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A Tax Deduction for Direct Charitable Transfers: The Case Against Davis v. United States, 861 F.2d 558 (9th Cir. 1988)

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A TAX DEDUCTION FOR DIRECT CHARITABLE TRANSFERS: THE CASE AGAINST *Davis v. United States,* 861 F.2d 558 (9th Cir. 1988).

Abstract: Monetary transfers to charitable service providers may be deductible either as charitable contributions or as unreimbursed expenses. Whether a charity must possess the transfer to establish the charity control necessary to effect a charitable deduction is an unresolved issue. Using direct transfers to Mormon missionaries in *Davis v. United States* as an example, this Note concludes that direct transfers to service providers should be deductible and proposes a test for determining when charity control is sufficient without possession.

Congress has provided a tax deduction for charitable contributions,[1] but specifically has prohibited a deduction for transfers of money directly from one taxpayer to another to cover the transferee's living costs.[2] When the recipient of a transfer is a charitable service provider, however, the question arises whether the transfer is deductible as a charitable contribution. This issue is illuminated by cases involving direct monetary transfers to missionaries of The Church of Jesus Christ of Latter-Day Saints ("Mormon Church").

The Mormon Church operates a worldwide missionary program with 25,000 missionaries serving at any given time.[3] Young men apply to become missionaries, and, if found worthy by the Church, are "called" to serve for a period of two years.[4] The Church does not pay for a missionary's expenses. Instead, after a missionary is called, the Church determines where the missionary is to be sent, solicits financial support from the missionary's parents, suggests a sum it deems appropriate for the area in which the missionary will serve, and requests that payments be made directly to the missionary.[5]

1. *See* I.R.C. § 170 (West 1988 & Supp. 1989).
2. *Id.* § 262.
3. *See* Davis v. United States, 861 F.2d 558, 559 (9th Cir. 1988).
4. A Mormon missionary's primary duty is to propagate the Mormon faith.
5. *Davis,* 861 F.2d at 560. The Mormon Church believes its direct payment scheme promotes several worthy objectives: It encourages frugality by making the missionaries aware of their families' sacrifice, it involves the family directly in an important Church program, and it relieves the Church of a costly administrative burden. *Id.*

The Mormon Church strictly regulates a missionary's expenses and activities. Missionaries are admonished to spend money only for missionary work, and are required to explain their expenses in weekly reports to their Mission President. In addition, each missionary is expected to dedicate at least 75 hours per week to Church service. Dating and attending movies or plays is prohibited. *Id.* at 559.

In *Davis v. United States,*[6] the Ninth Circuit Court of Appeals held that Section 170 of the Internal Revenue Code[7] ("I.R.C.") did not provide taxpayer parents a charitable deduction for the payments made to their two missionary sons.[8] The court held that the payments were not deductible either as charitable contributions, because the Mormon Church never possessed the payments,[9] or as charitable unreimbursed expenses, because the taxpayers themselves had not performed the charitable service.[10]

6. *Id.*

7. I.R.C. § 170 (West 1988 & Supp. 1989); *see also* Treas. Reg. § 1.170A-1(g) (1986). Section 170 provides, in pertinent part:

(a) ALLOWANCE OF DEDUCTION.—

(1) GENERAL RULE. - There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.

. . . .

(c) CHARITABLE CONTRIBUTION DEFINED - For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of —

. . . .

(2) A corporation, trust, or community chest, fund, or foundation —

. . . .

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

I.R.C. § 170 (West 1988 & Supp. 1989).

Treasury Regulation § 1.170A-1(g) provides in pertinent part:

(g) Contribution of services. No deduction is allowable under section 170 for a contribution of services. However, unreimbursed expenditures made incident to the rendition of services to an organization contributions to which are deductible may constitute a deductible contribution. For example, the cost of a uniform without general utility which is required to be worn in performing donated services is deductible. Similarly, out-of-pocket transportation expenses necessarily incurred in performing donated services are deductible. Reasonable expenditures for meals and lodging necessarily incurred while away from home in the course of performing donated services also are deductible.

Treas. Reg § 1.170A-1(g) (1986).

8. The Davises claimed $9,133.89, the amount sent to their missionary sons, as a charitable deduction. *Davis,* 861 F.2d at 560.

9. *Id.* at 562.

10. *Id.* at 565.

The *Davis* court's holding directly conflicts with the holdings of the Fifth and Tenth Circuit Courts in cases with facts virtually indistinguishable from *Davis*.[11] This Note examines the holdings of these Circuit Courts and argues that direct charitable transfers[12] similar to those in *Davis* should be deductible either as charitable contributions or as charitable unreimbursed expenses.

I. BACKGROUND

The legislative history of Section 170, the charitable deduction statute, the administrative and judicial interpretation of Section 170, and the federal courts' decisions regarding Mormon missionary deductions provide the legal framework needed to analyze *Davis*-type direct charitable transfers.

A. Legislative History and Purpose of Section 170

Congress first provided a tax deduction for charitable contributions in the War Revenue Act of 1917.[13] The original legislation was intended to encourage charitable giving in the face of sharply increased tax rates which were imposed during World War I.[14] Since enactment, legislative declarations of the purpose of the charitable deduction allowance have been few.[15] Congress has recognized, however, that missionary work, even when it is performed in a foreign country, is a charitable cause to which deductible contributions can be made.[16]

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11. *See* Brinley v. Commissioner, 782 F.2d 1326, 1336 (5th Cir. 1986) (transfers to Mormon missionary deductible either as unreimbursed expenses or charitable contributions upon proper showing); White v. United States, 725 F.2d 1269, 1272 (10th Cir. 1984) (transfers to Mormon missionary deductible as unreimbursed expenses).

12. For purposes of this Note, "direct charitable transfer" will mean a taxpayer's monetary transfer made at a charity's request to a service provider or other charity-selected beneficiary which benefits both the charity and the transferee.

13. *See* War Revenue Act of 1917, ch. 63, § 1201(2), 40 Stat. 300, 330. A charitable deduction was proposed in 1913 but was rejected. 50 CONG. REC. 1259 (daily ed. May 6, 1913).

Commentators have both attacked and defended the charitable deduction since its enactment. *See, e.g.*, Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1972); Bittker, *Charitable Contributions: Tax Deductions or Matching Grants*, 28 TAX L. REV. 37 (1972); Gergen, *The Case for a Charitable Deduction*, 74 VA. L. REV. 1393 (1988); McDaniel, *Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction*, 27 TAX L. REV. 377 (1972).

14. *See* 2 B. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 35.1.1 (1981).

15. *Id.*

16. "If the recipient . . . is a domestic organization the fact that some portion of its funds is used in other countries for charitable and other purposes (such as missionary and educational purposes) will not affect the deductibility of the gift." H.R. REP. NO. 1860, 75th Cong., 3d Sess.

Congress has made several changes in the charitable deduction provision since 1917 to stimulate charitable giving. First, Congress has increased repeatedly the percentage of a taxpayer's gross income which may be deducted annually, from fifteen percent in 1917 to the present limit of fifty percent.[17] Congress also has increased the number of organizations that qualify as recipients of deductible charitable contributions.[18] The Mormon Church is included on an Internal Revenue Service ("IRS") list of organizations to which deductible contributions can be made.[19]

Congress also has expanded the charitable deduction provision to allow deductions for expenses incurred by a taxpayer while performing charitable services. Originally, only contributions of money or property "to" a charity were deductible.[20] By adding the words "or for the use of" to the statute in 1921,[21] Congress expressed its willingness to allow deductions for a taxpayer's charitable service-related expenses that are not reimbursed by the charity.[22] The I.R.C. thus currently recognizes two types of deductible charitable contributions: First, direct contributions of money or property,[23] and second, service-related unreimbursed expenses paid by a taxpayer from personal funds.[24] These two types of deductions provide the analytic backdrop from which the deductibility of any expenditure will be measured.

(1938), *reprinted in* J. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS 1938-1861, at 17 (1939).

17. *Compare* War Revenue Act of 1917, ch. 63, § 1201, 40 Stat. 330 (15% of gross income deductible) *with* I.R.C. § 170(b) (West 1988 & Supp. 1989) (50% of gross income deductible). For a report indicating that Congress intended these changes to encourage charitable giving, see S. REP. NO. 1584, 82d Cong., 2d Sess. (1953), *reprinted in* 1 J. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS 1953-1939, at 1364 (1954).

18. Originally, only contributions to an organization itself engaged in charitable service were deductible. Congress granted qualified recipient status to community chests, trusts, and foundations, which merely funnelled donations to charities, in 1921. Revenue Act of 1921, ch. 136, § 214(a)(ii), 42 Stat. 227.

19. Internal Revenue Service Pub. No. 78, *Cumulative List of Organizations* 268 (1988).

20. War Revenue Act of 1917, ch. 63, § 1201(2), 40 Stat. 330.

21. Revenue Act of 1921, ch. 136, § 214(a)(ii), 42 Stat. 227.

22. In 1939, the Treasury Department issued regulations to govern the deductibility of unreimbursed expenses. *See* Treas. Reg. § 39.23(a)-1 (1939). Even before this change, however, courts had allowed such deductions. *See, e.g.,* Wolfe v. McCaughn, 5 F. Supp. 407, 410 (E.D. Pa. 1933) (taxpayer's unreimbursed expenses for services for YMCA in Europe during World War I held deductible as contributions "to" charity).

23. I.R.C. § 170 (West 1988 & Supp. 1989).

24. Treas. Reg. § 1.170A-1(g) (1986).

B. Administrative and Judicial Interpretation of Section 170

Both the IRS and the judiciary have interpreted Section 170. Often utilizing IRS interpretations of the statute, courts have developed separate and distinct tests to determine the deductibility of taxpayer expenditures, either as charitable contributions or unreimbursed expenses.

1. The Deductibility of Charitable Contributions

Charitable contributions must satisfy two conditions to be deductible under Section 170: First, the transfer must be a "contribution or gift,"[25] and, second, it must be "to or for the use of" a qualified recipient.[26]

A transfer constitutes a "contribution or gift" when the donor receives no economic benefit, no *quid pro quo,* from the charity as consideration for making a donation.[27] When the economic value of the *quid pro quo* received is less than the total value of a transfer, the deductible gift portion of the transfer is reduced by the value of the *quid pro quo* received.[28] A transfer's characterization as a gift is precluded entirely, however, by the donor's receipt or expectation of an economic benefit commensurate with the amount of money or property transferred.[29]

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25. I.R.C. § 170(c) (West 1988 & Supp. 1989). The terms "contribution" and "gift" are synonymous. *See, e.g.,* Allen v. United States, 541 F.2d 786, 787 (9th Cir. 1976).

26. I.R.C. § 170(c) (West 1988 & Supp. 1989).

27. *See* Rev. Rul. 76-185, 1976-1 C.B. 60; Rev. Rul. 76-232, 1976-1 C.B. 62. Some courts, however, also appear to require that the transfer proceed from "detached and disinterested generosity," a test first announced by the Supreme Court for Section 102 purposes in Duberstein v. Commissioner, 363 U.S. 278 (1960). The Ninth Circuit was first to adopt the *Duberstein* test for Section 170 purposes in Dejong v. Commissioner, 309 F.2d 373, 379 (9th Cir. 1962). Commentators have vigorously criticized application of the *Duberstein* test to charitable contributions. *See, e.g.,* Colliton, *The Meaning of "Contribution or Gift" For Charitable Deduction Purposes,* 41 OHIO ST. L.J. 973, 999–1002 (1980); Comment, *Disinterested Generosity: An Emerging Criteria of Deductibility Under § 170,* 1968 UTAH L. REV. 475. In addition, the First and Seventh Circuits, and a Court of Claims have declined to use the *Duberstein* test. *See* Sedam v. United States, 518 F.2d 242, 245 (7th Cir. 1975); Oppewal v. Commissioner, 468 F.2d 1000 (1st Cir. 1972); Singer v. United States, 449 F.2d 413 (Ct. Cl. 1971).

28. *See* Rev. Rul. 76-185, 1976-1 C.B. 60; Rev. Rul. 76-232, 1976-1 C.B. 62. By way of example, in two prior cases, the deductible portion of contributions to schools attended by the taxpayer's children have been reduced by the amount the IRS deemed to be tuition payments. *See Oppewal,* 468 F.2d at 1002; *DeJong,* 309 F.2d at 379.

29. Both Congress and the IRS have so indicated. *See* H.R. REP. NO. 1337, 83d Cong., 2d Sess. A44 (1954); S. REP. NO. 1622, 83d Cong., 2d Sess. 196 (1954); Rev. Rul. 76-185, 1976-1 C.B. 60; Rev. Rul. 76-232, 1976-1 C.B. 62. When the value of the *quid pro quo* received cannot be determined accurately but is nevertheless "substantial" so as to appear commensurate with the value of the transfer, the transfer is not a gift. *See, e.g., Singer,* 449 F.2d at 423; Stubbs v. United States, 428 F.2d 885, 887 (9th Cir.), *cert. denied,* 400 U.S. 1009 (1971).

The second requirement for deductibility is that the gift must be contributed "to or for the use of" a qualified recipient.[30] A taxpayer satisfies this requirement by showing that the charity has exercised control over the donated funds.[31] Charity control preserves the indefiniteness of a beneficiary[32] and, therefore, prevents the deduction of earmarked contributions.[33] Transfers to private individuals, regardless of their charitable nature, are not deductible.[34] Likewise, when a taxpayer restricts a transfer's use by earmarking it specifically for the benefit of a particular individual, the transfer is private and, lacking indefiniteness, cannot be deducted.[35] When, however, a charity retains control by itself selecting the beneficiary of a donation, taxpayer transfers to the beneficiary are deductible.[36] Under these circumstances, the fact that the donor knows the identity of an individual or cause which is to benefit does not preclude a deduction.[37]

Charity control that guarantees a charity discretion as to the use of the donated funds is sufficient to effect a deduction.[38] The IRS's test in each case is whether the organization had "full control" which ensured that the donation was used to carry out the charity's functions

30. Qualified recipients are defined in I.R.C. § 170(c)(2)(A)–(D) (West 1988 & Supp. 1989).

31. *See* Rev. Rul. 62-113, 1962-2 C.B. 10, 11 (the test in each case is whether the organization had full control of the contribution and, thus, discretion as to its use).

32. Indefiniteness in beneficiary exists when a charity rather than a donor identifies who is to benefit from the transfer. *See, e.g.*, Thomason v. Commissioner, 2 T.C. 441, 443 (1943) (charity begins where certainty in beneficiary ends).

33. A donor may not restrict a donation for the benefit of a specific individual. *See, e.g.*, Russell v. Allen, 107 U.S. 163, 167 (1882) (indefiniteness in beneficiary is an essential characteristic of a charitable donation); Tripp v. Commissioner, 337 F.2d 432, 436 (7th Cir. 1964) (scholarship designated by donor for specific individual not deductible).

34. Dohrmann v. Commissioner, 18 B.T.A. 66, 68–69 (1929) (no deduction for donation to needy individuals).

35. *See, e.g., Thomason,* 2 T.C. at 443 (transfer earmarked for charity's charge not deductible). *See generally* Blasi & Denesha, *Avoiding Disallowance of Earmarked Charitable Contributions,* 9 REV. OF TAX'N OF INDIVIDUALS 160, 163–64 (1985) (discussion of permissible extent of earmarking charitable contributions).

36. *See, e.g.*, Brinley v. Commissioner, 782 F.2d 1326, 1335 (5th Cir. 1986) (transfers to Mormon missionary deductible where Church selects beneficiary); Winn v. Commissioner, 595 F.2d 1060, 1065 (5th Cir. 1979) (transfers to a specific missionary held deductible when Church selected the beneficiary and funds dealt with as Church wished); Bauer v. United States, 449 F. Supp. 755, 759 (W.D. La. 1978) (direct payment to scholarship recipient selected by school deductible), *aff'd,* 594 F.2d 44 (5th Cir. 1979).

37. Indefiniteness in beneficiary becomes an irrelevant consideration once a charity has made the beneficiary definite. *See Brinley,* 782 F.2d at 1332; *Winn,* 595 F.2d at 1065.

38. Rev. Rul. 62-113, 1962-2 C.B. 10, 11.

and purposes.[39] Although charity possession of donated funds sometimes has been viewed as a required element of full control,[40] courts have found sufficient control when possession was lacking.[41]

2. *The Deductibility of Charitable Unreimbursed Expenses*

In addition to charitable contributions, a taxpayer may deduct charitable unreimbursed expenses.[42] A two-step test is used to determine whether a claimed unreimbursed expense may be deducted.[43] First, the connection between the expenditure and service is examined to determine whether the expenses truly were incurred incident to charitable service. The IRS has indicated that an expenditure is incurred incident to charitable service when it is directly connected with and solely attributable to the rendition of charitable services.[44] Under this test, deductions have been allowed for the purchase price of religious material used in missionary work,[45] expenses for the operation and maintenance of a privately owned aircraft,[46] legal fees,[47] and even for the purchase price of illegal drugs and information in connection with a drug enforcement program.[48]

Second, unreimbursed expenses must be incurred "for the use of" a charity to be deductible. Many service related expenses have a dual character[49] in that they benefit both the charity and the service provider. A "primary benefit" test is used to distinguish between situations where benefits accrue primarily to the service provider, and those where benefits accrue primarily to the charity and only incidentally to the service provider. While in the latter situation an expenditure will be "for the use of" the charity, the presence of a substantial direct

39. *Id.*

40. *See, e.g.*, Davis v. United States, 861 F.2d 558, 562 (9th Cir. 1988).

41. *See Brinley*, 782 F.2d at 1335; Archbold v. United States, 444 F.2d 1120, 1123 (Ct. Cl. 1971); Bauer v. United States, 449 F. Supp. 755, 758 (W.D. La. 1978), *aff'd*, 594 F.2d 44 (5th Cir. 1979).

42. Treas. Reg. § 1.170A-1(g) (1986) indicates that the value of services is not deductible but lists several examples of deductible expenses. *See supra* note 7. In addition, only actual payments are deductible; thus, deductions are not allowed for depreciation, Orr v. United States, 343 F.2d 553, 557 (5th Cir. 1965), or for fair rental value, McCollum v. Commissioner, 37 T.C.M. (CCH) 1817, 1820 (1978).

43. *See* Note, Brinley v. Commissioner: *A Modified Charitable Deduction Standard for Missionary Support Payments*, 40 Sw. L.J. 1267, 1272 (1987).

44. *See, e.g.*, Rev. Rul. 76-89, 1976-1 C.B. 58; Rev. Rul. 69-473, 1969-1 C.B. 37.

45. *See, e.g.*, Rev. Rul. 76-89, 1976-1 C.B. 58.

46. *See* Rev. Rul. 58-279, 1958-1 C.B. 145.

47. Archbold v. United States, 444 F.2d 1120, 1124 (Ct. Cl. 1971).

48. Sampson v. Commissioner, 43 T.C.M. (CCH) 1408, 1414 (1982).

49. Seed v. Commissioner, 57 T.C. 265, 276 (1971).

personal benefit inuring to and anticipated by the service provider precludes a deduction.[50]

Whether a taxpayer who donates money to cover the unreimbursed expenses incurred by a service provider is entitled to a deduction is unclear. Neither Treasury Regulation § 1.170A-1(g) nor legislative declarations concerning Section 170 specifically prohibit deductions by such third party taxpayers.[51] The IRS has argued, however, that allowing third parties a deduction invites two types of taxpayer abuse:[52] First, deduction shifting where high bracket donors assign income to lower bracket service providers in excess of the amount the charity itself would provide, and, second, double deductions where deductions for the same funds are taken by both the third party and the service provider. Nevertheless, a majority of courts that have examined deductions by third parties have held them deductible, reasoning that expenditures that primarily serve the charity satisfy the statutory requirements.[53]

C. Mormon Missionary Cases: The Tenth and Fifth Circuits

Both the Tenth and Fifth Circuits have allowed the deduction of Mormon missionary support payments. In *White v. United States,*[54] the Tenth Circuit allowed the third party parents an unreimbursed expense deduction, seeing no rational basis for distinguishing the expenses of a dependent son from the payment of a taxpayer's own expenses to perform the same services.[55] Because the missionary's expenses were incurred incident to charitable service and primarily

50. *Id.* at 275–76; *see also* Babilonia v. Commissioner, 681 F.2d 678, 679 (9th Cir. 1982) (parents' expenses incurred while traveling overseas for daughter's skating competition not deductible).

51. *See* Treas. Reg. § 1.170A-1(g) (1986), quoted in part *supra* note 7. The legislative history of the 1986 Tax Reform Act implies that the deduction is properly taken by a service provider. *See* H.R. REP. NO. 426, 99th Cong., 1st Sess. 119 (1985) ("A taxpayer may deduct . . . unreimbursed out-of-pocket expenses incurred incident to the rendition of services provided by the taxpayer to a charitable organization.").

52. *See, e.g.,* Davis v. United States, 861 F.2d 558, 563 (9th Cir. 1988).

53. *See, e.g.,* Rockefeller v. Commissioner, 676 F.2d 35, 42 (2d Cir. 1982) (salaries, travel, entertainment, and other expenses incurred by charitable service providers deductible to third person donor); Archbold v. United States, 444 F.2d 1120, 1123 (Ct. Cl. 1971) (legal fees paid for attorney services to protect a gift of property to a city deductible to third person donor); McCollum v. Commissioner 37 T.C.M. (CCH) 1817, 1820 (1978) (parents' payments of expenses incurred by children who rendered services to National Ski Patrol deductible). The Ninth Circuit alone denys third parties an unreimbursed expense deduction.

54. 725 F.2d 1269 (10th Cir. 1984).

55. *Id.* at 1271.

served the Mormon Church, the court had "no difficulty" in concluding they were deductible.[56]

In *Brinley v. Commissioner,*[57] the Fifth Circuit held that the payments would be deductible either as unreimbursed expenses or direct contributions upon the proper showing.[58] In its unreimbursed expense analysis, the court concluded that the expenses were incurred incident to charitable services.[59] While finding the primary benefit test applicable, the court remanded the case to the Tax Court because it could not determine on the evidence before it which expenditures primarily served the Church. On remand, the Tax Court allowed the deduction of all of the claimed expenses.[60] The *Brinley* court next considered whether the amounts were deductible as direct charitable contributions. The court rejected a formal requirement of charity possession of donated funds.[61] The court determined that when the charity itself selects a charitable cause and solicits funds for that cause, charity control and discretion may be maintained without possession.[62] The court concluded that a donor's payment in response to the charity's specific solicitation would be deductible upon the taxpayer's showing of a matching of solicitation and expenditure.[63]

II. THE NINTH CIRCUIT'S APPROACH: *DAVIS V. UNITED STATES*

The Ninth Circuit in *Davis v. United States,*[64] held that the taxpayers' transfers were not deductible either as direct contributions or as

56. *Id.* at 1272. Courts have reached disparate conclusions regarding the deductibility of Mormon missionaries' lodging and meal expenses as unreimbursed expenses. Treasury Regulation § 1.170A-1(g) (1986) indicates that lodging and meal expenses are deductible only if the service provider is "away from home." *See supra* note 7. The Tenth Circuit in *White* found that the missionary was "away from home" and allowed the deduction of lodging and meal expenses. *White,* 725 F.2d at 1272. The Fifth Circuit in *Brinley* held, however, that the missionary was not "away from home" and, therefore, denied a deduction for lodging and meal costs. Brinley v. Commissioner, 782 F.2d 1326, 1334 (5th Cir. 1986). The *Davis* court did not reach the "away from home" issue. *See* Davis v. United States, 861 F.2d 558, 564 n.1 (9th Cir. 1988). This topic is beyond the scope of this Note.

57. 782 F.2d 1326 (5th Cir. 1986).

58. *Id.* at 1333, 1336.

59. *Id.* at 1331–32. The court concluded that indefiniteness is irrelevant when services are contributed since both the donor and beneficiary charity already are ascertained. *Id.* at 1332.

60. The parties stipulated to this outcome. The amount deducted included lodging and meal expenses. *See* Brinley v. United States, Tax Court Doc. No. 28349-81 (October 30, 1986).

61. *Brinley,* 782 F.2d at 1330, 1334–35.

62. *Id.* at 1334.

63. *Id.* at 1335–36. The court could not determine on the record whether sufficient control existed. *Id.*

64. 861 F.2d 558 (9th Cir. 1988).

unreimbursed expenses. The transfers were not deductible as direct contributions because, first, the parents' receipt of a *quid pro quo*—the assurance that their missionary son would be clothed, housed, and fed—brought into question the transfer's gift status.[65] Second, the court held that the transfers were not "to or for the use of" the Mormon Church because the missionaries' direct receipt of the funds precluded the Church's possessory control.[66] The court held that possession is a required element of control which preserves the indefiniteness of beneficiary and prevents earmarked transfers.[67]

The *Davis* court also disallowed deduction of the transfers as charitable unreimbursed expenses. The court did not read Treasury Regulation § 1.170A-1(g) as allowing a deduction by anyone other than the service provider; it feared that allowing third parties a deduction would promote taxpayer abuse and impose an administrative burden upon the IRS.[68] The court declined to follow *White*[69] and *Brinley,*[70] and distinguished cases where third parties had deducted unreimbursed expenses, contending that those deductions actually "were for unreimbursed expenses incurred by the taxpayers in rendering services to charities."[71]

III. ANALYSIS

A. Section 170 Charitable Contribution Analysis

Direct charitable transfers should be deductible as Section 170 charitable contributions. First, these transfers constitute a "contribution or gift" because neither the donor nor the service provider receives an impermissible *quid pro quo*. Second, the presence or absence of charity possession does not guarantee or preclude charity control. Third, these transfers are "to or for the use of" the charity because, under the "charity control" test proposed below, charity control can be demonstrated even when possession is lacking.[72]

65. *Id.* at 562.
66. *Id.*
67. *Id.*
68. *Id.* at 564.
69. *Id.* at 562.
70. *Id.* at 563–64.
71. *Id.* at 564–65. The court's contention is incorrect. Although in the cases cited by the court the third parties rendered charitable service, they in fact received deductions for expenses incurred by other individuals. *See* Rockefeller v. Commissioner, 676 F.2d 35, 37 (2d Cir. 1982); McCollum v. Commissioner, 37 T.C.M. (CCH) 1817, 1820–21 (1978).
72. The *Davis* court noted that public policy demands that charitable deduction statutes must be given a broad construction, citing Helvering v. Bliss, 293 U.S. 144, 150–51 (1934), and that

1. The "Contribution or Gift" Requirement

The first requirement for the deduction of charitable contributions was satisfied in *Davis* because neither the taxpayer nor service provider received an impermissible *quid pro quo*. A donation is a gift and therefore deductible when no economic *quid pro quo* is received by a donor; a deduction is disallowed, however, to the extent that a donor economically benefits because of a transfer to charity.[73] In *Davis,* the court accepted the government's argument that the *quid pro quo* received by the parent taxpayers was an assurance that their sons would receive proper care.[74] Receipt of an assurance is not an economic event which, standing alone, precludes a transfer's gift status. The taxpayers' sons, however, did economically benefit because the payments were used for their care. The parents in *Davis* argued that the funds should be deductible because payment of the missionary sons' living costs conferred a benefit on the church.[75] The IRS responded that the transfers were neither to nor for the use of the Church.[76] When one who benefits from a contribution is a charitable service provider, whether a transfer is a deductible charitable gift or a non-deductible personal gift turns on whether the charity or the service provider primarily benefitted from the transfer.

A transfer is a gift when a charity is primarily benefitted. The Ninth Circuit in *Davis,* however, relied on its previous decision in *DeJong v. Commissioner*[77] for the proposition that transfers to a charity are non-deductible when the taxpayer's child is benefitted by the transfer.[78] In *DeJong,* the taxpayer parents contributed money to their children's school. As students, the children rendered no charitable service, but instead received educational services from the charity. The school's benefit from the parents' donation was reduced by the expense it incurred to educate the children. The court held that the parents' payment was partly for a personal expense and denied a deduction for that portion of the payment which represented tuition.[79] The situation is different, however, when, as in *Davis,* the donations are to a charitable service provider. In this situation, the charity is benefitted by the

tax provisions generally should be construed whenever possible in favor of taxpayers, citing Burnet v. Niagara Falls Brewing Co., 282 U.S. 648, 654 (1931). *Davis,* 861 F.2d at 565.

73. *See supra* text accompanying notes 27-29.

74. *Davis,* 861 F.2d at 562.

75. *Id.*

76. *Id.*

77. 309 F.2d 373 (9th Cir. 1962).

78. *Davis,* 861 F.2d at 562.

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

charitable work of the service provider. In the Mormon missionary context, but for the parents' payment of essential living expenses, no charitable service could be rendered.[80] Because direct charitable transfers facilitate the provision of charitable services, the charity primarily benefits while the service provider benefits only incidentally.[81] Because neither the taxpayer nor the service provider are impermissibly benefitted, a direct charitable transfer is a "contribution or gift."

2. The Control Requirement

A charity must exercise control over a taxpayer's transfer to qualify the transfer for a deduction.[82] Charity control prevents donor earmarking and guarantees that the beneficiary of a donation will be indefinite. The abuse feared in cases like *Davis* is that taxpayers will earmark funds for particular service providers and, by characterizing the transfers as charitable contributions, obtain deductions for transfers which are in fact personal gifts.[83] Transfers earmarked for donor-selected beneficiaries are correctly held non-deductible because there is no assurance that the charity, in its discretion, would apply a transfer to the same cause or select the same beneficiary as did the donor.[84] When a charity controls a contribution and itself selects the beneficiary of the transfer, charity discretion is maintained and the deduction of earmarked personal gifts is prevented. The requirement of indefiniteness also is satisfied because the charity, rather than the donor, makes the beneficiary definite. Therefore, a deduction is warranted only when the charity exercises control sufficient to guarantee it discretionary use of donated funds.[85]

Cases cited by the Ninth Circuit in *Davis* do not support its holding that possession is an essential element of charity control which preserves indefiniteness and prevents earmarking. For example, in *Winn*

80. The Church pays the expenses if the missionary's parents do not pay. *Davis,* 861 F.2d at 559.

81. A mere showing of incidental benefit to a service provider does not preclude a deduction. *See, e.g.,* Brinley v. Commissioner, 782 F.2d 1326, 1334 (5th Cir. 1986) (even when service provider primarily benefits, a deduction is allowed provided charity controls the donation); Bauer v. United States, 449 F. Supp. 755, 759 (W.D. La. 1978) (no reason or authority shows that benefit by the individual should defeat deductibility of a gift), *aff'd,* 594 F.2d 44 (5th Cir. 1979).

82. *See* Rev. Rul. 62-113, 1962-2 C.B. 10, 11.

83. *See, e.g., Davis,* 861 F.2d at 562–66. I.R.C. § 262 (West 1988 & Supp. 1989) proscribes the deduction of personal, family, or living expenses; thus, the deduction of personal gifts also is precluded.

84. Rev. Rul. 62-113, 1962-2 C.B. 10, 11 (control must guarantee charity discretion as to fund's use).

85. *Id.*

v. Commissioner,[86] a church established "Sara Barry Days" to collect funds for the support of Sara's missionary work. A church officer, Sara's father, obtained possession of the funds and forwarded them directly to her. The contribution was held deductible.[87] In *Brinley*, the Fifth Circuit which had decided *Winn* cautioned, however, that *Winn* "should not be construed to require physical control over donated funds."[88] The court indicated that possession was not critical to its finding of sufficient charity control.[89] Instead, the fact that the church established the charitable cause and selected the donation's beneficiary led to the conclusion of deductibility.[90]

Likewise, in *Peace v. Commissioner*,[91] a taxpayer sent several checks to a mission in Sudan, insisting each time that they be used only by specific missionaries.[92] Under the mission's policy all transfers restricted by a donor to a specific individual were applied as designated.[93] This policy guaranteed the donor, not the charity, discretion with respect to selection of a beneficiary. Although the mission received possession of the funds, the donor's restrictions were honored for each transfer.[94] Surprisingly, the *Peace* court allowed a deduction notwithstanding the strong indications of impermissible donor earmarking.[95] Under the *Peace* court's rationale, a donor could deduct an earmarked contribution so long as the charity agrees to the donor's earmarking, a result which comports neither with IRS revenue rulings[96] nor prior case law.[97]

86. 595 F.2d 1060 (5th Cir. 1979).

87. *Id.* at 1065.

88. Brinley v. Commissioner, 782 F.2d 1326, 1335 (9th Cir. 1986). The court noted that the officer's control in *Winn* contributed to the degree of control required. *Id.*

89. *Id.*

90. *Id.* at 1334–36.

91. 43 T.C. 1 (1964).

92. *Id.* at 2–5. The missionaries' names were written on the face of the checks which were made payable to the mission. Other correspondence reiterated the restrictions. *Id.*

93. *Id.* at 5.

94. The *Davis* court viewed the control in *Peace* as sufficient because the funds were "distributed only as the mission determined, despite specific directives by the donors." Davis v. United States, 861 F.2d 558, 562 (9th Cir. 1988). At no time, however, were the funds in *Peace* distributed to non-designated missionaries despite the donor's directives. *See Peace*, 43 T.C. at 2–6.

95. The *Peace* court believed the donor's restrictions were merely manifestations of desire, and found control because the funds were possessed and distributed under the mission's policy. *Peace*, 43 T.C. at 7, 8.

96. Funds distinctly marked by a donor for a specific person or received by a charity pursuant to a commitment or understanding that they would be so used are not deductible. *See, e.g.*, Rev. Rul. 62-113, 1962-2 C.B. 10, 11.

97. *See supra* notes 32-33 and accompanying text.

Other cases demonstrate that charity possession is not a threshold issue whose presence or absence necessarily creates or destroys charity control. For example, in *Tripp v. Commissioner,*[98] a taxpayer made payment to a scholarship fund, restricting the payments for the benefit of a particular student. The school received possession of the funds and dealt with them as the donor requested. The court denied a deduction despite the school's possessory control because the payments were not to be used as the college saw fit, but were to be applied to the educational expenses of a designated student.[99]

In contrast, the lack of charity possession does not necessarily preclude charity control. For example, in *Bauer v. United States,*[100] the taxpayer supported a scholarship fund for several schools. The schools, not the donor, selected the recipients and requested the donor to forward payment to the students directly. The schools themselves never possessed the donated funds. Holding the contribution deductible, the court found the direct payment a perfectly "practical procedure for handling . . . contributions,"[101] and noted that the fact that the donation was made payable to the student was not inconsistent with an intent to further educational purposes.[102] These cases demonstrate that possession of donated funds does not guarantee charity discretion nor does its absence preclude discretion.

3. *Control Without Possession: The Charity Control Test*

Although the Ninth Circuit in *Davis* adopted a possessory control test,[103] the Fifth Circuit in *Brinley* enunciated a viable non-possessory control test[104] that better implements Congress' policy of encouraging contributions to charity. Courts could use the following "charity control" test to determine when control by the charity is sufficient in the absence of possession. Adapted from *Brinley,* the proposed charity control test has three requirements: First, a charity must unilaterally

98. 337 F.2d 432 (7th Cir. 1964).

99. *Id.* at 436; *see also* Thomason v. Commissioner, 2 T.C. 441, 443 (1943) (donor payments for a charity's charge to attend a special school not deductible despite charity possession because payments were for privileges the charity in its discretion would not have furnished); Cook v. Commissioner, 37 T.C.M. (CCH) 771, 774 (1978) (deduction denied despite possession by church ministers because fund's use not determined by church); Mayo v. Commissioner, 30 T.C.M. (CCH) 505, 507 (1971) (payments to missionaries in excess of amounts allocated by church not deductible).

100. 449 F. Supp. 755 (W.D. La. 1978), *aff'd,* 594 F.2d 44 (5th Cir. 1979).

101. *Bauer,* 449 F. Supp. at 759.

102. *Id.*

103. Davis v. United States, 861 F.2d 558, 562 (9th Cir. 1988).

104. Brinley v. Commissioner, 782 F.2d 1326, 1334–35 (5th Cir. 1986).

establish a charitable cause.[105] Second, the charity itself must designate who is to benefit from transfers to that cause. Third, the charity must solicit financial support for that cause, in writing, from the taxpayer.[106] Thereafter, taxpayer transfers will be deductible upon demonstration of a matching between charity solicitation and taxpayer response.

Meeting the charity control test assures that charity discretion is preserved and deductions for earmarked transfers and personal gifts are prevented. The charity has control and discretion because the charity, not the donor, establishes the charitable cause and itself designates who is to benefit from the taxpayer's transfers. Once the charity has ascertained the beneficiary, indefiniteness becomes irrelevant.[107] Further, because only the charity may select a beneficiary, donor earmarking is prevented.[108] The deduction of personal gifts also is prevented because the donor must prove that a charitable organization specifically requested a donation and that response was made only to the extent requested.[109]

The charity control test has the further advantage of allowing a charity to select a donation scheme which best serves its goals.[110] Many charitable organizations establish specific charitable causes for which they solicit funds. A variety of methods are employed to direct donated funds to charitable causes. So long as charity discretion is preserved, one method need not be favored over another. Requiring a taxpayer to sanitize funds by passing them through the charity's hands raises the form of the donation over its substance.[111] Moreover, where

105. Missionary work or a scholarship program are examples of what may constitute a charitable cause.

106. The *Brinley* court did not require a written solicitation. A writing requirement, however, would assure that the solicitation was in fact charity initiated and could be required by the IRS for proof of the taxpayer's right to a deduction. Amounts contributed in excess of the solicitation, if used to support service providers, would be considered non-deductible personal gifts.

107. *See supra* note 37 and accompanying text.

108. Under the charity control test, charities would be unlikely to allow donor earmarking because the test's written solicitation requirement would implicate the charity in an impermissible donation scheme, and, thus, subject it to possible IRS action with respect to its qualified recipient status.

109. When a transfer is to a charitable service provider, the reasonableness of the charity's request could be judged by comparing the amount requested with the per diem amount allowed by the Federal government to its employees for the same area in which the service provider renders service. Also, the IRS views reimbursed expenditures of up to $44 per day for actual expenses as reasonable and not includible in gross income. *See* Rev. Rul. 80-62, 1980-1 C.B. 63, 64.

110. The Mormon Church, for example, believes its direct payment scheme furthers several worthy goals. *See supra* note 5.

111. The Ninth Circuit appears to advocate the rise of form over substance by its adoption of *Peace*. Under the *Peace* rationale, a donor may earmark funds and still obtain a deduction

donors are requested to make direct contributions to charitable causes, the unpredictability of a deduction may discourage contributions or decrease the amount donated. For these reasons, an absolute requirement of possessory control does not promote, but frustrates the Congressional purpose of encouraging contributions behind Section 170.

Under the charity control test, the direct charitable transfers to the Mormon missionaries in *Davis* would be deductible. Although it never physically possessed the donated funds, the Mormon Church itself established the charitable cause of missionary work and selected the taxpayers' sons as missionaries. It then solicited support from the missionaries' parents in writing. The Church had control over support payments and discretion as to their use because the Church, not the donor parents, designated how the solicited funds were to be used.[112] The Church's control was enhanced by its exercise of pervasive control over the missionaries' activities and expenditures.[113] Further, because the Church proscribes non-missionary activities and requests payments only in an amount necessary to cover basic living essentials,[114] the likelihood that the funds would be used for non-charitable purposes was minimized.

Indefiniteness in beneficiary also was preserved because the Church, not the parents, made the beneficiary definite.[115] Moreover, the ultimate beneficiary of support payments was not the missionaries but the persons who received the missionaries' services. The payments facilitated the missionaries' rendition of services to an indefinite number of individuals whose identity was unknown to the donors. Thus, the indefiniteness in ultimate beneficiary was preserved. Therefore, under the charity control test, the transfers in *Davis* would be deductible.[116]

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simply by funnelling the donation through a complacent charity, thus altering the form of donation rather than its substance.

112. The *Davis* court implied that the church must exercise discretion over each missionary expenditure. *See* Davis v. United States, 861 F.2d 558, 562 (9th Cir. 1988). Such a scheme is impractical, not necessary to stem abuse, and not mandated by previous case law.

113. *See supra* note 5.

114. Brief for Appellant at 6, Davis v. United States, 861 F.2d 558 (9th Cir. 1988) (No. 87-4170).

115. The requirement of indefiniteness is satisfied once the charity ascertains the beneficiary. *See supra* note 37.

116. Application of the charity control test need not be limited to service provider support situations. Scholarship donations, or donations to medical researchers made at the request of a sponsoring hospital are examples of situations where the test could have equal applicability.

B. Unreimbursed Expense Analysis

As an alternative to a charitable contribution deduction, direct charitable transfers to service providers also should be deductible as unreimbursed expenses. Judicial decisions support the conclusion that third party donors should be allowed a deduction. In analyzing third party deductions, however, courts should use the "charity control" test rather than the "primary benefit" test because it provides greater safeguards against taxpayer abuse.

Neither Treasury Regulation § 1.170A-1(g)[117] nor the legislative history of Section 170[118] explicitly prohibit a third party deduction for unreimbursed expenses. The *Davis* court held, however, that only service providers may deduct unreimbursed expenses, relying heavily on the legislative history of the 1986 Tax Reform Act as support for this conclusion.[119] The legislative history cited, however, is at best vague as to who is to take a deduction.[120] With no clear statutory or legislative guidance, it is left to the judiciary to resolve whether a third party donor should be allowed an unreimbursed expense deduction.

The vast majority of courts that have examined the deduction of unreimbursed expenses by third parties have held them deductible.[121] This result is appropriate because allowing third party deductions encourages joint charitable giving, where one individual contributes time and another money. Individuals who, for whatever reason, value their time more than the expenditure of personal funds may be matched with individuals who have sufficient time to donate to charitable service but lack the funds to do so. When these two types of individuals join together the cause of charitable service is promoted, fulfilling the purpose of the charitable deduction allowance.

Abuse of a third party deduction, however, is a relevant concern.[122] While Congress has consistently sought to stimulate charitable giving, it has revised Section 170 when it perceived the statute was being abused.[123] The *Davis* court's fear of abusive double deductions and

117. *See* Treas. Reg. § 1.170A-1(g) (1986).

118. *See supra* note 51.

119. Davis v. United States, 861 F.2d 558, 564 (9th Cir. 1988) (citing H.R. REP. No. 426, 99th Cong., 1st Sess. 119 (1985)).

120. *See* H.R. REP. No. 426, 99th Cong., 1st Sess. 119 (1985); *supra* note 51.

121. *See supra* note 53.

122. For types of abuse feared by the IRS *see supra* note 52 and accompanying text.

123. For example, in response to abuse Congress in 1969 repealed the unlimited deduction for charitable contributions and greatly restricted deductions for gifts of property to charity. *See* H.R. REP. No. 413, 91st Cong., 1st Sess. (1969), *reprinted in* 1969 U.S. CODE CONG. & ADMIN. NEWS 1645, 1697–1708.

deduction shifting was a primary motivation behind its denial of a deduction.[124]

Use of the primary benefit test is justified when a service provider seeks a deduction because the possibility of abusive double deductions or deduction shifting is not present. Moreover, in this situation the expenses claimed are entitled to a presumption of reasonableness. This presumption is warranted because Treasury Regulation § 1.170A-1(g) does not allow a deduction for the value of services.[125] A service provider thus gives personal service for the charitable cause without compensation. This personal sacrifice provides a built-in check on the reasonableness of a service provider's expenses and the deduction sought; it seems unlikely that such a person would manipulate the occasion by incurring unreasonable expenses merely to gain a tax benefit.

The same presumption of reasonableness does not attach when a deduction is sought by a third party. The opportunity for abuse that arises because the charitable organization does not control the expenditure or require the third party to donate increases as the connection between the unreimbursed expense and the charitable service becomes more removed. In these circumstances, the actual intent of the third party donor becomes suspect. Particularly where the transfer benefits the taxpayer's relative, the suspicion arises that the transfer is a personal gift. Likewise, the question of who should determine whether an expenditure will further the aims of the charitable organization, the third party donor or the charity, begs for an inquiry into whether the expenditure was for a donor-restricted or charity-selected cause. To be consistent with the statute, case law, and the intent of Congress only expenditures for charity-selected causes should be deductible.

Accordingly, in the third party deduction context, charity control should be required.[126] Control in this situation should be determined under the charity control test[127] rather than a possessory control test. Indeed, unreimbursed expenses are made "for the use of" a charity

124. Davis v. United States, 861 F.2d 558, 563 (9th Cir. 1988).

125. *See* Treas. Reg. § 1.170A-1(g) (1986), quoted in part *supra* note 7.

126. The *Brinley* court concluded that rigorous application of the primary benefit test would preclude serious possibility of abuse. Brinley v. Commissioner, 782 F.2d 1326, 1332 (5th Cir. 1986). The government, however, has consistently argued for application of a control test. *See, e.g., Davis,* 861 F.2d at 563; *Brinley,* 782 F.2d at 1330; White v. United States, 725 F.2d 1269, 1271 (10th Cir. 1984). Commentators also have argued for a control test. *See* Note, *Does Charity Begin at Home? The Tax Status of a Payment to an Individual as a Charitable Deduction,* 83 MICH. L. REV. 1428 (1985); Burke & Friel, *Charity Begins at Home:* Brinley v. Comm'r, 10 REV. OF TAX'N OF INDIVIDUALS 379 (1986).

127. *See supra* note 103–05 and accompanying text.

out of the taxpayer's own funds.[128] Requiring a charity to physically possess donated funds would effectively read "for the use of" out of Section 170, and preclude characterization of the transfers as unreimbursed expenses. Application of the charity control test, however, would not require the statute to be rewritten, and would permit funds to be contributed for the use of a charity.

The requirement of control in third party deduction cases would prevent double deductions and deduction shifting. Under the charity control test, the third party taxpayer would bear the burden of showing a specific request from a charity for a specific amount of money to be eligible for a deduction. The possibility of double deductions would decline because only the taxpayer incurring the expense, the third party donor, would be able to produce the required proof. Likewise, the likelihood of deduction shifting would be reduced because the charity itself requested the taxpayer to incur the financial liability of a donation. Donations in excess of what the charity itself would provide would be foreclosed because the amount in excess of the charity request would be considered a non-deductible personal gift. Moreover, charities are unlikely to request more than is necessary for a given cause because the IRS has the power to remove the charity from the list of charities to which deductible funds may be contributed.[129]

Under this proposed analysis, transfers to the Mormon missionaries in *Davis* would be deductible. Control existed because the church requested the expenditure and designated the cause. Double deductions could not occur because the missionaries had no wage income.[130] Deduction shifting was not possible because the taxpayer parents were specifically requested to donate. Similarly, because only the amount the church requested is deductible, the possibility of deductions in excess of the church's request, an abuse feared by the *Davis* court, did not exist.[131] Therefore, the transfers would be deductible as unreimbursed expenses.

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128. Some courts have construed unreimbursed expenses as contributions "to" a charity. *See* Rockefeller v. Commissioner, 676 F.2d 35, 41 (2d Cir. 1982); Wolfe v. McCaughn, 5 F. Supp. 407, 410 (E.D. Pa. 1933).

129. The IRS also has the option of reducing a deduction to an amount it considers reasonable.

130. Because missionaries are paid no wages, most file no income tax return. If a missionary had significant non-wage income, the IRS could require the taxpayers to include the charity's written request for funds with their tax returns. A comparison of the written request with the missionary's return would preclude double deductions.

131. The Mormon Church's request is prima facie reasonable because the amount requested by the church rarely exceeds one-half of the Federal per diem allowance. Telephone interview with Robert Lunt, Attorney for the Davises (April 26, 1989) (notes on file with *Washington Law Review*).

IV. CONCLUSION

Direct charitable transfers should be deductible as Section 170 charitable contributions. The possessory control test adopted by the Ninth Circuit in *Davis v. United States* fails to guarantee the required element of charity discretion, and frustrates charitable giving by unnecessarily impeding the deduction of charitable transfers. The better reasoned approach lies in applying the proposed charity control test which both assures that charity discretion is preserved and prevents taxpayer abuse of Section 170. If it had applied the charity control test, the *Davis* court could have furthered the underlying purpose of Section 170 by encouraging contributions to charity.

Alternatively, direct charitable transfers should be deductible as unreimbursed expenses. In *Davis,* the Ninth Circuit held that only service providers are entitled to an unreimbursed expense deduction. Allowing the third party taxpayers in *Davis* a deduction, however, would have promoted the public policy of encouraging taxpayers to use personal funds to further charitable service. The *Davis* court could have applied the charity control test to avoid taxpayer abuse and assure the use of the transfers for bona fide charitable service.

David L. Herron