The Sum of its Parts: Reforming Charitable Donations of Partial Interests

SARAH B. LAWSKY*

I. INTRODUCTION

This Essay begins with a tax puzzle, and not the type of tax puzzle that can be solved merely by following a twisting path of cross references and allusions through the Code. It is a deeper puzzle: Why does the Code permit someone who donates property to a charity to take a deduction for that donation, but deny a deduction to someone who donates a partial interest in that same property?1 For example, someone who donates a building to a charity may be permitted to take a deduction for the fair market value of the building.2 But if instead of donating the entire building, that person permits the charity to use the building rent-free for a year, he cannot take any deduction.3 This is a rule of great practical significance, denying as it does charitable deductions for, among other things, permitting a charity to use real estate,4 providing a charity with an interest-free loan,5 and granting a charity a license to use a patent.6

The place to start when searching for a justification, or at least some justification, for a particular Code section is, of course, legislative history. But unfortunately, the only reason Congress gave for including the partial interest provision in the Code does not actually, on further investigation, provide a way to distinguish between partial interests and whole interests. Thus I will ruin this puzzle by revealing the an-

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1 IRC § 170(f)(3).
2 IRC § 170(a).
3 Reg. § 1.170A-7(a)(1).
4 Id.
5 Reg. § 1.170A-7(d)(Ex. 3).
swer up front: The provision denying a deduction for the charitable donation of partial interests is, I think, wrong. This rule is at best unnecessary and at worst inconsistent with other areas of tax law.

After this introduction, Part II describes the partial interest ban and then investigates two possible justifications for it. The first, that partial interests are difficult to value, is not true of all partial interests and if anything favors a limitation on the amount of the deduction available, not a complete ban on a deduction. The second, Congress’ supposed justification for the ban on charitable deductions for partial interests, the “double benefit” justification, fails to distinguish partial interests from whole interests. Thus neither concern justifies the ban.

Part III shows how the rule denying a deduction for the charitable donation of partial interests is inconsistent with the treatment of partial interests in other areas of tax law. Part IV explains how the law should be redrafted to address concerns about the donations of partial interests in a way consistent with the rest of tax law. Part V concludes.

II. The Unjustified Ban on Deductions for Charitable Donations of Partial Interests

As a general rule, a taxpayer who donates property to certain charitable organizations is permitted to take a charitable deduction for that donation,7 either a fair market value deduction (for property that would generate long-term capital gain if sold),8 or a deduction equal to the lesser of the property’s fair market value or its basis (for property that would generate ordinary income or short-term capital gain if sold).9 But a taxpayer who contributes a partial interest in property is permitted no deduction.10 This Part first examines what sorts of interests are covered by this rule, and then examines and finds inadequate two possible justifications for the partial interest ban.

7 IRC § 170(a).
8 Reg. § 1.170A-1(c)(1).
9 IRC § 170(c)(1) (requiring that deductions for the charitable donation property be reduced by the amount of gain that would not have been long-term capital gain if the property had been sold at its fair market value instead of contributed). For these purposes, § 1231 property, which includes depreciable property and real property used in a trade or business, is considered a capital asset. IRC § 170(e)(1) (flush language) (stating that property used in a trade or business, as defined in § 1231(b), is treated as a capital asset for purposes of determining whether a fair market value deduction is permitted), § 1231(a) (providing special rules for property used in a trade or business), (b)(1) (defining “property used in a trade or business” for purposes of § 1231 as including depreciable property used in a trade or business and real property used in a trade or business).
2010] THE SUM OF ITS PARTS 39

A. What Is a Partial Interest?

Although the subsection of the Code that contains the partial interest rule uses the phrase “partial interest” in its title, the text of the statute simply denies a deduction for “a contribution . . . of an interest in property which consists of less than the taxpayer’s entire interest in such property.”11 The explicit language of the statute provides only one example of such an interest: the right to use property.12 For example, a taxpayer who owns an apartment building and donates the use of one floor of that building to a charity for one year may not take a charitable deduction for the value of the use of the floor.13 The taxpayer would not receive a deduction even if he let the charity use the entire building for one year, because he did not donate his entire interest in the property.14

The right to use property may take such a central position in the statute because the statute was at least in part a response to Threlfall v. United States,15 which permitted a deduction for the charitable donation of the use of four rooms of a building. However, as the broad language of the statute suggests, the ban covers much more than simply donations of the right to use property.16 The right to future income is a partial interest for these purposes, as are, among other things, interest-free loans,17 voting stock if the donor retains the right to vote the stock,18 and a license to use a patent if the donor retains the right to license the patent to others.19

There are a few statutory exceptions to this very broad rule. A partial interest does not include an “undivided portion of the taxpayer’s entire interest in property,”20 that is, a portion of “each and every substantial interest or right owned by the donor in such property,” if the donation extends over the entire term of the donor’s interest in the property.21 There are also two substance-based exceptions to the

11 Id.
12 Id.
13 Reg. § 1.170A-7(d)(Ex. 1).
14 Reg. § 1.170A-7(a)(1); see, e.g., Rev. Rul. 89-51, 1989-1 C.B. 89 (denying a charitable deduction for the donation to a charitable auction of one-week’s use of a vacation home, on the grounds that “the gift of the right to use property is not a deductible contribution”).
17 Rev. Rul. 81-282, 1981-2 C.B. 78; see also text accompanying notes 67-68.
20 Reg. § 1.170A-7(b)(1)(i). For example, donating half a remainder interest held in trust is deductible, because half a remainder interest is an undivided portion of a donor’s
denial of a deduction for partial interests. Deductions are available for the donation of a remainder interest in a personal residence or farm,\textsuperscript{22} or of a qualified conservation contribution.\textsuperscript{23} Finally, taxpayers may take a deduction for the donation of a guaranteed annuity or a fixed percentage of the fair market value of the trust.\textsuperscript{24}

\section*{B. Unconvincing Justifications}

As this Section explains, the justifications for the partial interest ban are unconvincing. Valuing some sorts of partial interests may be difficult, but not all partial interests are difficult to value; moreover, the better way to address valuation concerns is to limit the deduction to basis, not to deny taxpayers a deduction altogether. And the only justification for the rule in either the legislative history\textsuperscript{25} or the legal literature\textsuperscript{26}—that the taxpayer receives a “double benefit” for the donation of a partial interest—does not actually distinguish partial interests from whole interests and, once again, can be resolved by limiting the amount of the deduction to the taxpayer’s recoverable basis in the property, as subsequent Parts show.

\subsection*{1. Valuation}

Donors who receive a charitable deduction equal to the fair market value of the donated property have a strong incentive to overvalue that property. And partial interests may be particularly susceptible to overvaluation, for at least two reasons. First, no market exists in some kinds of partial interests, and valuing anything in the absence of a market is difficult. Second, remainder interests may be particularly easy to overvalue, because donors may manipulate the retained interest, assuming the donor has no other interest in the trust property. Rev. Rul. 79-295, 1979-2 C.B. 349.

\begin{itemize}
\item \textsuperscript{22} IRC § 170(f)(3)(B)(i).
\item \textsuperscript{23} IRC § 170(f)(3)(B)(iii).
\item \textsuperscript{24} IRC § 170(f)(2)(B) (limiting deductions for the value of any interest in property (other than a remainder interest) transferred in trust to interests in the form of a guaranteed annuity and trust instruments that specify the interest is a fixed percentage distributed yearly of the fair market value of the trust property when the grantor is treated as the owner of such interests for § 671 purposes).
\item \textsuperscript{26} See, e.g., Scott Andrew Bowman & Danaya C. Wright, Charitable Deductions for Rail-Trail Conversions: Reconciling the Partial Interest Rule and the National Trails System Act, 32 Wm. & Mary Envtl. L. & Pol’y Rev. 581, 596 (2008) (“Denying a deduction for mere use prevents what was seen as, in essence, a double benefit for the taxpayer: the taxpayer reduced actual gross income by foregoing the income that the asset could have produced if not used by the charity, and the taxpayer also received a deduction in calculating taxable income for the same foregone income that the asset would have produced. In this sense, the foregone income was subtracted twice.”).
\end{itemize}
come stream to create more income now and leave less than the market might predict to the remainderman. Denying a deduction altogether, however, is not necessary to solve the valuation problem. A better solution is to limit the amount of the deduction to the donor’s appropriately taxed dollars already invested in the property—that is, to the donor’s basis.

Valuation is of course always difficult, particularly for assets that are not regularly traded. Valuing partial interests might be particularly difficult; for example, while it might be fairly easy to determine the market value of a used car, determining the market value of the use of that car a few days a week might be more difficult.27

Some kinds of partial interests also present a particular sort of opportunity for donors to overvalue property, because some donors may be in a position to manipulate the retained portion to reduce the value of the donated portion. For example, before 1969, donors of remainder interests used actuarial tables and an assumed interest rate to value those interests for charitable deduction purposes.28 This was not a terribly accurate way of valuing the interests, in part because donors of remainder interests could (and apparently did) manipulate the income stream produced by the property to increase the amount of current income and thus effectively reduce the value of the remainder interest, resulting in an inflated charitable deduction.29 To guard against such overvalued donations, Congress limited deductions for charitable donations transferred in trust to certain kinds of trusts30 and income interests (including annuities).31 As the House report explained, these requirements were meant to remove the incentive to favor the income beneficiary over the remainder beneficiary by means of manipulating the trust’s investment. The amount received each year by the income beneficiary must be either a stated dollar amount or a fixed percentage of the value of the trust property each year, in which case the amount the income beneficiary receives will vary directly with the type of investments made by the trust.32

28 Id.
30 IRC § 170(f)(2)(A) (permitting deductions for remainder interests transferred in trust only if the trust is a charitable remainder annuity trust, a charitable remainder unitrust, or a pooled income fund).
31 IRC § 170(f)(2)(B) (permitting deduction for interests other than remainder interests transferred in trust only if the interest is in the form of a guaranteed annuity or the interest is a fixed percentage of the fair market value of the trust).
The partial interest statute incorporates by reference this trust provision, permitting deductions for partial interests that “would be allowable as a deduction . . . if such interest had been transferred in trust.” Thus, although the legislative history of the partial interest subsection does not mention valuation, it seems reasonable to conclude that the partial interest ban is meant to address valuation problems, at least in part.

But denying a deduction in response to valuation concerns is too broad a response, for at least two reasons. First, some partial interests are easily valued and are not subject to manipulation to the benefit of the donor. For example, if nonvoting stock is publicly traded, it can be valued simply by checking stock exchange listings, and a taxpayer who donates voting stock to a charity but retains the right to vote the stock cannot manipulate the value of the stock to his own benefit. Such a donation is nonetheless caught up in the current partial interest rule, resulting in no deduction.

More generally, while determining the fair market value of property may be difficult, determining the basis of that property is not. Thus Congress has addressed valuation problems in the charitable donations context by limiting the deduction to the taxpayer’s basis. For example, in 2004, Congress changed the tax law to deny a fair market value deduction for certain intellectual property donated to charities precisely out of concern that donors of patents, copyrights, and other types of intellectual property overvalued such property to obtain outsized charitable deductions. As the legislative history explains: “[T]axpayers with intellectual property are taking advantage of the inherent difficulties in valuing such property and are preparing or obtaining erroneous valuations. In such cases, the charity receives an


34 See, e.g., G.C.M. 39,729 (May 23, 1988) (stating that one purpose of the partial interest ban can be “inferred from the fact that . . . it incorporates the safeguards of [the trust transfer provision] section 170(f)(2) [which was] intended to provide a closer correlation between the amount of a charitable contribution deduction and the value of the benefit received by charity”).

35 Rev. Rul. 81-282, note 18 (“While [the donor’s] retention of the right to vote the stock will not defeat [the donee’s] right to dividends or the right to dispose of the stock, and, while the right retained by the donor will not defeat the donee’s interest in the transferred property, nevertheless, [the donor] has not transferred all substantial rights in the stock to [the donee]. Therefore, [the donor] has transferred a partial interest in property to [the donee] within the meaning of section 170(f)(3) of the Code.”); see also Lawsky, note 27, at 1543 (explaining that permitting a deduction for a tax-free loan does not raise valuation problems because the market rate for money is easily available).

36 IRC § 170(e)(1)(B)(iii) (limiting the deduction for the charitable donation of “any patent, copyright . . . trademark, trade name, trade secret, know-how, software . . . or similar property, or applications or registrations of such property” to the lesser of the property’s basis or fair market value).
asset of questionable value, while the taxpayer receives a significant tax benefit."\textsuperscript{37}

Congress’ solution was not simply to deny all deductions for the donation of intellectual property; this would have been a serious blow to some charities. Instead, donors of intellectual property may deduct the basis of that property, rather than the fair market value; as the legislative history notes, “for other types of charitable contributions for which valuation is especially problematic—charitable contributions of property created by the personal efforts of the taxpayer and charitable contributions to certain private foundations—a basis deduction generally is the result under present law."\textsuperscript{38}

In short, some partial interests may be difficult to value, but limiting the amount of the charitable deduction to basis resolves the valuation problem while retaining some tax incentive for taxpayers to donate certain partial interests to charities.

2. Double Benefit

The second justification for the partial interest ban, and the only explicit justification in the legislative history, is that permitting a deduction for the donation of partial benefits would give donors a double benefit for their donation. This justification is somewhat more complicated than the valuation objection, and thus it is the subject of the balance of this Article. This Subsection explains why the double benefit justification is correct for some (but not all) partial interests, but nonetheless does not provide a reason to distinguish between partial interests and whole interests.

a. The Double Benefit Justification

Legislative history tells us that the denial of partial interest deductions is intended to prevent a double benefit for charitable contributions.\textsuperscript{39} As the House Committee on Ways and Means explained in 1969, the year the ban on deductions for the donation of partial interests was enacted:

\texttt{[I]f the individual owns an office building, he may donate the use of 10 percent of its rental space to a charity for 1 year. As a result, he may report for tax purposes 90 percent of the income which he otherwise would have had if the building was fully rented, and may claim a charitable deduction

\textsuperscript{38} Id.
Imagine, for example, a ten-floor building that rents for $100 per floor per year. If no deduction is permitted for the donation of partial interests, the owner is treated the same whether he donates use of a floor of the building for a year, or rents the floor and donates the cash he receives from that rental.

<table>
<thead>
<tr>
<th>Current Law</th>
<th>Income</th>
<th>Deduction</th>
<th>Taxable Income</th>
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<tbody>
<tr>
<td>Donate use of one floor</td>
<td>$900</td>
<td>$0</td>
<td>$900</td>
</tr>
<tr>
<td>Rent building, donate cash</td>
<td>$1000</td>
<td>($100)</td>
<td>$900</td>
</tr>
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In contrast, if the donation of a partial interest were deductible, the taxpayer who donated the use of one floor would not only escape $100 of rent (thus avoiding paying tax on that amount), but also would be able to use his $100 deduction to offset other income. Donating the use of the floor to charity thus would be preferable to renting the building and donating cash to the charity.

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40 H.R. Rep. No. 91-413, note 25, at 57-58. This example is not drawn from thin air. As discussed in the text accompanying note 15, the statute seems to have been at least in part a response to Threlfall v. United States, 302 F. Supp. 1114 (W.D. Wis. 1969), which involved the charitable donation of the use of a portion of a building. The Threlfall court permitted a deduction and rejected the government’s argument that if a deduction were to be permitted, the taxpayer should also be required to constructively recognize the income he would have received had he rented out the donated space, that is, that no net deduction should be permitted because to permit such a deduction would be to give the donor a double benefit. Id. at 1120 (“[T]he government asserts that if the plaintiff had leased the property to the Foundation, received the rent and then donated the rent back to the Foundation, the rental income would have been includable in plaintiff’s gross income, but would have been offset by a charitable deduction in the same amount . . . . The tax consequences here . . . should not be different merely because the property was donated rent-free directly to the Foundation.”). See G.C.M. 39,729 (May 23, 1988) (stating that the legislative history shows that “Congress agreed with the Service’s position that [a taxpayer who donates use of property] obtains a double benefit by being able to claim a deduction for the fair rental value of property and also exclude from income the receipts from the donated interest during the period of the donation. See, e.g., Threlfall . . . (which held against the Service’s position). The legislative solution was to permit the exclusion but deny a deduction”).

41 All examples assume that the individual taxpayer itemizes deductions and that the taxpayer’s total charitable donations do not exceed the charitable deduction cap. See IRC § 170(b) (limiting charitable contributions to a certain percentage of a taxpayer’s “contribution base”); see generally Miranda Perry Fleischer, Generous to a Fault? Fair Shares and Charitable Giving, 93 Minn. L. Rev. 165 (2008) (providing a theoretical justification for the cap on charitable donations).
THE SUM OF ITS PARTS

If Partial Interest Donations Were Deductible

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This is the same sort of reason that no charitable deduction is available for donating one’s services.\(^{42}\) As the Tax Court explained in a decision upholding the regulation that denies a deduction for services:

Physician A works without compensation for 1 day at a charitable hospital’s clinic. These services are valued at $500. Physician B works for 1 day at his or her usual practice, and contributes the day’s net fees (also $500) to the same hospital; the hospital uses that contribution to hire physician C to work for 1 day at its clinic. As an economic matter, A and B are even on the day’s work. The hospital has had the benefits of a day’s work from each of them (directly from A, indirectly from B). Yet, petitioner would have us declare that A is entitled to reduce his or her other taxable income by $500 (since A’s services for the hospital do not generate any taxable income for A) while B is in effect permitted only to offset the $500 of net fees received.\(^{43}\)

As the chart below suggests, to equalize the treatment of donating actual services and donating the value of services, the Code should deny a deduction for donated services. Physician A’s deduction, comes, in some sense, from not being compensated for the hours worked.

<table>
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<th>Deduction</th>
<th>Taxable Income</th>
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<tr>
<td>Physician A (does not work, donates time)</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Physician B (works one day, donates money)</td>
<td>$500</td>
<td>($500)</td>
<td>$0</td>
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If Physician A deducts the fair market value of her donated services, this deduction would offset “other . . . income.”\(^{44}\) Physician B, in contrast, can offset only the fees he received for his services. Thus,

\(^{42}\) Reg. § 1.170A-1(g).

\(^{43}\) Grant v. Commissioner, 84 T.C. 809, 818 (1985), aff’d, 800 F.2d 260 (4th Cir. 1986) (“Grant is not entitled to a deduction for the contribution of his services. The purpose of the regulation is to achieve similar results for taxpayers in similar circumstances.”).

\(^{44}\) Id.
to allow Physician A to deduct the fair market value of her donated services would result in an unjustified double benefit for Physician A.

<table>
<thead>
<tr>
<th>If FMV of Services Were Deductible</th>
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A taxpayer who donates to charity something that generates income—whether a building or his own skills—does not receive taxable income for the period for which it has been donated. This avoided taxable income, according to the double benefit justification, should be the extent of the tax benefit.

b. Why the Double Benefit Justification Proves Too Much

The double benefit justification is correct as far as it goes, but it does not support differentiating between the donation of partial benefits and the donation of whole benefits. All charitable donations involve a double benefit to the extent that the amount of a charitable deduction exceeds the amount of taxed dollars already invested in the donated property. To see why, imagine that instead of donating temporary use of all or part of a building to a charity, the taxpayer donates his entire interest in the building: He gives the charity a permanent right to the entire building and retains no present or future interest in the building. The donor’s charitable deduction equals the fair market value of the building, that 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.”

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45 See Greene v. United States, 864 F. Supp. 407, 413 (S.D.N.Y. 1994) (finding that the presence of a double benefit does not necessitate partial interest treatment; “the code does generally allow the kind of double benefit the Government is complaining about”), rev’d on other grounds, 19 F.3d 1348 (2d Cir. 1996).

46 See note 9.

47 Reg. § 1.170A-1(c)(2).
But, as has been recognized by cases, legal treatises, and experts in valuation, the fair market value of an asset incorporates the market’s estimation of the present value (PV) of the expected future income stream the asset will generate. That is, where the building would generate an income stream over \( n \) years, and the expected income generated in year \( i \) is designated by \( \text{Income}_i \), the fair market value of the building equals

\[
\sum_{i=1}^{n} PV(\text{Income}_i)
\]

To sell the building is to realize currently this future income stream. Someone who donates the property to charity instead of selling the building avoids realizing the future income stream. To be consistent with the reasoning that denies a deduction for the donation of partial interests, avoiding this income stream should be his charitable deduction. If the deduction for the fair market value of the building offsets income other than the income that would be realized on the sale of the building, the donor receives a double benefit.

Put another way, a taxpayer who donates use of a building for \( n \) years (where the building’s useful life is only \( n \) years) avoids income to the extent that the amount he receives exceeds his basis, which is usually the amount he paid for the property. This is because if the

48 E.g., United States v. Maginnis, 356 F.3d 1179, 1182 (9th Cir. 2004) (“Many assets . . . are typically valued on the basis of the present value of their future income stream . . . .”).

49 E.g., Boris Bittker, Martin McMahon & Lawrence Zelenak, Federal Income Taxation of Individuals ¶ 31.12[5] (7th ed. 2005) (“[S]ales of income-producing assets regularly serve to convert the present value of income streams into capital gains. If, for example, the taxpayer in . . . [Hort v. Commissioner, 313 U.S. 28 (1941)] had sold the building, the sales price would include the value of the favorable lease. Similarly, if the taxpayer in . . . [Commissioner v. P.G. Lake, Inc., 356 U.S. 260 (1958)] had sold its working interests, the sales price would reflect the present value of the periodic payments anticipated during the remaining life of the mineral deposit. In both cases, therefore, a portion of the sales proceeds could be viewed as a substitute for ordinary income; yet it is clear that neither Hort nor Lake intended to deny capital gain treatment in these routine sale situations.”).

50 E.g., Andrew Baum & David Mackmin, The Income Approach to Property Valuation 53 (3d ed. 1989) (“Valuation . . . [can be] summarised as the estimation of the future benefits to be enjoyed from the ownership of a freehold or a leasehold interest in land or property, expressing those future benefits in terms of present worth.”); Alfred M. King, Valuation 91 (2002) (“In the final analysis, an investment in any asset is worth no more than the present value today of the income to be derived in the future from that investment.”).

51 This is only roughly true, as the fair market value may also reflect a risk discount or premium, depending on the market’s taste for risk.

52 To be more specific, basis of a purchased property is determined by cost, IRC § 1012, but it may be adjusted subsequently; for example, it may be reduced by depreciation deductions, or increased by capitalizable expenses related to the property, IRC § 1016. See IRC § 1011(a).
taxpayer had sold the building instead of donating it, he would have recognized as taxable income his gain on the sale,\textsuperscript{53} where

\[ \text{Gain} = \text{FMV} - \text{Basis} \] \hspace{1cm} (1)

For example, a donor who donates a building with a fair market value of $100,000 and a basis of $10,000 avoids $90,000 of taxable income by donating his property to charity, and he also offsets $100,000 of other income.\textsuperscript{54} (Of course, if his property is not appreciated, he avoids no taxable income.)

But the fair market value of the building is, as already discussed, the present value of the expected future income stream, or

\[ \sum_{i=1}^{n} PV(\text{Income}_i) \]

where the building has a useful life of \( n \) years.

So we can rewrite Equation (1) as

\[ \text{Gain} = (\sum_{i=1}^{n} PV(\text{Income}_i)) - \text{Basis} \]

For example, saying that property is worth $100,000 simply means that the expected present value of all future income generated by the building is $100,000. Thus the taxpayer who donates this building receives a double benefit for his donation to the extent that the fair market value of the building exceeds his basis. If, for example, the taxpayer's basis in the property is zero, selling the building and donating cash provides a much less favorable result than simply donating the building.

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<tr>
<td>Donate building</td>
<td>$0</td>
<td>($100,000)</td>
<td>($100,000)</td>
</tr>
<tr>
<td>Sell building, donate cash</td>
<td>$100,000</td>
<td>($100,000)</td>
<td>$0</td>
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\textsuperscript{53} See IRC § 61(a)(3) (income includes “\[g\]ains derived from dealings in property”), § 1001(a) (“The gain from the sale . . . of property shall be the excess of the amount realized therefrom over the adjusted basis . . . for determining gain . . .”).

Now consider the scenario in which the taxpayer donates use of the building for \( n \) years (where the building generates income only over \( n \) years). Had he continued to receive rent, rather than donating use of the building, his taxable income would not have increased by the full amount of rent paid. Rather, just as his income on the sale of the building is offset by his basis, so his taxable income if he rents the building is reduced by depreciation. \(^{55}\) If he donates use of the building for \( n \) years, each year he avoids some amount of rent, less some amount of the remaining basis. So, looking forward from the current year, over \( n \) years he avoids

\[
\sum_{i=1}^{n} PV(Income_i - Depreciation_i)
\]

\[= \sum_{i=1}^{n} (PV(Income_i) - PV(Depreciation_i)) \]

\[= \sum_{i=1}^{n} PV(Income_i) - \sum_{i=1}^{n} (Depreciation_i) \]

\[= FMV - \sum_{i=1}^{n} PV(Depreciation_i) \]

For example, if \( n = 25 \) (that is, the building will generate income for twenty-five years and will be fully depreciated in twenty-five years), and the present value of the depreciation deductions is $20,000, the donor avoids $80,000 of income ($100,000 – $20,000) by donating the use of his building for twenty-five years. \(^{56}\)

The difference between avoiding income from property over a period of years and avoiding income from the sale now, at least when it comes to depreciable property, is thus simply the difference between deducting basis currently and deducting basis over a period of years—that is,

\(^{55}\) See IRC § 167(a) (permitting a depreciation deduction for the “exhaustion, wear and tear” of property used in a trade or business or held for the production of income).

\(^{56}\) This assumes economic depreciation where an asset is fully depreciated only when it no longer has any value. Under current tax law, depreciation is generally extremely accelerated. See, e.g., IRC § 168 (permitting accelerated depreciation, including, for example, a 50% write-off in the first year for certain property, § 168(k)), § 179 (permitting a 100% write-off in the first year for certain property purchased by small businesses). This increases the present value of the depreciation deductions and therefore reduces the double benefit.
Taxable rental income – Taxable gain from sale

\[ \sum_{i=1}^{n} PV(\text{Income}_i - \text{Depreciation}_i) - (\text{FMV} - \text{Basis}) \]

\[ = (\text{FMV} - \sum_{i=1}^{n} PV(\text{Depreciation}_i)) - (\text{FMV} - \text{Basis}) \]

\[ = \text{Basis} - \sum_{i=1}^{n} PV(\text{Depreciation}_i) \]

The difference between these the two types of charitable deduction is merely the difference in cost-recovery methods. The double benefit argument provides no reason for a different result if the building is donated for fewer years than the building’s total useful life—that is, it provides no reason why there should be a different treatment simply because the building is donated for \( m \) years, where \( m < n \), and the taxpayer thus avoids income equal to

\[ \sum_{i=1}^{m} PV(\text{Income}_i) \]

Return to the office-building owner. If he donates the use of 10% of the building’s rental space to a charity for one year, he cannot take a deduction. Why? Because, the legislative history tells us, he excludes “10 percent of the amount which would have been included in his income if the property had been rented to a noncharitable party.”\(^{57}\) Indeed, under this reasoning, he cannot take an annual deduction for the forgone income even if he donates the use of 100% of the rental space to a charity for ten years, because he is excluding 100% of the amount that would have been included in his income if the property had been rented to a noncharitable party. But permitting a taxpayer to deduct the fair market value of the property is the same as permitting him to deduct the present-valued income stream. The double benefit argument does not give us a reason why the result should be any different if, instead of (not) taking a deduction each year, he present-values the entire stream of income.

The double benefit distinction between the taxpayer who donates a partial interest and the taxpayer who donates a complete interest is thus one only of degree, not of kind. A fair market value deduction for donation of a partial interest provides a double benefit, but no

more of a double benefit than any charitable deduction of property with a fair market value that exceeds its basis. It is true that donating a partial interest in property permits a taxpayer to avoid income, and that permitting a fair-market-value charitable deduction for that donation could allow him to offset other income as well, unrelated to the donated partial interest. But all property represents a potential future income stream; donating that property always permits the taxpayer to avoid that future income stream, and any deduction for that donation in excess of his previously taxed investment in that property (that is, his basis) permits him to offset other income unrelated to the donated property.

In short, the double benefit justification for the ban on deductions for the donation of partial interests, while correct as far as it goes, provides no reason to deny a deduction for the charitable donation of partial interests but permit a deduction for the donation of whole interests.

III. THE MANY FACES OF PARTIAL INTERESTS

As the prior Part described, the double benefit justification does not distinguish between partial interests and whole interests, because permitting a fair market value deduction for a charitable donation always results in a double benefit to the extent that the fair market value of the property exceeds the property’s basis. The double benefit stems from the income avoided by the donation of the property, as opposed to its sale. Thus one possible, very rough, justification for the partial interest rule could be that the sale of a partial interest results in no basis recovery, and thus the entire amount of the donation constitutes a double benefit. In contrast, a fair market value deduction for a whole benefit would result in only a partial double benefit, because the double benefit would include only the amount of the deduction in excess of the property’s basis. But, as this Part shows, while disposition of some sorts of partial interests results in no cost recovery, cost recovery is currently permitted on the disposition of other partial interests.

A. At the Intersection of No Deduction and Cost Recovery: The Right to Future Income and Interest-Free Loans

No cost recovery is permitted on the disposition of certain kinds of partial interests, including the right to future income. The sale of the right to future income, such as the right to receive revenue generated by the sale of oil from an oil well, results in taxable income of the entire amount received, not offset by any prior taxed dollars invested
in the property.\textsuperscript{58} Additionally, the sale of the right to future income results in ordinary income, not capital gain.\textsuperscript{59} For example, a taxpayer who sold the right to receive $600,000 of revenue from an oil well for $600,000 would have $600,000 of ordinary income.\textsuperscript{60} Thus, if this taxpayer donated the right to receive revenue to a charity, he would avoid a full $600,000 of taxable income. If he were permitted to take a $600,000 fair market value deduction as well, he would receive $600,000 in double benefit. Denying a deduction for the donation of the right to future income thus accurately addresses Congress’ concern about the double benefit.

Similarly, imagine a taxpayer who loans $10,000 to a charity for ten years at 10% interest. He would have $1000 interest income a year; if he donated that amount back to the charity, he would have a $1000 deduction. This would provide him with no net benefit. If the taxpayer instead loaned $10,000 to the charity interest-free, he also should have no net benefit. Put another way, the donated portion is the amount of the forgone interest; in order for that amount to have any basis, the taxpayer would first have to include it in his income. He could recover cost only if he first had tax cost. Thus the current treatment—denying a deduction—precisely avoids a double benefit.

\textbf{B. Partial Cost Recovery: The Right to Use Depreciable Property}

Perhaps ironically, Congress’ core example used to justify the partial interest rule\textsuperscript{61} is not quite correct. The use of property is another type of partial interest (as the term is used for the purpose of the charitable deduction partial interest rule), but renting out property provides a slightly different result than does selling the right to receive future income or providing an interest-free loan. Rent is, of course, ordinary income. But a taxpayer who rents out property may, in some situations, take depreciation deductions on that property. Some cost recovery is permitted when the partial interest in question is the right to use certain types of property.

This is analogous to the treatment of services under current law. An individual does not offset his services income by some sort of “basis” in himself, but he is permitted to offset services income by business-related out-of-pocket expenses.\textsuperscript{62} Under current law, the donor of services may offset his other income not by the full fair market value of his services, but by the amount by which he would have been

\textsuperscript{58} Hort v. Commissioner, 313 U.S. 28 (1941).
\textsuperscript{60} Id.
\textsuperscript{61} See text accompanying note 40.
\textsuperscript{62} See IRC §§ 162, 212.
able to offset any services income. Specifically, an individual who donates services to charity may treat as a charitable contribution those expenses arising from that donation (such as, for example, transportation expenses or the cost of a uniform).  

Return to the office-building owner. Recall that he can lease a floor of his building for $100. But he does not actually have $100 of taxable income; because he recovers his investment over time, he includes in his taxable income $100 reduced by the amount of depreciation he would be able to take on that floor—$2, say, for a total of $98. So if he donates the floor to charity instead of leasing it, he does not avoid $100 of income. Rather, he avoids $98 of income. Denying him a deduction altogether does not merely prevent a double benefit; it also takes away from him the $2 of cost recovery he would have otherwise had, which we might call a “single benefit.”

To prevent a double benefit, the law therefore should not deny the taxpayer a deduction altogether; rather, it should permit a taxpayer a charitable deduction equal to the amount of depreciation he would have been able to take had he not donated the property. Depreciation is another way to recover basis, another version of reducing gain on disposition by the amount of basis. To prevent a double benefit, only the avoided income need be disallowed.

C. Cost Recovery: No-Vote Voting Stock and Stripped Bonds

Other types of partial interests provide even more striking examples of the mismatch of the partial interest rule with the rest of the Code. As explained above, no basis recovery is associated with the disposal of many kinds of partial interests. Denying a deduction thus perfectly

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63 Reg. § 1.170A-1(g).
64 See text accompanying note 41.
65 Under current law, an owner who permits a charity to use the floor of the office building for free may not take a depreciation deduction for the portion of the building used by the charity. Depreciation is permitted only for property used in a trade or business or held for production of income, and donated property is used for neither purpose. See, e.g., Thriftimart, Inc. v. Commissioner, 59 T.C. 598, 616 (1973) (“Section 167 allows a deduction for depreciation of property used in the trade or business or held for the production of income. Petitioner did not use the premises donated to the Salvation Army in its trade or business and did not hold that property for the production of income. Rather, petitioner chose to donate the property by means of a charitable lease for the use of the Salvation Army.”). Permitting depreciation for donated property would not be precisely equivalent to permitting a charitable deduction equal to the forgone depreciation for technical reasons unrelated to the core concepts here. For example, charitable deductions, unlike depreciation deductions, are taken below the line (that is, are itemized deductions), so charitable deductions are unavailable to taxpayers who do not itemize. See IRC §§ 62(a), 63(d).
66 See text accompanying notes 55-56.
avoids a double benefit for donors of many types of partial interests—it is neither over- nor underinclusive. But some property that qualifies as a partial interest under the partial interest rule could result in complete cost recovery if sold.

For example, the IRS takes the position that the partial interest rule prevents a deduction for the donation of stock to a charity if the donor retains “substantial” rights in the stock, including the right to vote the stock.\(^67\) This is, however, inconsistent with the treatment of a stock sale in some other situations. A taxpayer who holds stock for investment and sells that stock while retaining only the right to vote the stock will under some circumstances recover his full basis on the sale.\(^68\) A taxpayer who sold the stock and donated the proceeds to charity therefore would have full basis recovery, whereas a taxpayer who donated the stock to charity would receive no deduction at all. For example, a taxpayer who sold stock with a $10 basis for $100 and bargained with the purchaser to retain voting rights would have gain in the amount of $90 if a true sale occurred. If he then donated the $100 to charity, he would take a $100 deduction, for a net benefit of $10. In contrast, if he donated the stock sans voting rights to charity, he would receive no deduction at all. Denying a fair market value deduction for the donation of stock stripped of voting rights is overbroad if the goal is avoid a double benefit. The donor would avoid only the excess of the fair market value of the stock sans voting rights over the basis in that stock ($90, in this example).\(^69\) This excess is the only double benefit.

Similarly, under the current rule, it is possible that a taxpayer who donates stripped coupons to a charity will receive no deduction for that donation. But this is inconsistent with the treatment of stripped coupons for other purposes. The law specifically requires basis to be allocated to the right to interest payments on bonds, if those interest payments (or “coupons”) are sold separately from the underlying bond (that is, the right to receive the ultimate payment of principal).\(^70\)

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\(^67\) Rev. Rul. 81-282, note 18.

\(^68\) Compare Lowe v. Commissioner, 44 T.C. 363 (1965) (finding a completed sale that resulted in capital gain and basis recovery notwithstanding that the seller retained the right to vote the stock, because such retention was only a security device and the seller intended to make a sale), with Evans v. Commissioner, 63 T.C.M. (CCH) 3001 (1992) (finding no completed sale, and requiring the “seller” to recognize ordinary income, when the seller retained the stock certificates and voting rights because the seller believed the buyer might not have the means to complete the sale).

\(^69\) Contrary to what some courts have found, a better conceptual approach might be to allocate some basis to the right to vote the stock. For a general discussion of the issue of when and how to allocate basis, see Stephen B. Cohen, Apportioning Basis: Partial Sales, Bargain Sales and the Realization Principle, 34 San Diego L. Rev. 1693 (1997).

\(^70\) IRC § 1286(b)(3).
This rule was enacted because taxpayers were taking advantage of the rule that no basis recovery was permitted on the sale of a partial interest that constituted a right to future ordinary income.71 Specifically, taxpayers would separate interest payments associated with Treasury bonds from the right to the principal on the bonds.72 Under old law, the entire tax basis was allocated to the right to the repayment of the principal, so the taxpayer would sell the right to repayment of the principal to trigger a large tax loss.73 (The loss of course would later be offset by a gain, when the rights to the coupons were sold; the abuse was a timing play.) In response, Congress in 1984 added § 1286,75 which requires taxpayers to allocate basis between the stripped coupons and the right to the principal.

To understand how the bond stripping rules work, imagine that a taxpayer has a $1000 bond with a basis of $1032 that bears interest at 10% payable semiannually.76 The market for bonds changes so that the fair market value of interest coupons ten years before the bond matures is $709, and the fair market value of the stripped bond (that is, the right to $1000 in ten years) is $500.77 The fair market value of the unstripped bond is therefore $1209. Assume as well that the taxpayer wishes to donate the coupons to a charity.

If the taxpayer sold (rather than donated) the coupons, he would have a very different result than if he sold another sort of right to future income. Section 1286 departs from the usual treatment of partial interests and allocates to the right to future income (that is, the stripped coupons) a portion of the bond’s basis.78 In the example, the overall basis of the property of $1032 would be allocated between the coupons and the stripped bond in accordance with their relative fair market values. The basis of the stripped coupons would be $605,79 and thus the taxpayer would recognize $104 on the sale of the coupons ($709 - $605). In contrast, if § 1286 did not exist, the taxpayer would be required to recognize the full fair market value of the right to fu-

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72 Id.
74 See, e.g., Joseph P. McGrath, Coupon Stripping Under Section 1286: Trees, Fruit, and Felines, 38 Tax Law. 267, 269 (1985) (stating that the coupon stripper “would later realize ordinary income upon the sale or retirement of the interest coupons,” but that “he would have deferred tax liability by the basis allocation”).
76 This example is a simplified version of the example in Boris Bittker & Lawrence Lokken, Federal Taxation of Income, Estates, and Gifts ¶ 56.6.1, Ex. 56-3 (2009).
77 This is equivalent to a bond with 7.05% interest payable semiannually.
78 IRC § 1286(b)(3).
79 $605 = $709/$1209 x $1032.
ture income represented by the coupons if he chose to strip those coupons from the bond and sell them separately.

Denying a fair market value deduction for the donation of stripped coupons is thus too broad. As with stock, the income avoided by donating the coupons to charity is simply the excess of the fair market value of the coupons over the basis allocated to them—$104, in the above example. There is a double benefit only to the extent of $104.

Indeed, this result is so different from the results for the disposal of most sorts of partial interest that it is possible that coupons stripped from a bond would not constitute a partial interest for purposes of the charitable deduction rules. If current law persists, the IRS should probably take this approach, particularly given that the purchaser of a stripped bond or stripped coupon treats that bond or coupon as a bond issued on the date of purchase.80

The ruling with regard to stock donated with retained voting rights does not give great hope that the IRS would reach the correct conclusion with regard to stripped coupons. Moreover, although there appears to be no law directly on point addressing the stripped-coupon question, one letter ruling suggests, although does not hold, that the partial interest rule would apply to stripped bonds.81 According to this ruling, § 1286 does not apply to certain donated debentures because the holders of stripped coupons would receive payment even if the debenture’s principal is prematurely discharged, and the principal and coupon receipts thus constitute separate evidences of indebtedness, not interrelated ownership interests.82 The ruling then goes on to say that because the principal and coupons are separate evidences of indebtedness, the partial interest rule will not apply.83 This suggests that, at least under the logic of this ruling, § 1286 applies only if the principal and coupon receipts are interrelated ownership interests, and that if the principal and coupon receipts are interrelated, the partial interest rule will apply, which seems a curious result at best.

The partial interest ban, which completely denies a deduction for the donation of partial interests, seems particularly inappropriate for the donation of “partial interests” whose sale results in complete basis recovery.

IV. A Better Rule

Denying a deduction for the donation of partial interests is too drastic a response to the problems attendant to such donations. A better

80 IRC § 1286(a).
81 Ltr. Rul. 8939014 (June 30, 1989).
82 Id.
83 Id.
approach is to limit the deduction to the amount of cost recovery available if that property were sold instead of donated. This proposed rule would solve both the valuation concern and the double benefit concern, because a charitable deduction results in a double benefit only to the extent that a sale of the donated property would result in taxable income.

As it happens, implementing such a rule would be extremely simple: All that is necessary is to repeal the current rule that denies any deduction for the donation of partial interests. The rule for the charitable donation of ordinary income property is designed to address valuation concerns and also perfectly addresses the double benefit problem. This Part first explains the rule governing deductions for the donation of ordinary income property, and then shows how that rule would apply to the donation of partial interests.

A. The Cost Recovery Rule: Charitable Donations of Ordinary Income Property

Limiting the deduction for the donation of ordinary income property to cost recovery (and hence a single benefit for the donor) and addressing valuation concerns were not the original goals of the current rule for the donation of ordinary interest property. Rather, Congress drafted the law to address the possible advantages of using a charitable donation to avoid gain that would be taxed at a high rate (the highest marginal rate in 1969, when this provision was added to the Code, was 70%84). As the legislative history points out, at the time the rule was added to the Code, a taxpayer could do quite well by donating low-basis, high-value ordinary income property to a charity:

[A] taxpayer in the 70-percent tax bracket could make a gift of $100 of inventory ($50 cost basis) and save $105 in taxes (70 percent of the $50 gain if sold, or $35, plus 70 percent of the $100 fair market value of the inventory, or $70). The committee does not believe that the charitable contributions deduction was intended to provide greater—or even nearly as great—tax benefits in the case of gifts of property than would be realized if the property were sold and the proceeds were retained by the taxpayer. In cases where the tax saving is so large, it is not clear how much charitable motivation actually remains.85

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The statute does not state that the deduction is limited to basis, but rather reduces the amount of charitable deduction by the amount of income that, if the property were sold instead of donated, would not be treated as long-term capital gain.\textsuperscript{86}

While lower marginal rates now make impossible an actual gain from a charitable donation,\textsuperscript{87} lower rates do not remove the double benefit that arises from donating appreciated property, a problem that the current statute also addresses (perhaps accidentally). A taxpayer’s basis in property equals the amount of appropriately taxed dollars invested in that property. Appreciated property is simply property whose fair market value exceeds its basis. Put another way, because a taxpayer recognizes gain on sale equal to the excess of the property’s fair market value (which is, presumably, the amount realized on sale) over the taxpayer’s basis in that property,\textsuperscript{88} the taxpayer’s basis must equal the difference between fair market value and gain on sale.\textsuperscript{89} Reducing the amount of the charitable donation by the amount of gain recognized (other than long-term capital gain) is therefore the same, for assets that generate income taxed at ordinary rates when sold, as limiting the deduction to basis.

Because the current statute means that a charitable donation of ordinary-income or short-term capital gain property results in cost recovery (and only cost recovery), a donor of such property cannot receive a double benefit for his donation. For example, imagine that a taxpayer is considering donating ordinary-income property that is worth $100 and has a basis of $10. If the taxpayer sells the property, he triggers $90 in taxable gain (the fair market value of the property less the basis). This is the amount of gain he avoids when he donates the property to a charity instead of selling it. When he donates the property to charity, the statute requires him to reduce his deduction by precisely this amount. His remaining $10 deduction ($100 - $90) represents a single benefit only. This approach therefore precisely ad-

\textsuperscript{86} IRC § 170(e)(1)(A) (“The amount of any charitable contribution of property otherwise taken into account under this section shall be reduced by . . . the amount of gain which would not have been long-term capital gain . . . if the property contributed had been sold by the taxpayer at its fair market value . . . .”).

\textsuperscript{87} The maximum benefit possible now would be 70% of the fair market value. A taxpayer in the top bracket pays tax at a 35% marginal rate. IRC § 1. If he made a gift of $100 of inventory with a zero basis, and the tax law permitted a fair market value deduction for ordinary income property, he would save $70 in taxes: 35% of the $100 gain if sold, or $35, plus 35% of the $100 fair market value of the inventory, or 35%. The maximum benefit possible (that is, the benefit available for donating zero-basis property and receiving a full fair market value deduction) will always be twice the tax rate times the fair market value, so it is not possible to make a profit until the top tax rate exceeds 50%.

\textsuperscript{88} IRC § 1001.

\textsuperscript{89} Because Gain = Amount Realized – Basis under § 1001, Basis = Amount Realized – Gain.
dresses the concern Congress raised about the double benefit that would result from the donation of a partial interest.

Limiting the charitable deduction to the amount of cost recovery if the property been sold rather than donated thus resolves the double benefit concern as well as the valuation concern. Indeed, it is difficult to understand why this approach is not used with all property, including capital gain property. A rule that eliminated a double benefit for the donation of all property would simply say that the amount of the deduction should be reduced by any gain that would result from the sale of the property, instead of limiting the reduction to the amount of income other than long-term capital gain that would result from the sale.

A. Applying the Cost Recovery Rule to Partial Interests

As this Section shows, the ordinary income cost recovery rule provides the conceptually correct answer for each type of partial interest. For example, because of the way the statute is currently drafted (that is, because the statute operates by reducing the amount of a deduction by the amount of ordinary income that would result from the sale of the donated property), repealing the partial interest rule would have no effect on the donation of the right to future income. As explained above, the sale of the right to future income results in ordinary income with no cost recovery (that is, no offset for basis). If the partial interest rule were repealed, the statute would still require reducing the amount of the deduction by the full fair market value of the donation, and thus result in no net deduction.

For the same reason, repealing the partial interest rule would result in no change in the treatment of interest-free loans. Recall the taxpayer who loans $10,000 to a charity interest-free for ten years. If he charged the charity 10% interest, he would have $1000 interest income a year; if he donated that amount back to the charity, he would have a $1000 deduction. If the partial interest rule were repealed, the taxpayer would still receive no deduction for his forgone interest, because he would not have included it in his income and it would thus have no basis. Without a basis to recover, the sale of the forgone interest would result in $1000 of ordinary income a year, which would reduce the amount of the charitable deduction to zero.

Mere repeal of the partial interest ban is neither necessary or sufficient to change the treatment of the use of donated depreciable property, but regulations probably could permit a charitable deduction

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90 See, e.g., Halperin, note 54 (arguing against a fair market value deduction for the donation of capital gain property).
equal to depreciation for the portion of depreciable property used for charitable purposes, just as current regulations permit a charitable deduction for out-of-pocket expenses for services donated to charity.91

Stock sans voting rights and stripped coupons are perhaps the most striking cases, because repeal of the current partial interest rule would significantly change the treatment of the donor of both types of interest. Not only, as discussed above, does sale of stock or of stripped coupons involve basis recovery, but in addition, these sales can result in long-term capital gain if the original underlying asset was a capital asset in the seller’s hands.92 Thus, because no ordinary income would result from the sale, the donation of the amount of the fair market value would not be reduced, and a taxpayer who donated stock sans voting rights or stripped coupons would be permitted to take a deduction for the full fair market value of the donated asset, resulting in a double benefit if the property’s fair market value exceeded its basis.

But the double benefit occurs not because the donated property is a partial interest, but rather because the partial interest is reclassified to generate capital gain. In other words, this is a problem with the rule that permits a fair market value deduction for the donation of capital assets, not a problem with the donation of partial interests. The case for repeal of the double-benefit capital asset rule has been made convincingly elsewhere,93 and that rule, not the partial-interest nature of the stock or the stripped coupons, is the source of the double benefit here.

B. Why Revising the Partial Interest Rule Matters

One might reasonably wonder whether the partial interest rule is worthy of sustained attention. What is really at stake here? As discussed, most kinds of partial interest generate ordinary income when sold and permit of no basis recovery, so no deduction would be available for donation of these interests even under the general charitable deduction rules. If repealing the rule would make no bottom-line difference for most types of partial interests, perhaps Congress’ time

91 Reg. § 1.170-2(a)(2).

92 With regard to stripped bonds see, e.g., Bittker & Lokken, note 76, ¶ 56.6.1 (“The stripper’s gain on the sale of the coupons . . . is capital gain if the unstripped bond was a capital asset in the stripper’s hands.”); Kevin Keyes, Federal Taxation of Financial Instruments and Transactions ¶ 10.03[2][a][iii] (2009) (“[T]he better view is that the recognized gain or loss is capital in nature to the same extent as if the entire bond . . . were sold to the buyer.”); McGrath, note 74, at 286-87 (“[A] proper reading of the legislative purpose would characterize the stripped coupon in the hands of a stripper as a capital asset if the bond is so characterized.”).

93 Halperin, note 54.
would be better spent addressing other, more important provisions of the Code.

There are, however, at least two reasons why the partial interest rule matters. First, the rule is costly precisely because it is so difficult to justify. Lawyers who face questions about this provision from their clients spend time trying to explain or justify or work around the rule, and this costs their clients money. In short, a portion of the Code that does not fit with the rest, whether because it is redundant or because it is inconsistent, creates transaction costs.

Second, the partial interest rule is inconsistent with the way some kinds of partial interests are treated in the rest of the Code, and this disparate treatment may distort taxpayers’ choices. For example, as discussed, stripped coupons are usually a capital gain asset, and disposing of stripped coupons results in cost recovery, but the IRS may take the (perhaps erroneous) view that the partial interest provision does not respect this treatment of stripped coupons.\(^\text{94}\) A taxpayer choosing between donating stripped coupons to a charity (and receiving no charitable deduction) and donating some other capital gain asset to the charity (and receiving a fair market value deduction) probably will choose to donate the other capital gain asset. Tax considerations may be the crucial factor in the donor’s decision, not, for example, whether the charity would prefer the stripped coupons, or whether the taxpayer would prefer, for personal reasons, to retain the other capital gain asset (perhaps the taxpayer has reason to think that this other asset will appreciate rapidly or it, unlike the coupons, has some sentimental value to him).

V. Conclusion

Current law denies a deduction for the charitable donation of partial interests, but, as this Article shows, there is no sensible justification for this ban. The partial interest provision is either unnecessary (for some types of partial interests) or inconsistent with other tax law (for other types of partial interest), and as a result the rule may increase transaction costs and distort taxpayer behavior. The partial interest rule therefore should be repealed, and deductions for donations for partial interests should be governed by the general rules for charitable deductions.

\(^{94}\) See Section III.C.
62

TAX LAW REVIEW