford.html> (last visited Nov. 12, 2011) (“On the fireground, when all else fails and success or survival is measured in seconds and inches, we all fall back on our experience and what we learned in training to pull us through. Not much in today’s fire service pays bigger dividends than intense, realistic fire training.”); *National Fire Fighter Near-Miss Reporting System: Live Burn Training*, FIRE ENGINEERING, <http://www.fireengineering.com/articles/2011/01/near-miss-live-burn.html> (last visited Nov. 12, 2011) (“[Live burn training] exercises are much sought after and provide valuable experience.”).

178. Sullivan, *Training Fire*, *supra* note 3 (discussing the donation of a home by a resident of Richmond, Virginia to the local Richmond Fire Department “instead of having it leveled as they prepare to build a new home on the property”). See also Burmeister, *Burnin' Down the House*, *supra* note 177, at 1047–48.

[C]ontrolled burning exercises serve as training opportunities for arson investigators, who come to the scene after the burn and work through standard protocol to determine the origin of the fire, which is unknown to the investigators at the time. While the rate of building donations to small fire departments can vary from year to year, each donation represents added value to the expertise of the responding fire departments. Unlike burn towers, a commercially available practice facility that can cost hundreds of thousands of dollars, the uniqueness of each donated structure provides unpredictability common to normal household fires. Additionally, the use of a donated structure can stretch beyond the controlled burn itself. Often times, the use of a donated structure can extend beyond a week’s time, consisting of several smoke drills, flashover simulations, and rescue technique training exercises. Depending on the size of the structure, local fire departments may invite departments from neighboring towns to practice the coordination process that takes place when more than one department is called to a fire.

Id.

them break through the wall and find a space between the studs so that they could get out. We also had a chance to practice breaking out windows and breaking through walls to get to someone who was down and then carry them out of the home. It provides great training for us.¹⁷⁹

Additionally, in some cases, the donated house is also used for training by the local police department, SWAT teams, and rescue crews.¹⁸⁰

In some rural areas, this is the only training firefighters receive since fire training centers are costly and many departments have limited budgets.¹⁸¹ “Live burns supply invaluable training for volunteer departments, which make up a bulk of the nation’s firefighters.”¹⁸²

Unfortunately, not every house qualifies for live burn training because there are certain structural and environmental requirements.¹⁸³ Once

179. Sullivan, *Training Fire*, *supra* note 3; Burmeister, *Burnin’ Down the House*, *supra* note 177, at 1047 (“For small communities, donated structures in some cases represent the only true exposure to live fire training for new firefighters.”).

180. Barr, *IRS nixes tax deductions*, *supra* note 7.

The [donated house] was put to good use before the fire department burned it to the ground. SWAT teams barged through the front door in an exercise on dealing with domestic violence. Rescue crews scattered mannequins around the house and blew smoke through the halls to simulate a meth lab explosion. Firefighters set fires in one room after another and practiced putting them out. Then, in one last drill, the [fire department] torched the place.

Id. See also MICHAEL J. KARTER, JR. & GARY P. STEIN, NAT’L FIRE PROT. ASS’N, U.S. FIRE DEPARTMENT PROFILE THROUGH 2010, (2010), <http://www.nfpa.org/assets/files/pdf/os.fdprofile.pdf> (providing that there are 1,103,300 firefighters in the United States, of which twenty-nine percent are career firefighters and the remaining seventy-one percent are volunteer firefighters).

181. Chris Shay, *Training Rural Fire Departments*, FIRE ENGINEERING, <http://www.fireengineering.com/articles/print/volume-163/issue-10/departments/volunteers-corner/training-rural-departments.html> (last visited Aug. 3, 2011) (“Like any rural fire department in the United States, we do our best to get by training with limited personnel and limited budgets.”). See also Scharf v. Commissioner, 32 T.C.M. (CCH) 1247, 1251 (1973), *action on dec.* 1974-36031 (Mar. 20, 1974) (“The testimony of the municipal fire chief indicated it is only by similar donations of buildings for use in fire drills that the volunteers in this rural area are able to test their new equipment and train new staff members under controlled conditions.”)

182. Barr, *IRS nixes tax deductions*, *supra* note 7 (“[S]ome fear that the tax disputes will discourage donors from coming forward.”).

183. Balding Interview, *supra* note 177. See also Rolfs v. Commissioner, 135 T.C. 471, 474 (2010) *aff’d* 668 F.3d 888 (7th Cir. 2012) (discussing the taxpayer

a home is accepted, a tremendous amount of work goes into preparing the house for the live burn because each live burn must follow the standards of the National Fire Protection Association (NFPA) 1403.¹⁸⁴ The cost associated with preparing the building for the live burn is typically incurred by the donor.¹⁸⁵ Additionally, when all is said and done and the house has been burnt down, the donor is responsible for the cost of clearing the debris.¹⁸⁶ Thus, while the donor of a live burn donation does get the benefit of the home being demolished, there is an economic cost associated with this type of donation. Most importantly, a live burn donation serves as an invaluable training opportunity to firefighters and other public service agencies.

B. *The Deductibility of the Live Burn Donation*

1. *Scharf — Allowing the Live Burn Donation*

In 1973, the Tax Court allowed the taxpayers to claim a charitable deduction for their live burn donation.¹⁸⁷ In *Scharf*, the taxpayers contributed a fire damaged building to the local fire department for fire training purposes and claimed a charitable deduction.¹⁸⁸ The building donated by the taxpayers was purchased for investment purposes, but was partially destroyed by a fire thereby resulting in the taxpayers receiving insurance proceeds. Because the building was so badly damaged and the underlying land had increased in value to the extent it was worth more than the building, the taxpayers

obtaining the “the necessary approval for the burn from the Wisconsin Department of Natural Resources”).

184. Gregory Havel, *Construction Concerns: Acquired Structures for Live Fire Training*, FIRE ENGINEERING, <http://www.fireengineering.com/articles/2010/04/cc-live-fire.html> (last visited Nov. 12, 2011) (discussing structural concerns when acquiring a donated property for live burn training). See also Balding Interview, *supra* note 177 (providing that various permits must be obtained); *National Fire Fighter Near-Miss Reporting System: Live Burn Training*, FIRE ENGINEERING, <http://www.fireengineering.com/articles/2011/01/near-miss-live-burn.html> (last visited Nov. 12, 2011) (“Today’s live burn requires an extensive investment of time. . . . The acquired structure burn, following NFPA 1403 Live Fire Training Evolutions, lays out a comprehensive plan for conducting an exercise in the safest manner possible.”).

185. Balding Interview, *supra* note 177; *Rolfs*, 135 T.C. at 475.

186. Barr, *IRS nixes tax deductions*, *supra* note 7.

187. *Scharf v. Commissioner*, 32 T.C.M. (CCH) 1247 (1973), *action on dec.*, 1974-36031 (Mar. 20, 1974).

188. *Id.* at 1249.

decided it was not “economically feasible to restore the existing building.”¹⁸⁹ Thus, the taxpayers decided to donate the building to the local volunteer fire department for live burn training.¹⁹⁰ The fire department used the building for three subsequent fire training exercises resulting in the building being completely burnt down.¹⁹¹ On their 1968 federal income tax return, the taxpayers claimed a charitable deduction of \$13,131.65 for the fair market value of the contributed building.¹⁹² However, the Service disallowed the charitable deduction arguing the taxpayers were not entitled to such deduction due to “the impending condemnation of the building, the [taxpayers] had no desire to rebuild and therefore donated it with the expectation that its demolition would increase the value of the land and make the property easier to convert to a more productive use.”¹⁹³ Based on the taxpayer’s motivation, the Service argued the deduction should be disallowed under the intent of the donor approach because it was not donated out of “detached and disinterested generosity.”¹⁹⁴ Alternatively, the Service argued that a charitable deduction should be disallowed under the substantial benefit test as the live burn donation was “made with the expectation of receiving something in return as a *quid pro quo* for the transfer.”¹⁹⁵ Thus, in a case of first impression, the Tax Court was confronted with deciding

189. *Id.* See also *id.* at 1248 (noting that the Mr. Scharf was an attorney, real estate broker, and a magistrate judge for over 30 years).

190. *Id.* at 1249 (“With the encouragement of municipal authorities, the petitioner arranged for the Mahwah Volunteer Fire Department to use the building to conduct fire drills and test the use of its new fire equipment.”).

191. *Scharf*, 32 T.C.M. (CCH) at 1249 (noting that the some debris was left which the taxpayer covered up and “the rest of the foundation and the chimney pushed over to avoid injury to persons nearby”).

192. *Id.* (“By an amendment to their petition filed February 15, 1973, the petitioners alleged that the value of their charitable contribution is \$28,500 rather than the \$13,131.65 originally claimed on their Federal income tax return for 1968, and that they are entitled to an increased charitable contribution carryover to 1969 and subsequent years.”). See U.S. INFLATION CALCULATOR <http://www.usinflationcalculator.com/> (last visited Sept. 13, 2011) (providing that, in 2011, a \$13,131.65 Charitable Deduction would be equivalent to the taxpayer claiming a \$85,250.82 Charitable Deduction).

193. *Scharf*, 32 T.C.M. (CCH) at 1251.

194. *Id.* (“[W]here evidence indicates that the primary motive for a contribution is to obtain a direct or indirect benefit by enhancing the value of his remaining property, then a charitable deduction for such a contribution should be denied.”).

195. *Id.*

“whether [the taxpayers were] entitled to a charitable contribution deduction for a building donated to a volunteer fire department for use in fire drills.”¹⁹⁶

The Tax Court began its analysis by discussing the motivation and benefit the taxpayer received stating:

There is no doubt that [taxpayer’s] donation of the fire-damaged . . . building resulted in a clearer tract of valuable land which he could market far more easily than before the demolition. There is also no doubt that [taxpayer] was somewhat motivated in his donation by a desire to have the building burned to the ground by the volunteer fire department.¹⁹⁷

The Tax Court recognized that, even though the requisite intent for a claimed charitable deduction “is frequently difficult to determine,” it has used the intent of the donor approach in the past.¹⁹⁸ However, the Tax Court reasoned that often when a charitable deduction has been disallowed under the intent of the donor approach “a *quid pro quo* flowed back to the donor from the exempt organization donee which certainly exceeded the satisfaction which flows from the performance of a generous act.”¹⁹⁹ Thus, without much explanation, the Tax Court decided to use the substantial benefit approach, stating:

[T]here are situations where the benefits of a charitable contribution inuring to the donor are incidental to the much greater benefits inuring to the general public from the donation. When this occurs, the small benefit to the donor does not destroy his right to a charitable contribution deduction. . . .

Thus, where the primary benefit inures to the general public with only lesser and incidental benefits flowing back to the donor, then a charitable deduction will be allowed.²⁰⁰

196. *Id.* at 1248 (“Alternatively, whether petitioners are entitled to an abandonment or demolition loss as a result of its use by the fire department.”).

197. *Id.* at 1251.

198. *Scharf*, 32 T.C.M. (CCH) at 1252 (“This Court has often held that a charitable gift must proceed from affection, respect, admiration, charity or like impulses, rather than from either the incentive of anticipated benefit beyond the satisfaction flowing from the performance of a generous act, or the constraining force of any moral or legal duty.”).

199. *Id.*

200. *Id.*

Accordingly, the Tax Court held that while it was a close call, “the benefit flowing back to [the taxpayer], consisting of clearer land, was far less than the greater benefit flowing to the volunteer fire department’s training and equipment testing operations.”²⁰¹ The Tax Court, thus, determined that while the taxpayer did receive the return benefit of clearer land, the taxpayer still had to remove debris and prepare the property before he could place it on the market. In balancing this benefit with the benefit to the general public, the Tax Court found the live burn donation primarily benefited the community “in its fire control and prevention operations.”²⁰² Accordingly, the benefit to the taxpayer was an incidental benefit and, therefore, the taxpayer was entitled to a charitable deduction for the live burn donation.

Having held the live burn donation was deductible, the Tax Court then faced the issue of determining the fair market value of the live burn donation. The taxpayer asserted that the live burn donation consisted of a donation of the entire building and, therefore, the fair market value should be based on the reproduction cost of the building. The Service asserted that the taxpayer only donated the use of the building, and the taxpayer did not establish “a marketable value for the privilege of using the building for fire drills.”²⁰³ Alternatively, the Service argued reproduction cost should not be used as the building was already damaged by fire at the time of the donation.

Based on the facts and circumstances,²⁰⁴ the Tax Court held that the best method for valuation was the fair market value of the building for insurance loss purposes less the amount of any insurance proceeds recovered. Furthermore, the Tax Court stated: “we need not choose here between the value of the donated use of the building and its fair market value in its damaged condition because in these circumstances we find they are the same.”²⁰⁵

Three months after the Tax Court decided *Scharf*, the Service issued an Action on Decision (the *Scharf* AOD) agreeing with the holding in *Scharf*.²⁰⁶ In the *Scharf* AOD, the Service stated:

The Court found as a fact that the benefits flowing back to petitioners, consisting of clearer land, were far less than the greater benefit flowing to the fire department and that petitioners benefited only incidentally. There was evidence

201. *Id.*

202. *Id.*

203. *Scharf*, 32 T.C.M. (CCH) at 1252.

204. *Id.* (“All factors bearing on value are relevant, including the cost, selling price, sales of comparable properties, the present condition of the property, opinion evidence and market conditions.”).

205. *Id.*

206. *In re Scharf*, 1974 WL 36031 (I.R.S. AOD Mar. 20, 1974).

in the record to support this factual finding and such finding is not clearly erroneous. In view of the Court's finding that the benefits received by petitioners were incidental, the mere fact that petitioners were benefited is not sufficient to deny the deduction.²⁰⁷

Additionally, the Service agreed, based on the facts in *Scharf*, that the Tax Court was correct in holding a "donation of the right to destroy a building is the same as donation of the building itself. Such finding is correct."²⁰⁸ Moreover, the Service stated it would no longer use the intent of the donor approach, requiring a donor's intent in making a donation to be out of "detached and disinterested generosity," stating "[n]otwithstanding that the Court in *dicta* appeared to approve this position, the Service will no longer make this argument."²⁰⁹

2. *Hendrix* — Lack of a Qualified Appraisal

In July 2010, in *Hendrix v. United States*,²¹⁰ the United States District Court for the Southern District of Ohio, was the first federal court in over thirty-five years to examine the deductibility of a live burn donation.²¹¹ In 2000, Hendrix purchased a house located in the prominent historic neighborhood of Upper Arlington in the Columbus, Ohio area. Four years later, the taxpayers decided to demolish the house sitting on the lot and build

207. *Id.* at *1.

208. *Id.*

209. *Id.* In the *Scharf* AOD, the Service also provided that "[i]n cases involving the donation of the use of property, for transfers in taxable years beginning before January 1, 1970, a contribution of the right to use property is allowable as a charitable contributions deduction if, under local law, a legally enforceable present interest has been conveyed." *Id.* at *2. Clearly, this is the Service preserving its position that Code section 170(f)(3) applies to live burn donations.

210. 106 A.F.T.R.2d (RIA) 2010-5373 (S.D. Ohio 2010).

211. *Id.* *But see* *Wells v. Dep't of Revenue*, No. TC-MD 030449B, 2003 WL 22905250, at *1 (Or. Tax Magis. Div. Dec. 8, 2003). In *Wells*, the Oregon Department of Revenue argued that a charitable deduction was not allowed for a live burn donation, as the volunteer fire department was not a qualified organization. *Id.* The court held based on *Scharf* and Revenue Ruling 71-47, 1971-1 C.B. 92, that the volunteer fire department was a qualified organization, as it was a "political subdivision" as "the volunteer fire department relieves a political subdivision of a function which it would normally perform." *Id.* Furthermore, in *dicta*, the court, relying on *Scharf*, stated "although it may be argued that the donor is in fact receiving a benefit through the destruction of an unwanted building, it has been reasoned that the incidental benefit to the donor is outweighed by the much greater benefit inuring to the general public." *Id.*

a new home. Accordingly, the taxpayers obtained two bids for demolition services.²¹² After declining to accept either of the demolition bids from private companies, the taxpayers decided to donate their personal residence to the Upper Arlington Fire Department for various training purposes. Thus, the taxpayers obtained an appraisal of the house, which valued the house at \$520,000. Additionally, the taxpayers consulted the accounting firm of Deloitte & Touche for tax advice. Despite receiving adverse advice from Deloitte & Touche, the taxpayers entered into a contract with the fire department.²¹³ The agreement provided the taxpayers would grant the city sole discretion to burn and/or demolish the house. From June 29, 2004 to October 29, 2004, the city used the house for various training exercises and ultimately demolished the house. The taxpayers subsequently claimed a \$287,400 charitable deduction.²¹⁴

In deciding whether the live burn donation was deductible, the District Court first examined the substantiation requirements for a charitable deduction.²¹⁵ In particular, the court looked at the “qualified appraisal”²¹⁶

212. *Hendrix*, 106 A.F.T.R.2d (RIA) at 2010-5374 (providing that the price to demolish the home was approximately \$10,000).

213. *Id.* (the advice from Deloitte & Touche stated that a Live burn donation “is aggressive and not explicitly sanctioned by the Internal Revenue Code.”).

214. *Id.*

215. *Id.* at 2010-5375.

216. I.R.C. § 170(f)(11)(E)(i) (defining qualified appraisal). A qualified appraisal is an appraisal of property which —

(I) is treated for purposes of this paragraph as a qualified appraisal under regulations or other guidance prescribed by the Secretary, and

(II) is conducted by a qualified appraiser in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed under subclause (I).

(ii) Qualified appraiser. Except as provided in clause (iii), the term “qualified appraiser” means an individual who —

(I) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Secretary,

(II) regularly performs appraisals for which the individual receives compensation, and

and “contemporaneous acknowledgment” requirements.²¹⁷ Ultimately, the court held these two requirements were not met, and thus granted the Service’s motion for summary judgment thereby ending the litigation.²¹⁸

(III) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance.

(iii) Specific appraisals. An individual shall not be treated as a qualified appraiser with respect to any specific appraisal unless —

(I) the individual demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and

(II) the individual has not been prohibited from practicing before the Internal Revenue Service by the Secretary under section 330(c) of Title 31, United States Code, at any time during the 3-year period ending on the date of the appraisal.

Id. See also Reg. § 1.170A-13(c)(3) (explaining the requirements of the qualified appraisal); Reg. § 1.170A-13(c)(4) (explaining the requirement of the summary appraisal); Reg. § 1.170A-13(c)(5) (defining qualified appraiser).

217. See I.R.C. § 170(f)(8) (providing the contemporaneous acknowledgment requirement). I.R.C. § 170(f)(8) states that: “No deduction shall be allowed under subsection (a) for any contribution of \$250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization. . . .” The written acknowledgement must contain the following information:

(i) The amount of cash and a description (but not value) of any property other than cash contributed.

(ii) Whether the donee organization provided any goods or services in consideration, in whole or in part, for any property described in clause (i).

(iii) A description and good faith estimate of the value of any goods or services referred to in clause (ii) or, if such goods or services consist solely of intangible religious benefits, a statement to that effect.

Id.

218. *Hendrix*, 106 A.F.T.R.2d (RIA) at 2010-5375. The appraisal submitted by taxpayers failed to contain:

[T]he expected date of contribution, the terms of the agreement between [the taxpayers] and the city, the qualification of [the taxpayers’] appraiser . . . and the required statement that the

Unfortunately, the court did not reach the looming issue of whether a charitable deduction is allowed for live burn donation, stating:

Either of the foregoing grounds ends this litigation. Thus, as noted, the Court declines to reach the remaining moot issues involved in the parties' dispute. The consequent result of the foregoing analysis is that, regardless of whether taxpayers may be able to claim a deduction for the type of donation involved in this case — a question this Court need not ultimately answer today — the deficient manner in which [the taxpayers] pursued such a donation here proves dispositive.²¹⁹

Even though the court did not decide the issue of whether a charitable deduction is allowed for a live burn donation, it was evident from the tone of the *Hendrix* opinion that the court did not agree with the deductibility of the live burn donation.

C. *Rolfs* — The Tax Court Extinguishes the Live Burn Donation

In October 2004, thirty-five years after the Tax Court held that a charitable deduction was allowed for a live burn donation, the court was once again confronted with the same issue.²²⁰ This time, however, there was a different landscape in which to view this issue in light of *American Bar Endowment* and *Hernandez*. Due to the Chief Judge requiring an *en banc* review of the *Rolfs* opinion, it was not until November 2010 that the Tax Court issued the *Rolfs* opinion disallowing the live burn donation as a

appraisal was prepared for income tax purposes. . . . In fact, in addition to failing to contain *any* of the identified, specifically required information, one provision of the appraisal arguably disavows by omission that the appraisal was prepared for income tax purposes. The appraisal indicates its “purpose and scope” by providing that “[t]he intended use of this appraisal is to assist the owner in estimating the fair market value of the subject property.”

Id. at 2010–5376 (emphasis in original).

219. *Id.* at 2010–5379.

220. *Internet Docket Inquiry in the matter of Rolfs v. Commissioner*, U.S. TAX CT., <https://ustaxcourt.gov/UstcDockInq/DocketDisplay.aspx?DocketNo=04009377> (last visited Sept. 13, 2011) (showing that on October 24, 2005, the trial for the *Rolfs*' case took place before the United States Tax Court. However, it was not until six years later, on November 4, 2010, the Tax Court issued an opinion).

charitable deduction.²²¹ In early 2012, the Seventh Circuit affirmed that Tax Court's decision.²²²

In 1996, the Rolfs purchased a 1900s lake house located on 3-acres, at which time they were unsure whether they would remodel the home or demolish it.²²³ Finally, in late 1997, the taxpayers decided to tear down the house and build a new one.²²⁴ Around the same time that the taxpayers learned that demolition and debris removal of the lake house would cost between \$10,000 and \$15,000, the taxpayers became aware of an individual who claimed a charitable deduction for a live burn donation. As a result, the taxpayers decided to donate the lake house to the local volunteer fire department for training purposes and claim a charitable deduction for their live burn donation.

The taxpayers did not enter into a written contractual agreement with the fire department for the contribution of the house, but rather communicated orally with the fire department their desire to donate the property. On February 10, 1998, the taxpayers memorialized their previous conversations with the fire chief and expressed their desire to donate their lake house "to the Fire and Police departments of the Village for [the sole use of] training and eventually demolition."²²⁵ The letter purported to "serve as an acknowledgment that it is [the taxpayers'] intention to donate the house for such purposes" and that "[t]he house is available immediately."²²⁶ According to testimony of the local fire department chief, there was a mutual understanding between the taxpayers and him that "the lake house would be destroyed within 'the first part of [1998].'"²²⁷ Additionally, the taxpayers donated \$1,000 to the fire department to defray the costs associated with the live burn training.²²⁸ Within the following eleven days after the letter was

221. See Vielmetti, *Decision Awaited*, *supra* note 177 (Rolfs' attorney of record, Michael Goller, stated that while the presiding judge is studious and academic, he believes that "the whole Tax Court may be reviewing this." Such belief is shared by others, as one tax scholar believes that "[the Rolfs' case] does have larger significance" and that if the IRS does not prevail Congress would be expected to enact a law specifically addressing the deductibility of such donations.).

222. *Rolfs v. Commissioner*, 668 F.3d (7th Cir. 2012), *aff'g* 135 T.C. 471 (2010).

223. *Id.* at 473 (stating that the taxpayers paid \$600,000 for the lake house).

224. *Id.* (stating that as the mother of "Julia A. Gallagher's mother, Beatrice Gallagher (Mrs. Gallagher)" proposed that the taxpayer "build a new house to her specifications as her residence in its place, and then exchange the lake property for her existing residence").

225. *Id.* at 474.

226. *Id.*

227. *Rolfs*, 135 T.C. at 474.

228. *Id.* at 475. "The record does not include an itemization of this amount, and it is unclear whether [taxpayers] claimed a deduction for the \$1,000 remitted to

sent, the fire and police departments used the lake house for training, ending with the fire department burning and demolishing the house. Soon after, on March 30, 1998, the taxpayers entered into a construction contract for a new residence on the lake property.²²⁹ The taxpayers claimed a charitable deduction for \$76,000²³⁰ on their 1998 federal income tax return, which the Service denied.²³¹

The Service asserted that a charitable deduction was not allowed for the live burn donation based on three alternative legal arguments. Relying on *American Bar Endowment* and the quid pro quo regulation, the Service asserted that the taxpayers received the substantial benefit of demolition services in return for their live burn donation. Thus, because the fair market value of the benefit received, the demolition services, was greater than the fair market value of the live burn donation, there was no “contribution or gift” (the quid pro quo argument).²³² Alternatively, the Service argued a charitable deduction was disallowed for the live burn donation because the taxpayers “transferred to the [fire department] less than their entire interest in the lake house.”²³³ The Service’s final argument was that the “lake house as

the [fire department] to defray the costs incurred in connection with the use of the lake house for training exercises.” *Id.* at 476 n.3.

229. *Id.* at 475 (stating the cost of the new house was \$383,000).

230. *But see id.* at 472 (stating that the taxpayers amended their petition claiming valuing the land based on its reconstruction value of \$235,350, “rather than the \$76,000 claimed on their return . . . resulting in an overpayment of \$39,672 for 1998”).

231. *Rolfs*, 135 T.C. at 476. *See also id.* at 477 (stating that the taxpayers “subsequently filed an amended petition in which they averred that they were entitled to a charitable contribution deduction for their donation of the lake house of at least \$235,350, the reproduction cost of the house”).

232. *Id.* at 480–81.

233. *Id.* at 481 (relying on Code section 170(f)(3)(A)). *See* I.R.C. § 170(f)(3)(A) (providing that a charitable deduction is not allowed for certain contributions of partial interests in property). Section 170(f)(3) reads as follows:

(A) In general. 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.

(B) Exceptions. Subparagraph (A) shall not apply to

(i) a contribution of a remainder interest in a personal residence or farm,

donated to the [fire department] was worthless.”²³⁴ On the other hand, the taxpayers argued²³⁵ that, in accordance with a qualified appraisal, the value of the lake house was \$76,000; thus it was not worthless. Additionally, the taxpayers, relying on *Scharf*, argued they only received an incidental benefit; as a result, they should be able to deduct the entire fair market value of the house. Finally, the taxpayers asserted that “because [they transferred] the lake house to the [fire department] with the right to demolish it, they transferred their entire interest in the property.”²³⁶

In reaching its decision to disallow the charitable deduction for the live burn donation, the Tax Court only addressed the quid pro quo argument. Essentially, the Tax Court found the taxpayers did, indeed, receive a substantial benefit in excess of the value of their live burn donation and, ultimately, disposed of the case.²³⁷ In reaching this conclusion, the Tax Court began its analysis by citing the definition given by the Supreme Court in *Hernandez* to the term “contribution or gift,” stating:

The legislative history of the “contribution or gift” limitation [of the charitable deduction], though sparse, reveals that Congress intended to differentiate between unrequited payments to qualified recipients and payments made to such recipients in return for goods or services. Only the former were deemed deductible. The House and Senate Reports on the 1954 tax bill, for example, both define “gifts”

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- (ii) a contribution of an undivided portion of the taxpayer’s entire interest in property, and
 - (iii) a qualified conservation contribution.

Id. See also *infra* note 246 (arguing that Code section 170(f)(3)(A) does apply to the live burn donation).

234. *Rolfs*, 135 T.C. at 481.

235. *Id.* (providing that the taxpayers also argued that the under Code section 7491(a) the burden of proof shifted to the Service and that the Service’s quid pro argument that the taxpayer’s received a benefit in return should not be heard as “this argument constitutes new matter that respondent raised for the first time in his opening brief”). The Tax Court held against both of these assertions. For the Tax Court’s analysis of these issues see *Rolfs*, 135 T.C. at 482–86.

236. *Id.* at 482.

237. *Id.* at 495 n.19 (stating that the Tax Court “need not decide [the Service’s] alternate contentions that the deduction is disallowed pursuant to sec. 170(f)(3) or on account of the worthlessness of the lake property at the time of the donation”). See also *Rolfs*, 668 F.3d, n.3 (“The IRS offered an alternate theory for denying the Rolf’s deduction: that the gift transferred only a limited right to use (i.e., burn down) a house and therefore was not a qualifying contribution under 26 U.S.C. § 170(f)(3), which denies deductions for gifts of most partial interests in property. . . . The Tax Court did not reach this question, and we affirm without reaching it.”).

as payments “made with no expectation of a financial return commensurate with the amount of the gift.”²³⁸

Accordingly, the Tax Court concluded that “[a] payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return.”²³⁹ In determining whether a payment was made with the expectation of a return benefit, “the external, structural features of the transaction, which obviates the need for imprecise inquiries into the motivations of individual taxpayers” must be examined.²⁴⁰

The Tax Court, agreeing with the Service, found the taxpayers did receive a benefit, since the taxpayers contacted the fire department to burn down the lake house after deciding they wanted to build a new home on the lakefront property and, thus, needed the lake house demolished. Accordingly, the external features of the transaction showed that the taxpayers anticipated a demolition benefit in exchange for their live burn donation. The Tax Court rejected the taxpayers’ reliance on the *Scharf* test on the grounds that *American Bar Endowment* rendered *Scharf* moot, stating:

The test applied in *Scharf*, which examines whether *the value of the public benefit* of the donation exceeded the value of the benefit received by the donor, differs from the Supreme Court’s test announced 13 years later in *United States v. Am. Bar Endowment*. The *Am. Bar Endowment* test examines whether *the fair market value of the contributed property* exceeded the fair market value of the benefit received by the donor. The test applied in *Scharf* has no vitality after *Am. Bar Endowment*.²⁴¹

Accordingly, the transaction was a quid pro quo transaction and was required to be examined under the two-prong quid pro quo test announced in *American Bar Endowment*: (1) “the payment is deductible only if and to the extent it exceeds the market value of the benefit received,” and (2) “the

238. *Id.* at 480 (quoting *Hernandez v. Commissioner*, 490 U.S. 680, 690 (1989)).

239. *Id.* (quoting *United States v. Am. Bar Endowment*, 477 U.S. 105, 116 (1986)). The Tax Court also interestingly cited *Singer Co. v. United States*, 196 Ct. Cl. 90 (1971).

240. *Rolfs*, 135 T.C. at 480, (relying on *Hernandez*, 490 U.S. at 690–91).

241. *Id.* at 487 (internal citations omitted). *See also Rolfs*, 668 F.3d 888 (“The Tax Court ruled correctly in this case that the *Scharf* test “has no vitality” after *American Bar Endowment*.”). *But see Hagen, Capricious Nature*, *supra* note 20, at 302–04 (arguing that *American Bar Endowment* did not render *Scharf* moot).

excess payment must be made with the intention of making a gift.”²⁴² Consequently, the Tax Court turned to the issue of determining the values of the demolition benefit and the lake house.²⁴³

The Tax Court held the value of the demolition benefit received by the taxpayers was \$10,000. The taxpayers asserted they did not receive a benefit because the contract for the construction of the new house included a fee of “‘\$10,000 to \$15,000’ in excavation charges for clearing the remnants of the burn and concrete foundation of the lake house.”²⁴⁴ The Tax Court, however, rejected this assertion because the construction contract did not include a line item specifically allocating any portion of the total contract price to excavation and debris removal.²⁴⁵ Instead, the Tax Court based its finding on the fact that both the taxpayers’ and the Service’s experts found the cost to have the lake house demolished to be in the range of \$10,000. Thus, the Tax Court turned to the harder issue of valuing the donation of the lake house.

In valuing the lake house, the Tax Court focused on the rule of law requiring that any restrictions and/or conditions limiting the marketability of contributed property on the date of the contribution, including those imposed by the donor, must be considered when determining the fair market value of the contributed property. The Tax Court agreed with the taxpayers that the lake house could be separately valued from the underlying land as the “donation of the lake house to the [fire department], without [the taxpayers’] conveyance of the underlying land on which it was sited, effected a ‘constructive severance’ of the structure from the land, recognized under Wisconsin law, even though the structure remained affixed to the land.”²⁴⁶

242. *Rolfs*, 135 T.C. at 486.

243. *See generally* Reg. § 1.170A-1(c)(1) (“If a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution”); Reg. § 1.170A-1(c)(2) (“The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.”).

244. *Rolfs*, 135 T.C. at 488 (“[Taxpayers] argue on brief that these additional excavation costs demonstrate that [taxpayers] did not save anything from the demolition resulting from the burning and therefore received no benefit from their donation of the lake house to the VFD.”)

245. *Id.* (stating that “[m]oreover, a preprinted portion of the contract covering ‘Building Site Conditions’ has been lined through by the parties to the contract, creating an inference that the contract price did *not* cover any significant debris or foundation removal services”).

246. *Id.* at 489–90. Arguably, based on the Tax Court’s holding that the home was severed from the underlying land, one could foresee that if the Tax Court would have addressed the Service’s alternative partial interest argument, that the Tax Court would have held that land and the house were two distinct pieces of property.

However, because the taxpayers transferred the lake house and not the underlying land, the Tax Court determined that a restriction or condition was created on the marketability of the donation because the lake house could not remain in its current location. The Tax Court determined there were two additional restrictions or conditions on the lake house: (1) restricting the use to fire and police training and (2) requiring the house to be burnt down within a short period of time after the donation.²⁴⁷

Consequently, the Tax Court did not accept the taxpayers' qualified appraisal in the amount of \$76,000 because it used the "before and after" approach which did not consider the restrictions placed on the lake house.²⁴⁸ Furthermore, the Tax Court determined there was no authority for using the "before and after" approach in situations where the property was severed from the underlying land and laden with restrictions on use.²⁴⁹ Instead, the Tax Court relied on the Service's experts and held that the property was of minimal value due to the underlying restrictions and conditions of the donated lake house. The Tax Court examined the impact of the severance of the lake house from the underlying land and determined this fact "rendered the lake house virtually worthless."²⁵⁰ The court subsequently examined the impact of the restriction on the use of the lake house and determined that although there was insufficient evidence to determine the dollar impact, the court was convinced the impact would be adverse.²⁵¹ Thus, the court held,

Thus, by giving the lake house to the fire department for live burn training, the taxpayers gave the entire house.

247. *Id.* at 490 (providing the Chief of the fire department "testified that he understood he could not use the lake house for any other purpose and that the burn-down was to take place during the first part of 1998").

248. *Id.* at 490–92. Under the "before and after" approach, the appraiser determined the value of the lake house and underlying land and then determined and subtracted the value of the lake property without the lake house. The appraiser determined that the \$76,000 difference was the value of the lake house when donated to the fire department.

249. *Rolfs*, 135 T.C. at 492–93.

[A]lternatively [the taxpayers] contend that the fair market value of the lake house as contributed to the [fire department] was \$235,350, its reproduction cost as estimated by [the appraiser] . . . [but] offer no expert testimony in support of this proposition . . . [taxpayers] merely borrow [the appraiser's] estimate of reproduction cost and assert on brief . . . that because the lake house was "unique" and was "special use" property in the hands of the donee, reproduction cost is the appropriate measure of its value.

Id. at 492.

250. *Id.* at 494.

251. *Id.* (stating that "the lake house's salvage value was zero").

after considering all the conditions and restrictions to ensure sufficient consideration existed to render the contract enforceable, the fair market value of the lake house was de minimis because no one would purchase the lake house for more than a nominal amount, which was between \$100 and \$1,000.²⁵²

As a result, the Tax Court held for the Service on its quid pro quo argument because the live burn donation failed the first prong of the quid pro quo test. Meaning, the taxpayers failed to show the fair market value of the lake house exceeded the value of the demolition benefit received by the taxpayers. Accordingly, the taxpayers were not entitled to a charitable deduction for their live burn donation.²⁵³ Thus, the Tax Court was not confronted with examining the second prong of the quid pro quo test—“whether the excess of the value of the donation over the value of the benefit received was transferred with the intention of making a gift.”²⁵⁴ Had the court determined the fair market value of the live burn donation exceeded the fair market value of return benefit, the Tax Court would have been forced to examine the second prong of the quid pro quo test. Surely the Tax Court would have concluded that the second prong was met as the taxpayers clearly knew they were making a donation in excess of the return benefit.

V. THE PUBLIC BENEFIT EXCEPTION

While it appears the Service has won the live burn donation fight in the courts,²⁵⁵ the deductibility of the live burn donation remains an issue of

252. *Id.* at 479, 495.

253. *Rolfs*, 135 T.C. at 495. *See also id.* at 495–96 (holding that the taxpayers were not subject to Code section 6662 accuracy-related penalties, as the taxpayers “given all the facts and circumstances, including the uncertain state of the law . . . acted with reasonable cause and in good faith”).

254. *Id.* at 488 n.13.

255. In *Rolfs*, the Tax Court was correct in applying the quid pro quo test to the live burn donation. Arguably, however, the court incorrectly valued the amount of the contribution. *See supra* note 20 (discussing the improper valuation). As a result of undervaluing the donation at \$100 to \$1,000, the court’s analysis stopped at the first prong of the quid pro quo test. While I will not speculate to the actual value of the donation, I would assert that the value of the live burn donation clearly exceeded the value of the demolition services. Consequently, the court would have had to examine the live burn donation under the second prong of the quid pro quo test — whether the excess donation was transferred with the intention of making a gift. Surely, the Tax Court would have concluded that the second prong was met, as the taxpayers clearly knew they were making a donation in excess of the return benefit. As for the Services’s alternative arguments, the house was clearly not worthless, because it had some value, regardless of whether the taxpayers intended to demolish the house or not. Assuming a donation is deemed worthless because a

contention primarily due to the issue of valuation. Those who opposed the deduction did so mainly because of the large dollar figures associated with the deductions; this is commonly referred to as “wealthfare.”²⁵⁶ Due to the perceived abuse of the live burn donation, it is believed that Congress might enact legislation specifically disallowing live burn donations.²⁵⁷ This article proposes Congress should not extinguish the live burn donation. Rather, exceptions to the application of the quid pro quo test should be made when the benefit of the donation to the public substantially outweighs the benefit received by the donor (the public benefit exception). The public benefit exception should be used to encourage donations that otherwise would be underfunded, as is the case in live burn donations. This section will first discuss the public benefit exception using the live burn donation as the lens to examine the application of the proposed exception. Ultimately, this section proposes an amendment to the charitable deduction, thereby allowing a charitable deduction for live burn donations, while recognizing the need for limitations given the perceived abuse and valuation difficulties of the live burn donation.

taxpayer is done using the item, then most, if not all, charitable deductions would be worthless. *See also supra* 246 (arguing that the taxpayer transferred their entire interest in the house).

256. Marie Rohde, *Asbestos Could Stop Fox Point Firefighting Drill Village Officials Demand Review of Policy Allowing Residents to Donate Homes*, MILWAUKEE J. & SENTINEL, Mar. 3, 1999, at B1, available at 1999 WLNR 2868170. *See also* Editorial, *Burned-down house can't be used again*, COLUMBUS DISPATCH (Ohio), Aug. 2, 2009, at 04G, available at 2009 WLNR 14917592.

257. *See, e.g.,* Vielmetti, *Decision Awaited*, *supra* note 177 (quoting Professor Lloyd Mayer of Notre Dame School of Law stating that the *Rolfs* case “does have larger significance.... Usually, when you give to charity, you can deduct the fair market value. But in a number of cases, including [*Rolfs*] people, including Congress, were getting uncomfortable.”). Congress has promulgated similar laws to target abuse in the area of taxidermy and vehicle donations. *See, e.g.,* Kathy M. Kristof, *Charitable Donations Get Stricter Tax Rules*, L.A. TIMES (Aug. 27, 2006), <http://articles.latimes.com/2006/aug/27/business/fi-perfin27> (“Rules governing donations of automobiles, another area in which legislators believed there was widespread cheating, were tightened under a 2004 tax law. Now, if a charity sells — rather than uses — a donated car, the donor can write off only the amount the charity received for the car.”); Press Release, United States Senate Comm. On Fin. Summary of Senator Grassley’s Non-profit Oversight to Date (Nov. 20, 2007), <http://finance.senate.gov/newsroom/ranking/release/?id=83f6b20e-3327-4619-8b92-36ce643ef5fe> (Tax breaks for taxidermy. This shuts down a practice in which a donor received big tax breaks for the cost of his African safari while a museum received a nearly worthless, dusty boar’s head sitting in a railway car.”).

A. *The Application of the Public Benefit Exception*

As discussed above, exceptions have been made to the application of the quid pro quo test by the Service in situations where it would be administratively inconvenient to account for a taxpayer receiving a nominal return benefit, such as a coffee mug or a keychain bearing the logo of the charitable organization. The Service has also made exceptions when the value of a return benefit is difficult to determine, such as intangible religious benefits. Moreover, Congress enacted the season ticket exception, which is one of the most controversial exceptions. The season ticket exception was promulgated to eliminate potential valuation controversies based on the argument that the return benefit of the right to purchase season tickets would be difficult to value. With that said, congressional consideration of other exceptions to the quid pro quo test is warranted when the benefit of the donation to the public substantially outweighs the benefit received by the donor.

The balancing concept behind the public benefit exception was first discussed in *Singer* as part of the substantial benefit received approach. The court proposed a balancing test whereby “the benefits received, or expected to be received,” were balanced against the benefits “inur[ing] to the general public from transfers for charitable purposes.”²⁵⁸ Due to the lack of guidance from the court, it was unclear how to apply such a balancing test. It has been argued the test could be interpreted in two different ways because “it is not readily apparent whether the court intended that the transferor’s benefit be measured against those benefits received by the general public, or whether the benefits received by the transferor [were to be measured against] those that would incidentally inure to it as a member of the general public.”²⁵⁹ The better interpretation is to balance the return benefit inuring to the taxpayer with the benefits received by the general public as such conforms to the purpose of the charitable deduction —acting as a subsidy to those organizations the government recognizes as providing a community benefit.

Under the substantial benefit approach, the balancing test was troubling due to the immense ramifications. If the return benefit was deemed

258. *Singer Co. v. United States*, 196 Ct. Cl. 90, 106 (1971).

259. Hobbet, *Charitable Contributions*, *supra* note 53, at 7.

The better view would be to first determine whether the taxpayer has received a direct benefit from the recipient organization, disregarding whether it may also happen to benefit incidentally as a member of the general public. Once it [has been] determined that a direct benefit has been received, an objective test could focus upon the value of the direct benefit, measuring it against the benefit received by the public by virtue of the contribution, and not against any incidental benefit received by the taxpayer.

Id.

incidental, the substantial benefit approach allowed a charitable deduction for the entire amount of the payment to the charitable organization without a reduction for the value of the return benefit. Consequently, substantial weight was placed on a test that could potentially pose difficulty to the courts in assessing the value of the benefit to the charitable organization. This fear is alleviated under the public benefit exception because the balancing test would only be used to determine whether an exception to the application of the quid pro quo test for a particular donation should be considered. It is not the intended purpose of this article to suggest that if the benefit flowing to the public outweighs the benefit flowing back to the taxpayer the entire payment should be deductible. Instead, whether the public benefit exception applies, Congress should enact specific legislation for the donation at hand recognizing the need for limitations given any currently recognized or potentially perceived abuses, as well as any valuation issues.

In applying the public benefit exception, Congress must first determine the fair market value of the benefit taxpayers are receiving from the particular type of donation. The benefit that a taxpayer receives from a specific type of donation will vary among taxpayers based on various factors. Nevertheless, for administrative convenience, this article suggests that the average benefit received be used when determining whether the public benefit exception applies. Although the return benefit of demolition services received by taxpayers from the live burn donation will vary depending on the size and location of the home, if the nationwide average of the value of the demolition services received is, for example, \$10,000, then the value of the benefit received for purposes of testing the live burn donation under the public benefit exception should simply be \$10,000.

Most likely, the more difficult benefit to value is the benefit received by the general public.²⁶⁰ While it is highly unlikely that an exact monetary value can be placed on such benefit, Congress must determine whether the perceived value of the benefit to the general public outweighs the benefit inuring to the taxpayer. In determining the value of the benefit flowing to the general public Congress must look at all the facts and circumstances of the donation, including, but not limited to, the following three factors: (1) the scope of the benefitted group, (2) the type and use of property being donated, and (3) the potential underfunding of the donation.

260. See *Rolfs*, 668 F.3d 888 (stating the “*Scharf* court did not actually calculate a dollar value for the public benefit, and if it had tried, it probably would have found the task exceedingly difficult.”).

1. *The Scope of the Benefitted Group Factor*

The general public ultimately bears the cost of the charitable deduction; and accordingly, any exception to the quid pro quo test should be for the benefit of the greatest number of people.²⁶¹ The value of the benefit to the general public, thus, should increase as the scope of the benefitted group widens. If the benefit flowing from a donation only benefits a small segment of society, more likely than not the value of the donation being reviewed is low and the public benefit exception should not apply.

For example, live burn donations are used by firefighters and other public servants to train and enhance public safety. The live burn donation thus affects a broad segment of the population. Alternatively, the season ticket exception only benefits universities or colleges, and perhaps, primarily only the athletic departments. The season ticket exception thus benefits a much narrower group of society. Therefore, in the case of the live burn donation, the benefit to the general public should be viewed by Congress as being more valuable than the right to purchase season tickets to one's favorite collegiate sport.

2. *The Type and Use of Property Being Donated Factor*

The type and use of property being donated to the charitable organization must be considered in valuing the benefit to the general public. If donated property is unique or not commonly available to the charitable organization, the value of the benefit to the general public should increase. On the other hand, if the property being donated is money, the benefit to the general public should be deemed to have zero value as money is the most common type of property. However, if the return benefit inuring to the taxpayer is difficult to value, making the quid pro quo test difficult to apply and causing potential valuation controversy, monetary donations should not render the public benefit exception inapplicable. Instead, this factor should be viewed as neutral. Otherwise, the public benefit exception should not apply in the case of monetary donations.

For example, the property being donated in a live burn donation is unique property because the home must meet specific structural and environmental requirements.²⁶² Moreover, the property is not commonly available to local fire departments resulting in fire training typically taking

261. Shannon Weeks McCormack, *Too Close to Home: Limiting the Organizations Subsidized By the Charitable Deduction to Those in Economic Need*, 63 FLA. L. REV. 857, 866 (2011) [hereinafter McCormack, *Too Close to Home*] (“Because the cost of the charitable deduction is spread among all taxpayers, the benefit should also be somewhat dispersed.”).

262. See *supra* notes 183–84 and accompanying text.

place in burn towers, if such training is affordable. Live burn donations allow for firefighters to conduct live burn training, which provides a realism not seen in controlled tower burns.²⁶³ In some situations, the local fire departments do not have access to fire towers, so the only training after the academy takes place in one of these donated houses.²⁶⁴ Not to mention, the donated structures are utilized by other municipal departments, including SWAT teams, rescue crews, and fire investigators, prior to being burned to the ground. Thus, Congress should view the benefit to the general public as being extremely valuable in the case of the live burn donation. Alternatively, the season ticket exception involves the donation of money. Thus, generally, the public benefit would not apply because the season ticket exception involves a monetary donation. However, the congressional intent of the season ticket exception was to eliminate any valuation issues regarding the return benefit (i.e., the value of the right to purchase season tickets). Accordingly, in the case of the season ticket exception, this factor should be viewed as neutral.

3. *The Potential Underfunding of the Donation Factor*

Congress should use the public benefit exception sparingly. It should be applied only to encourage donations that otherwise would be underfunded. A charitable organization is underfunded when the donations it receives do not meet the organization's needs. While this definition of underfunding of a charitable organization has been discussed by various scholars,²⁶⁵ no scholar has yet presented a clearly measurable standard for determining to what extent, if any, a charity would be underfunded without the charitable deduction.²⁶⁶ In light of the difficulty in determining whether a charitable organization is underfunded, Congress's application of the public benefit exception must take into consideration whether the taxpayer would still donate the property despite the deduction being denied or limited by the quid pro quo test. In assessing the potential underfunding, consideration

263. Vielmetti, *Decision Awaited*, *supra* note 177 (Moreover, live burns "offer a more realistic, and cheaper, training opportunity than going to dedicated, and familiar, fire towers at area technical colleges.").

264. Kathy L. Gray, *Herbstreit 'Fire' Puts Focus on IRS Dispute*, COLUMBUS DISPATCH (July 24, 2009, 3:46 PM), http://www.dispatch.com/content/stories/local/2009/07/23/IRSburn.ART_ART_07-23-09_A1_DDEIB64.html [hereinafter Gray, *Herbstreit 'Fire'*].

265. *See, e.g.*, McCormack, *Too Close to Home*, *supra* note 261, at 872–910; Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1396–1406 (1988).

266. For a leading article on defining a clear standard for determining if an organization is underfunded see McCormack, *Too Close to Home*, *supra* note 261, at 884–908.

should be given to the taxpayer's alternatives, if any, for otherwise obtaining the return benefit.

For example, it is unclear whether a taxpayer would make a live burn donation if there was not a corresponding charitable deduction.²⁶⁷ Currently, there is an alternative to the live burn donation, which is known as deconstruction, whereby taxpayers pay a company to deconstruct their home piece-by-piece, salvaging everything, including bathroom fixtures, windows, doors, flooring, wires, pipes, nails, and wood.²⁶⁸ A charitable organization, such as Habitat for Humanity, provides the deconstruction services at no cost to the taxpayer.²⁶⁹ Essentially, the taxpayer donates all the deconstructed salvageable pieces to the charitable organization.²⁷⁰ Thus, deconstruction results in removal of the home from the land, minimum debris to clean up, and, more importantly, a charitable deduction.²⁷¹ Another alternative method is to sever the structure from the underlying land and claim a charitable deduction by donating the home to a charitable organization, which relocates the home to another site. Assuming a charitable deduction is disallowed for a live burn donation, taxpayers will either pay to have their home demolished and avoid the hassle of dealing with the fire department or have their home deconstructed or relocated. Accordingly, the live burn donation will clearly be underfunded if the corresponding charitable deduction is disallowed.

On the other hand, unlike the live burn donation, there is minimal to no potential for the underfunding of a monetary donation in return for the right to purchase season tickets. While the NCAA argued taxpayers would less likely make donations if the season ticket exception did not exist, it is highly unlikely universities and colleges, in particular their athletic programs, would not receive cash donations. Assume Congress chose to deny all charitable deductions for donations for the right to purchase season tickets; taxpayers would still give money to their favorite universities and colleges. Taxpayers would still purchase tickets and support collegiate

267. See, e.g., Gray, *Herbstreit 'Fire,' supra* note 264 (providing that a fire chief in Upper Arlington, Ohio stated that the number of house donations dropped off since 2005; after the Herbstreit and Hendrix families had donated their homes previously in 2004 and were denied charitable deductions); Stacie Zoe Berg, *Homes Go to Blazes for Public Safety, Private Savings*, WASH. POST, July 5, 1997, at E1, available at 1997 WLNR 7204221 (suggesting tax deductions have motivated homeowners to donate houses to fire departments for live burn trainings rather than hiring contractors for demolitions).

268. *Deconstruction*, REUSE PEOPLE, <http://thereusepeople.org/Deconstruction> (last visited Sept. 20, 2011) [hereinafter, REUSE PEOPLE] (providing the tax benefits to and guidance on deconstruction).

269. See, e.g., *Habitat ready to help 'deconstruct,' recycle*, ISLAND PACKET (Hilton Head Island, S.C.), Mar. 21, 2011, available at 2011 WLNR 5485607.

270. REUSE PEOPLE, *supra* note 268.

271. *Id.*

athletics. Currently, the minimum donation required at some universities varies depending on where the seat is located.²⁷² A right to purchase a season ticket on the 50-yard line might cost \$1,000 and the underlying season ticket only \$400.²⁷³ Arguably, since there is no alternative means to obtaining the 50-yard line ticket, a taxpayer wanting season tickets would pay \$1,400 for the ticket, whether the season ticket exception existed or not.

In applying the public benefit exception to the live burn donation, the benefit to the public substantially outweighs the benefit received by the donor. Thus, Congress should enact an amendment to the charitable deduction specifically allowing for a charitable deduction for live burn donations while recognizing the need for limitations given the perceived abuse and valuation difficulties of the live burn donation. Yet, in light of the public benefit exception analysis, the season ticket exception likely should have not been enacted. The goal of the public benefit exception is for Congress to enact needed exceptions to the quid pro quo test for donations that have a broad general public purpose and which might otherwise be underfunded. The goal is not to provide politically motivated exceptions, like the season ticket exception, which prove difficult in justifying the general public bearing the burden of the donation. Subsidizing another taxpayer's collegiate football season ticket purchase is not the intended purpose of the public benefit exception.

B. The Live Burn Donation Amendment

In drafting the live burn donation amendment, which would expressly allow for a charitable deduction for live burn donations, Congress should consider the need for limitations given the perceived abuse and valuation difficulties of the live burn donation. Specifically, Congress should limit (1) the maximum amount of the deduction allowed and (2) the length of time the taxpayer must allow the fire department and other municipal departments to train at the house.

1. The Maximum Amount of the Deduction Allowed

Due to the public perception of the live burn donation being another form of "wealthfare," Congress should consider limiting the amount of the charitable deduction allowed for a live burn donation.²⁷⁴ In doing so,

272. *Chart: Cheapest seat in the house*, RIVAL.COM, <http://collegefootball.rivals.com/content.asp?CID=1094191> (last visited Sept. 22, 2011).

273. Arguably, the donation is part of the season ticket price.

274. The amounts of the claimed charitable deduction were as follows: Rolfs (\$76,000), Hendrix (\$287,400), Vassos (\$622,825), Herbstreit (\$330,000), Dudley (\$350,000). *See also, e.g.*, Nigel Jaquiss, *Burning Down the House*,

Congress must find a balance between providing taxpayers with an incentive to donate their homes and limiting the deduction to the fire department's cost to purchase or construct a structure to conduct live-burn training.²⁷⁵

Two main approaches are (1) a percentage cap, similar to the season ticket exception, or (2) a specific dollar figure cap.²⁷⁶ In light of the valuation controversy that has arisen in determining the fair market value of the live burn donation structure the latter approach is easily administered and more effective.

Assume Congress opts to limit the maximum amount of a charitable deduction for a live burn donation to \$50,000. Despite a qualified appraisal establishing the fair market value of the home as \$200,000, the amount of the live burn donation would be \$50,000. In establishing the ceiling, Congress will be confronted the difficult task of determining the amount that will cost taxpayers the least, but still promote live burn donations. Any limitation must take into consideration the amount allowed as a deduction for deconstruction and relocation donations.

In 2010, the median and average square feet of floor area in a single-family home was 2,169 and 2,392 respectively.²⁷⁷ Based on a 2,200 square foot home, the total materials salvageable from the deconstruction of the home generally appraise for \$77,000 to \$112,000.²⁷⁸ Thus, in order to adequately compete with the major alternative of deconstruction, a cap of \$100,000 will most likely accomplish these goals.

WILLIAMETTE WK. (Oct. 6, 2010), http://www.wweek.com/portland/article-12555-burning_down_the_house.html (law professor and former IRS attorney posit there may be some justifiable deduction for home donations, but the \$350,000 deduction former gubernatorial candidate Chris Dudley took was too much); Jeff Mapes, *Dudley Defends \$350,000 Tax Deduction for Allowing Lake Oswego Fire Department to Burn Down a House He Owned*, OREGONLIVE.COM (Oct. 6, 2010, 6:43 PM), http://www.oregonlive.com/politics/index.ssf/2010/10/dudley_defends_350000_tax_dedu.html (Service's attorneys argued taking the full market value of a donated home as a deduction is too much).

275. See Wendy C. Gerzog, *From the Greedy to the Needy*, 87 OR. L. REV. 1133, 1133 (2008) (providing that when a taxpayer makes a charitable donation, "the loss of revenue to the government, and the corresponding gain to the taxpayer," should be less than "the benefit to the charity").

276. However, a different view is to have no cap at all asking oneself — should there be a different tax treatment for a taxpayer who donates \$350,000 in cash to a local municipality for the sole purpose of acquiring a structure for training purposes versus a taxpayer who donates a structure with an appraised fair market value of \$350,000 to the same local municipality for the sole purpose of being used in various trainings?

277. U.S. CENSUS BUREAU, MEDIAN AND AVERAGE SQUARE FEET OF FLOOR AREA IN NEW SINGLE-FAMILY HOUSES COMPLETED BY LOCATION (2010), <http://www.census.gov/const/C25Ann/sfttotalmedavgsqft.pdf>.

278. REUSE PEOPLE, *supra* note 268.

Finally, as part of the cap approach, in the example above, the fair market value of the live burn donation was used as the starting point. But considering the valuation controversy, using the taxpayer's adjusted basis in the home is more appropriate. Essentially, this will eliminate any valuation issue and ensure a taxpayer does not receive a deduction for more than his investment in the home. Under these guidelines, a taxpayer with an adjusted basis of \$300,000 would result in the value of live burn donation for purposes of the charitable deduction being \$100,000. Conversely, if the taxpayer's adjusted basis in the home was \$90,000, the value of live burn donation for purposes of the charitable deduction would be \$90,000.

2. The Time Limitation

In order for the live burn donation to provide the greatest benefit, it is essential for the fire departments and municipal departments to have an adequate amount of time to use the home for training. In *Rolfs*, the fire department had limited access to the house as the agreed upon turnaround time was a total of eleven days. While the fire department and numerous municipal departments did obtain a substantial benefit from the Rolfs' donation, arguably the benefit would have been greater had the home been made available for a longer period of time.

In determining the amount of time, there must be a balance between providing the fire department with adequate time to fully benefit from the live burn donation and avoiding any discouragement of live burn donations. While any length of time Congress ultimately chooses will be arbitrary, as there is no formula for determining this, a period in the range of three to six months is recommended. For purposes of this article, three months will be used, because the shorter the period, the more likely a taxpayer will be encouraged to consider a live burn donation as an option. Thus, in order for the taxpayer to claim a charitable deduction there must be a written contract allowing the fire department, and any other municipal department, to use the home for a minimum of three months before the home is to be burnt down. With that said, however, the fire department should have the option of using the home for a lesser period.

3. The Proposed Live Burn Donation Amendment

Thus, the following proposed legislation is recommended:

Special rule for certain real property transferred to or for the use of a fire department

(1) In general. For the purposes of this section, in the case of a live burn donation the amount described in paragraph (2) shall be treated as a charitable contribution.

(2) Amount described. For purposes of paragraph (1), the amount of the charitable contribution for a live burn donation is the lesser of:

(A) the taxpayer's adjusted basis (as described in section 1011) in the property described in paragraph (3)(A) donated as part of the live burn donation, or

(B) \$100,000.

(3) Live burn donation. For purposes of this paragraph, the term "live burn donation" means a:

(A) donation of any home, dwelling, building, or structure without donating the underlying land;

(B) to or for the use of an organization described in subsection (c)(1);

(C) for which, there is a written contract granting permission to a fire department and any other municipal departments (as described in subsection (c)(1)) to use the home, dwelling, building, or structure described in paragraph (3)(A) for a minimum period of three months (regardless of whether the organization uses the home, dwelling, building, or structure for a lesser period);

(D) resulting in the home, dwelling, building, or structure being demolished by fire; and

(E) such amount would be allowable as a deduction under this section but for the fact that the taxpayer receives (directly or indirectly) as a result of donating the home, dwelling, building, or structure (described in paragraph (3)(A)) demolition services.

Although not included in the suggested statutory language, an inflation adjustment might be appropriate. Ultimately, the government helps subsidize

invaluable training to a fire department at a cost less²⁷⁹ than the government could have purchased or constructed a similar structure. Thus, the live burn donation amendment acts as a subsidy to fire departments and other municipal departments resulting in a public benefit.

VI. CONCLUSION

The quid pro quo test serves a valuable purpose of making sure the government only subsidizes payments to charitable organizations that are truly donations and not situations where the taxpayer is merely purchasing good or services. It does so by only allowing a deduction for the excess of the payment to the charitable organization minus the benefit the taxpayer receives. It also requires the taxpayer to have knowledge he actually gave more to the charity than the fair market value of his return benefit. However, exceptions to the application of the quid pro quo test should be made when the benefit of the donation to the public substantially outweighs the benefit received by the donor. The public benefit exception should be used to encourage donations that otherwise would be underfunded, as is the case in live burn donations. Accordingly, Congress should enact legislation specifically allowing live burn donations, while recognizing the need for limitations given the perceived abuse and valuation difficulties of the live burn donation.

279. If a taxpayer was able to claim a charitable deduction for \$100,000, based on a twenty-eight percent tax rate, the maximum tax savings to the taxpayer (and thus the foregone revenue (cost) to government) would be \$28,000.