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Assignment of Income at the Ivory Tower: Relaxing the Tax Treatment of Services Donated to Charities by Their Employees

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ASSIGNMENT OF INCOME AT THE IVORY TOWER: RELAXING THE TAX TREATMENT OF SERVICES DONATED TO CHARITIES BY THEIR EMPLOYEES

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ABSTRACT

When a faculty member donates time to a college or university by, for example, teaching a summer course for no compensation, the federal income tax treatment of the donation can take one of two forms. One possibility is that the donation will have no tax consequences. The faculty member realizes no income from the donation and gets no charitable deduction. A second possibility is that the faculty member will be required to recognize taxable income equal to the value of the services provided and then may (subject to certain limits) be allowed a charitable contribution deduction. In many cases, the income and deduction do not fully offset, resulting in negative tax consequences for the faculty member. This second possibility occurs when the faculty member directs where the funds saved by the donation are used within the institution. Since faculty members normally would prefer to control the specific use of the saved funds, many donations would result in negative tax consequences sufficient to stifle the donation in the first place. This Article argues that the tax law should be clarified and relaxed to allow faculty members (and other employees of charitable organizations) to donate time to their employer institutions on a tax-free basis in more situations than is currently the case. Alternatively, the Article suggests ways for charities to encourage donations of time by employees, even in the absence of a favorable law change.

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"University professors never think of themselves as employees; they think of themselves as the heart of the place, as the texture of the place, as the essence of the place. And they are right."[1]

I. INTRODUCTION

The tax law stifles attempts by employees of charities to do volunteer work for their employers. The problem is manifest, for example, when a professor wants to contribute to his or her university employer by teaching a class for no compensation. This Article analyzes the problem of donated services by employees of charities (particularly in the context of colleges and universities), suggests reforms to remove the tax barriers to donating time, and recommends measures charities can take to ameliorate the tax impediments to employee volunteerism.

A. Illustrating the Problem: The Tax Education of Professor Flinty

Professors Flinty and Clement were as different as they were inseparable. For 34 years, Flinty and Clement taught accounting at Metro-State University—a quality, but perpetually underfunded, regional institution. "Hard Case" Flinty had a stern reputation for rigor. "Easy A" Clement was known for his jovial nature. Both were excellent teachers revered by generations of students. Together, they battled countless committee assignments, fought to keep the sparse budget from being diverted from traditional disciplines (like accounting, marketing, and the arts and sciences) to "new age" programs and centers, graded thousands of exams, consulted on troubled students, co-authored 22 peer-reviewed articles (three of which were actually worthwhile), dodged dozens of

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[1] A. BARTLETT GIAMATTI, A FREE AND ORDERED SPACE: THE REAL WORLD OF THE UNIVERSITY 43 (1989), *reprinted in* ROBERT BIRNBAUM, SPEAKING OF HIGHER EDUCATION: THE ACADEMIC'S BOOK OF QUOTATIONS 218 (2004).

pushy textbook salesmen, hiked in 32 national parks (30 of which were actually worthwhile), attended 176 home football games, and pondered and debated the great accounting questions of the day. Their relationship ended with Clement's sudden death on a spring day at age 62.

Flinty, nearing retirement and devastated over the loss of his friend, wanted to memorialize his colleague. Rather than donate money to the university in Clement's name, he thought a more appropriate honor would be to donate his time—doing what both he and Clement loved to do—teach. Flinty agreed to take over a summer course on basic accounting that Clement was assigned to teach. Flinty wanted to waive the usual $6,000 that he would receive for teaching the course and asked his department chair, Professor Toptier, to use the funds as seed money for a scholarship in Clement's memory. Toptier wanted to oblige, but informed Flinty that the Dean of the College of Business, Dean Rankings, was taking all available salary savings and redeploying the funds to set up a new online degree program in underwater basket weaving management.[2] Dean Rankings was under a lot of pressure to use the college's resources to get the program running because a major donor made his most recent gift contingent on the college setting up the new online program.[3] This was just the sort of "distracting new age boondoggle" that Clement and Flinty had fought against their entire careers.

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[2] *Cf.* Alisha Azevedo, *"UnderAcademy College" Satirizes Massive Open Online Courses*, CHRON. HIGHER EDUC., Sept. 14, 2012 (reporting on a free online "experimental college" that uses the motto "unaccredited since 2011" and offers courses such as "Grammar Porn" and "Underwater Procrastination and Advanced Desublimation Techniques").

[3] Someone likely convinced the Dean that the program aligned with (at least) two of the four goals in the college's strategic plan (increasing online offerings and increasing interdisciplinary programs). Never underestimate the importance of aligning—at least in form—your suggestions with the otherwise ignored strategic plan.

Furious, Flinty insisted that Dean Rankings agree—in writing—that the $6,000 savings be used for the Clement Memorial Scholarship fund rather than the new online program. After some posturing and making it seem like he was doing Flinty a huge favor, the Dean agreed. All was well—or so Flinty thought.

That summer, after the accounting course had finished, Flinty noticed that his paycheck was lower than usual. Upon inspection, he discovered that $6,000 had been added to his taxable income and that the income and payroll tax withholdings due on the $6,000 had been taken out of normal salary—reducing his take home pay. Figuring this was an error, Flinty immediately called the payroll department to complain about being taxed on $6,000 of salary that he never received. Payroll referred him to the university's in-house tax attorney, Ms. Chary.

Chary had recently been put in charge of the university's tax compliance after an IRS audit revealed some rather slipshod procedures, particularly with regard to payroll reporting. Chary had been instructed by the university's Chief Financial Officer to ensure compliance with the tax law and to err on the side of the government if there was any ambiguity.

Chary explained that since Flinty directed where the $6,000 would be spent (on the scholarship fund rather than at the whims of the Dean), in substance Flinty had received the $6,000 salary and then contributed it to the scholarship fund. Chary referred to this phenomenon as "anticipatory assignment of income."[4] Accordingly, the $6,000 salary was subject to income and payroll taxes as if he had received the cash. Sensing Flinty's rising anger, Chary quickly added that Flinty would be eligible to deduct the $6,000 that he was deemed to have contributed as a charitable contribution deduction.

[4] This confused Flinty, who had given out a lot of assignments in his career, but never income.

After all, Chary explained, if Flinty had simply donated $6,000 in cash to the scholarship fund, he would have been donating after-tax money and then taking a charitable tax deduction on his tax return. Chary stressed that the charitable deduction would only eliminate part of Flinty's issue because while it would reduce his taxable income for income tax purposes, it would not reduce his taxable income subject to payroll tax. Chary's logical explanation and alluring promise of a deduction came as cold comfort, since Flinty and his wife did not itemize deductions on their tax return (even taking into account the $6,000).

Flinty had tried to honor his good friend by donating his time doing what they both loved—teaching. His reward was lower take-home pay. Flinty was appalled, but got over it. He realized two things. First, that even time can be taxed. Second, he was glad he didn't specialize in tax accounting.

B. The Problem of Donated Services

The tax law governing services donated by employees of charities, especially by employees of colleges and universities (like Flinty), is in need of clarification and liberalization. In a time of budget cuts due to declining state funding or endowment earnings, colleges and universities must get creative. Reliance on more volunteers is one way to continue to staff student services while reducing costs. The ones most likely to volunteer to help with the teaching mission of the university are those who have dedicated their careers to that endeavor—full time faculty members. Such faculty may be willing to teach an extra class or a summer class sans compensation. Local business folks or other alumni also may be willing to pitch in and teach a course pro bono.

Unfortunately, as Flinty discovered, a tax barrier stands in the way of these otherwise salutary relationships. Unless structured properly, the service provider will have income and be deemed to have made a charitable contribution. Apart from the possible negative tax consequences,[5] the tax reporting involved simply comes as an unpleasant surprise and annoyance that may stifle attempts to encourage volunteerism.

While focusing specifically on the unique landscape of higher education (be it state or private, nonprofit institutions), many of the issues explored here would be applicable to services donated by employees of charities in general. The challenge throughout is crafting a rule that fosters donations of services while not opening the door to abuse. This seemingly straightforward issue, as will be seen, invokes important issues of tax law, tax policy, and modern higher education practice, framed by the dark underside of faculty politics and the specter of subterfuge.

This remainder of this Article is organized as follows. Part II briefly reviews the basic, relevant tax rules governing charitable contributions. Part III then looks at the rules that currently apply when services are donated to charity, how colleges and universities apply those rules, justifications for the rules, and how those rules can result in negative tax consequences to the donor. Part IV presents numerical examples of the impact of the current rules, shows how the current rules can sometimes violate horizontal equity, and makes the case for relaxing the rules. Part IV also provides examples of existing and proposed tax law provisions that provide (or would provide) relief in

[5] The negative tax consequences include the imposition of payroll taxes and the possibility that the charity deduction will not fully offset the imputed income because of limits on the deduction for charitable contributions. These issues will be discussed in detail at *infra* Part III.E.

situations that are somewhat analogous to donated services. Part V suggests ways that the rules can be relaxed and reviews the benefits and possible objections to relaxation. Part VI suggests ways that colleges and universities can, in the absence of liberalized treatment, remove the tax barriers themselves either by grossing-up employee-volunteers for the negative tax consequences of donating time or by changing their policies regarding the internal deployment of funds saved because of donated services. Part VII briefly concludes.

II. CHARITABLE CONTRIBUTIONS IN GENERAL

To understand the discussion which follows, this Part will briefly review the basic tax rules of charitable contributions. Individuals may deduct the amount of cash donated to charity during the year.[6] The deduction is only available if the taxpayer elects to itemize deductions rather than take the standard deduction.[7] The deduction is generally limited to 50% of the taxpayer's adjusted gross income (AGI), with any excess carried over to the subsequent five years.[8] While donations of cash are deductible, donations of

[6] I.R.C. § 170(a)(1). Special rules, not relevant here, apply to property donations.

[7] *See* I.R.C. § 63(d) (defining itemized deductions as all allowable deductions except those allowable in calculating adjusted gross income); § 62(a) (listing the deductions allowable in calculating adjusted gross income; the deduction for charitable contributions under § 170 is not on the list). Taxpayers who itemize tend to be those who own homes, with the mortgage interest and real estate tax deductions pushing their itemized deductions over the standard deduction. Because of the limits on deductibility, a minority of taxpayers actually benefit from the charitable contribution deduction. Nonetheless, charities often tout the benefits of tax-deductibility to potential donors, without acknowledging the limitations. Lilian V. Faulhaber, *The Hidden Limits of the Charitable Deduction: An Introduction to Hypersalience*, 92 B.U. L.REV. 1307, 1309-10 (2012).

[8] I.R.C. § 170(b)(1)(A) (setting forth the general 50% limitation); 170(d)(1)(A) (providing rules for the five year carryover of excess contributions). This is the general rule. Lesser percentage limitations apply to special situations not relevant here. Technically, the limit is 50% of the taxpayer's "contribution base" for the year. But the contribution base is simply the taxpayer's adjusted gross income without considering any net operating loss carrybacks. I.R.C. § 170(b)(1)(G). To simplify matters, and since net operating loss carrybacks are rare for employees, I will assume that the taxpayers in the examples in this Article do not have any net operating loss carrybacks.

time/services are not.[9] But unreimbursed out-of-pocket expenses incurred while performing volunteer services for a charity are deductible.[10]

To qualify for a deduction, the contribution must be made to (or for the use of) an entity listed in Section 170(c). For present purposes, the most relevant entities on the list are states and their political subdivisions[11] and entities "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes."[12] The latter category embraces the archetypal charities like churches, homeless shelters, museums, and private schools. These charities are normally ones that qualify for tax-exempt status under Section 501(c)(3).[13]

A private, nonprofit college or university, because it exists for educational purposes, is normally operated as a Section 501(c)(3) organization and is eligible to receive tax-deductible charitable donations.[14] A public college or university is exempt from the federal income tax by virtue of being part of the state government.[15] While state

[9] Reg. § 1.170A-1(g).
[10] *Id.* Such expenses are normally similar to the types of expenses one would incur with respect to a business. With regard to travel expenses incurred in charitable work, a deduction will only be allowed if "there is no significant element of personal pleasure, recreation, or vacation in such travel." I.R.C. § 170(j). Apparently the tax law views charitable work as serious labor. So whatever you do, don't enjoy yourself while volunteering. The standard mileage rate allowed for charitable use of a passenger automobile is limited to 14 cents per mile, rather than the normal business mileage rate. I.R.C. § 170(i).
[11] I.R.C. § 170(c)(1). Payments are only deductible to such entities if "made for exclusively public purposes." *Id.*
[12] I.R.C. § 170(c)(2)(B).
[13] *Compare* I.R.C. § 501(c)(3) *with* I.R.C. § 170(c)(2). While I.R.C. § 501(c)(3) defines what types of organizations are eligible for the exemption, it is I.R.C. § 501(a) that actually grants the exemption. Organizations that qualify for tax-exempt status under § 501(c)(3) and are eligible to receive tax-deductible contributions under § 170(c) are subject to several requirements to attain and maintain their tax-favored status. Such requirements are beyond the scope of this article. For more details, *see generally* Mark J. Cowan & Denise English, *A Tax Primer for CPAs Volunteering at Nonprofit Organizations*, THE TAX ADVISER, March 2007, at 150. For present purposes, I assume that all organizations at issue in this Article meet the requisite requirements.
[14] We are, of course, not discussing for-profit colleges and universities—like the University of Phoenix (owned by the Apollo Group; see http://www.apollogrp.edu) since such entities are taxable and are not eligible to receive tax deductible donations.
[15] At first glance, it appears that I.R.C. § 115 covers the tax treatment of state governments. § 115(1) states that "[g]ross income does not include income derived from a public utility or the exercise of any essential

governments are eligible to receive tax-deductible donations directly,[16] most donors give to a public university via a separate "supporting organization" that independently qualifies as a section 501(c)(3) organization. A supporting organization raises funds, manages endowments, and distributes funds for the benefit of the supported public university.[17] There appears to be, therefore, little distinction between giving to a private,

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governmental function and accruing to a State or any political subdivision thereof . . . ." Thus, per § 115, it appears that income from a commercial enterprise of a state government (which would not be considered an "essential governmental function") would be subject to the federal income tax while income from a governmental function would be exempt. The IRS, however, has interpreted the "accruing to" language in § 115 as meaning that the commercial/governmental distinction only applies to entities owned by state governments. *See* Gen. Couns. Mem. 14,407, 1935-1 C.B. 103 (Jan. 23, 1935). State governments themselves are not subject to § 115. *Id.* Rather, the IRS views state governments as simply falling outside the scope of the Internal Revenue Code. *Id.* Under the IRS's view, *all* income of a state government, commercial or governmental, is exempt from the federal income tax. *See id.* While the rationale for this stance is unclear, the IRS's approach at least has the virtue of avoiding the difficult task of distinguishing between the commercial and governmental functions of the state government. Although the IRS views states (including state colleges and universities) as generally beyond the reach of the I.R.C., there is one code provision that specifically subjects some income of states to the federal income tax. I.R.C. § 511(a)(2)(B) applies the unrelated business income tax (UBIT) to state colleges and universities.

[16] See *supra* note 11.

[17] The structure used by the University of Idaho, for example, is typical. The school's endowment is owned and managed by a separate entity, the University of Idaho Foundation, Inc., for the exclusive benefit of the University of Idaho. See http://www.uidahofoundation.org. The foundation handles fundraising for the University of Idaho, and all decisions regarding fundraising priorities are set by the administration of the university itself. See Frequently Asked Questions, at http://uidahofoundation.org/uidahofoundation/about/faqs. The foundation's website explains the use of a separate fundraising and endowment organization as follows:

> Why is the [University of Idaho] Foundation separate from the University of Idaho? The vast majority of American public colleges and universities have separate Foundations, organized as not-for-profit 501 (c) (3) corporations, for good reasons: confidentiality of personal documents related to gifts such as wills, trust agreements and correspondence; stewardship of endowment funds to ensure the joint goals of growth and return are met in the best interest of the donors; and to provide flexibility through discretionary funds to the growth of programs of excellence at the University of Idaho.

Id. The last point, regarding "flexibility through discretionary funds," is critical. Public colleges and universities use separate foundations in order to raise private money that they can use outside of the confines of state-imposed restrictions on expenditures. *E.g.*, BRUCE M. STAVE, RED BRICK IN THE LAND OF STEADY HABITS: CREATING THE UNIVERSITY OF CONNECTICUT, 1881-2006 112-13 (2006) (reporting that the University of Connecticut established a foundation in the 1960s to create a pool of funds the school could use, without state restrictions, to help the school achieve excellence); *see also* UConn Foundation FAQ at http://www.foundation.uconn.edu/faq.html (explaining the relationship between the University of Connecticut and its foundation). Many schools have more than one supporting foundation. For example, a school may have, in addition to its general supporting foundation, an athletic booster club that raises and invests money to support the school's athletics programs. *E.g.*, Paul Fain, *Oregon Debates Role of Big Sport Donors*, CHRON. HIGHER ED., Oct. 26, 2007, at A38 (indicating how donations raised by booster clubs are used in college and university athletic departments).

nonprofit university and a public university. [18] But the distinction may become important, as discussed below, when looking at the tax treatment of an employee's donation of time to her employer-university that benefits a separate supporting organization.[19]

A donation to an individual is not deductible, regardless of how needy the recipient may be.[20] Likewise, a donation to a charitable organization is not deductible if it is designated for the benefit of a particular individual.[21] Indeed, an essential element of a charitable contribution is "indefiniteness of bounty" in that the gift benefits the

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[18] The private/public distinction is, of course, relevant for nontax legal reasons. For example, a public institution owes due process and other constitutional protections to students, faculty, and staff while private institutions generally do not. *E.g.* WILLIAM A. KAPLIN & BARBARA A. LEE, THE LAW OF HIGHER EDUCATION 42 (4th ed. 2006). The line dividing public and private institutions is not always clear. *See id.* at 42-43.

[19] See *infra* Part V.A.1. Private colleges and organizations supporting public colleges are generally not classified as "private foundations" under the tax law. Colloquially, a private foundation is a section 501(c)(3) organization that derives the bulk of its support from limited sources—normally a wealthy family or a corporation. JAMES J. FISHMAN & STEPHEN SCHWARZ, TAXATION OF NONPROFIT ORGANIZATIONS: CASES AND MATERIALS 472 (3d ed. 2010). Note that whether or not an organization has "foundation" in its name is of no consequence. Many nonprofits use "foundation" in their name but are not subject to the private foundation rules. Technically, all section 501(c)(3) organizations are considered private foundations unless they meet one of the enumerated exceptions to such status. I.R.C. § 509. Colleges and universities, regardless of the source of their funds, are not classified as private foundations. I.R.C. § 509(a)(1) (indicating that an organization described in I.R.C. § 170(b)(1)(A) will not be considered a private foundation); I.R.C. § 170(b)(1)(A)(ii) (referring to "an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on"—a definition which obviously applies to the typical college or university). Likewise, organizations supporting public colleges and universities are normally exempt from private foundation status. I.R.C. § 509(a)(1) (indicating that an organization described in I.R.C. § 170(b)(1)(A) will not be considered a private foundation); I.R.C. § 170(b)(1)(A)(iv) (referring to an organization with substantial public support "which is organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of a college or university . . . and which is an agency or instrumentality of a State. . ."). Such organizations are commonly referred to as "supporting organizations." Provided these organizations meet the requisite public support test, they will not be classified as private foundations. Section 501(c)(3) organizations that are classified as private foundations are subject to a litany of requirements in addition to the normal rules governing tax exempt organizations *See generally* I.R.C. § 4940-4945. Further discussion is not necessary. Throughout all of the examples in this Article, I assume that the organizations at issue (be they associated with a college or not) are not private foundations.

[20] *See* I.R.C. §170(c) (listing the *organizations* eligible to receive tax-deductible donations).

[21] S.E. Thomason v. Comm'r, 2 TC 441 (1943) (holding that a taxpayer could not deduct payments made to support a specific individual, who was a ward of a charitable organization).

charitable class of the organization in general, and not any particular individual. [22] Thus, a donor cannot mandate that an endowed chair go to a particular professor or that a scholarship fund be disbursed to a particular student. But short of naming the intended beneficiary, donors have a lot of leeway in designating how their gifts will be used. A donor may, for example, earmark the donation for use in the construction of a particular building, for a scholarship for students with a particular attribute[23] (e.g., junior year accounting majors), or for an endowed chair to be awarded to a scholar that researches or teaches in particular area.[24] The key is that the organization (and not the donor) have control over the funds and the donor's "intent in making the payment must have been to benefit the charitable organization itself and not the individual recipient."[25] Given this landscape (no deduction for a gift designated for a particular individual; deduction for a gift with a designated purpose), charities and their donors can be quite ingenious in structuring donations so that the identity of the individual(s) benefiting are theoretically "indefinite," but in reality readily known. This "wink and a nod" type of arrangement, while questionable, is likely rather common. Imagine, for example, a wealthy donor wants to benefit a favorite teacher from many years ago who studies the impact of beer sales on fruit flies. The donor can designate her gift for an endowed chair for a scholar of

[22] *Id.* at 444. As the Tax Court notes: "Charity begins where certainty in beneficiaries ends, for it is the uncertainty of the objects and not the mode of relieving them which forms the essential element of charity." *Id.* at 443.

[23] The attributes should not involve racial or other suspect classes. There is a loose "public policy" requirement that is imposed on by the courts. The primary authority in this area is *Bob Jones University v. U.S.*, 461 U.S. 574 (1983). Even though I.R.C. § 501(c)(3) has no explicit public policy requirement, the Supreme Court upheld the revocation of Bob Jones University's tax exemption because the school discriminated on the basis of race. *Id* .at 605. Such discrimination violated a clear public policy and therefore violated common law notions of "charity." *Id.* at 586.

[24] *See, e.g.*, Rev. Rul. 68-484, 1968-2 C.B. 105 (allowing a charitable deduction for amounts given to schools for scholarships where the schools chosen were those at which the taxpayer recruited employees; a scholarship recipient was under no obligation to work for the donor and the donor was under no obligation to hire the scholarship recipient).

[25] *Id.*

such a topic. Lo and behold, it turns out there is really only one scholar eligible for the support.

Another limit on deductibility is that the donation must be a true gift to the charity. That is, the donation must be made with "detached and disinterested generosity" with no expectation of an economic benefit being given by the charity in exchange for the donation.[26] This rule exists to prevent taxpayers from deducting amounts paid to a charity that were really for purchases of goods and services. For example, a taxpayer cannot claim charitable contribution deductions for payments of tuition to a university or medical bills to a hospital. The payments were made to charities, but they were made in return for services, not as gifts.[27]

Individuals are motivated to give for a variety of reasons. Some give out of pure altruism—a genuine concern for the welfare of others.[28] Those who give out of a sense of altruism do so unselfishly and get no return benefit from their donations.[29] Others give to experience "warm glow"—the enjoyment from making others happy, the recognition, and the sense of self-satisfaction that can come with donating.[30] Others give perhaps for religious reasons or more selfish reasons—to butter up a business acquaintance, to bolster

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[26] Comm'r v. Duberstein, 363 U.S. 278, 285 (1960). While *Duberstein* involved the issue of whether a transfer was a gift for income tax purposes under I.R.C. § 102, the same standard applies for purposes of the charitable contribution deduction under I.R.C. §170.

[27] Such payments may be deductible under other provisions of the Internal Revenue Code—for example as tuition payments or medical expenses—but the payments do not qualify as charitable contributions. Often a taxpayer will make a payment to a charity that is really a dual payment—part charitable gift, part purchase. This often occurs where a taxpayer buys tickets to a benefit concert for more than the fair market value of the concert tickets. Part of the payment is a nondeductible purchase (the fair market value of the concert tickets) and part is a charitable contribution (the excess over fair market value). The taxpayer must prove that he intended to make a charitable gift for the excess. *See* Reg. § 1.170A-1(h). *See also* Rev. Rul. 67-246, 1967-2, C.B. 104 for examples of these scenarios. Further discussion is beyond the scope of this Article.

[28] THE STAFF OF THE JOINT COMMITTEE ON TAXATION, PRESENT LAW AND BACKGROUND RELATING TO THE FEDERAL INCOME TAX TREATMENT OF CHARITABLE CONTRIBUTIONS 33 (JCX-4-13, Feb. 11, 2013) [hereinafter PRESENT LAW].

[29] *Id.*

[30] *Id.*

one's image in the community, to attain donor privileges to buy athletic tickets, etc. The more selfish reasons for giving—those where the donor receives a substantial return benefit—may serve to limit or erase the deduction.[31]

Some scholars opine that the deduction for charitable contributions is a government subsidy; akin to the government providing funds to donors or charitable organizations.[32] But others view charitable contributions not as a subsidy, but as a necessary deduction to arrive at a normative measure of income.[33] The tax law's normative notion of income, at least in the personal realm, derives from the Haig-Simons definition: income is equal to the taxpayer's consumption during the year plus the increase in the taxpayer's wealth during the year (wealth at the end of the year less wealth at the beginning of the year).[34] The question is whether donations to charity are "consumption" for purposes of this definition. If charitable contributions are not consumption, but rather decreases in wealth, then they should be deductible. If charitable contributions are consumption, then they should not be deductible under a normative income tax. If charitable contributions are consumption but the government nonetheless allows a deduction for charity, then the government has made a policy choice to deviate from the norm and provide a subsidy to the charitable sector and to donors. Indeed, the tax expenditures budget, which reports the government's revenue losses from special tax

[31] See *supra* notes 26-27 and accompanying text.
[32] For an overview of the subsidy view of charity, see FISHMAN & SCHWARZ, *supra* note 19, at 595-615 (internal citations omitted). *See also* William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV.L. REV. 309, 344 n. 64 (1972) (referencing sources that call the charitable deduction a subsidy).
[33] *E.g.*, Andrews, *supra* note 32, at 346.
[34] HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (1938).

breaks that deviate from a normal income tax, takes this view.[35] The deduction for individuals is expected to cost the government $36.2 billion in lost revenue in 2012.[36]

Scholars such as William Andrews disagree with the subsidy view and argue that many contributions are not consumption by donors, but are consumption by the charitable class (needy, students, patients, etc.) of the donee organization.[37] Since consumption is shifted from the donor to the donee, the charitable contributions should be removed from the donor's taxable income under a normative income tax.[38] Andrews notes that this occurs in other areas of the tax law. When generous business owners pay slightly above-market wages to their employees, for example, they get business deductions—shifting the income from the business owners to the employees.[39] Andrews opines that a similar shift of income should occur for taxpayers who give to charity.[40]

With this basic overview in mind, we now look in more detail at the tax treatment of donated services.

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[35] THE STAFF OF THE JOINT COMMITTEE ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012-2017 2 (JCS-1-13, FEB. 1, 2013) [hereinafter TAX EXPENDITURES].

[36] *See id*. at 37 ($4.9 billion in lost revenue on charitable contributions to educational institutions), 38 ($28.8 million in lost revenue on charitable contributions other than for education and health; includes charitable donations to religious organizations), & 39 ($2.5 million in lost revenue on charitable contributions to health organizations).

[37] Andrews, *supra* note 32, at 347.

[38] *Id.* Andrews argues that the donation should in theory be taxed at the tax rate of the recipient members of the charitable class, but notes the rate will be zero in most cases (because the recipients are likely to have few earnings—most of which will be offset by personal exemptions and standard deductions in calculating taxable income). *Id.* As a practical matter, recipients of charitable assistance are normally viewed as receiving non-taxable gifts.

[39] *Id.*

[40] *Id.* Andrews acknowledges counterarguments that charitable contributions may be consumption if the donor is buying warm-glow effects or simply because the donor controls the resources being used—even though the resources are being used to help others. *Id.* at 346. Similarly, some commentators say that those who give out of pure altruism are shifting wealth rather than engaging in consumption while those who give for warm glow or other benefits are in fact engaging in consumption. *See* PRESENT LAW, *supra* note 28, at 33. But, as a practical matter, unless something tangible is received in return, it is hard for the tax system to look too closely into the subjective motives of donors.

III. THE CURRENT TAX TREATMENT OF DONATED SERVICES

This Part provides an overview of the current tax law guidance about donated services and the theories that commentators have articulated to explain those rules. The tax treatment of donations of time by employees of charities could arguably take one of two opposing forms, both based on long-established tax law. One possibility follows the general rules for donations of time in which there are no tax consequences. The second possibility, and the one that colleges and universities are assuming (with good reason) is applicable, relies on doctrines such as constructive receipt and assignment of income to impute income to the employee and then (if the employee otherwise qualifies) allow the employee a deduction for the charitable contributions. Parts A and B discuss each possibility, Part C reviews current practice in higher education, Part D reviews the rationale for the current rules, and Part E shows how the tax law does not always allow a taxpayer in the imputed income/deduction category to come out even.

A. First Possibility: No Income/No Deduction

As noted above, donations of services to charity are normally not deductible. There are two rationales for this seemingly harsh rule—one practical and the other theoretical. First, unlike cash donations, service donations are difficult to value. Any value chosen would necessarily be subjective, and the tax law becomes difficult to administer when forced to deal with subjectivity. The value of the donated services will vary by the skills of the individual donor and the nature of services being provided. The IRS simply cannot be expected to police the amount of claimed tax deductions for time on a taxpayer by taxpayer basis. The IRS does not confront this valuation issue in the non-gratuitous setting because the tax law assumes (reasonably, in most cases) that the services provided are worth exactly what the service recipient paid for those services. This notion, known as the arm's length concept,[41] is not available to assist in valuing services performed for charity without compensation.[42] Accordingly, not allowing a deduction for donated services appears sensible.

One could argue that the tax law could have taken a less draconian approach to the valuation issue. Congress could have, for example, provided for a deduction for time based on some arbitrary but uniform per-hour rate, with charities subject to reporting

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[41] *See, e.g.*, JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES 317 n. 15 (4th ed. 2008). Under the arm's length concept, the tax law generally assumes that the contracting parties and the market set prices and values in transactions between unrelated parties. The tax law will respect such prices and values in calculating tax even if they are "wrong" and one party got a bargain while another got a bad deal. But the tax law carves out special rules for, and the tax authority focuses its limited enforcement resources on scrutinizing, those prices/values that were *not* established in arm's length dealings—like transactions between related parties. It is those transactions that may well result in manipulated prices and reduced tax liability, and which are worthy of special scrutiny and possible adjustment to fair market value. *See, e.g.*, I.R.C. § 482 (giving Treasury power to reallocate income, deductions, and other tax items among related entities to clearly reflect income).

[42] Despite the practical difficulties of valuation, charities that prepare financial statements under Generally Accepted Accounting Principles (GAAP) are required to report the fair market value (both as revenue and as an expense—or an asset if capitalized) of certain donated services. These are generally limited to service contributions that enhance nonfinancial assets (like land, buildings, or supplies) or that require specialized skills (generally services provided by licensed professionals—like an accountant, a lawyer, a plumber, a teacher, etc.). Financial Accounting Standards Board Accounting Standards Codification (ASC) 958-605-25-16. The value of other service contributions need not be reported, but must be disclosed if practicable. ASC 958-605-50-1. It could be argued that since this information is readily available for GAAP, the tax law can simply accept these values. But, first, not all charities report their results under GAAP. The tax form that most charities are required to file, Form 990, specifically instructs charities to NOT include the value of donated services in revenue or expense (although they may provide a narrative description of such services). 2010 INSTRUCTIONS FOR FORM 990, RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX 12. Second, the tax law often disregards GAAP, especially when GAAP uses estimates. For example, for-profit entities estimate their bad debt expense for credit sales each year for GAAP purposes, but are only allowed to deduct such expense on their tax returns when the related receivable has been written-off/becomes worthless. I.R.C. § 166. As the Supreme Court has stated:

> Financial accounting, in short, is hospitable to estimates, probabilities, and reasonable certainties; the tax law, with its mandate to preserve the revenue, can give no quarter to uncertainty. This is as it should be. Reasonable estimates may be useful, even essential in giving shareholders and creditors an accurate picture of a firm's overall financial health; but the accountant's conservatism cannot bind the Commissioner in his efforts to collect taxes.

Thor Power Tool Co. v. Comm'r, 439 U.S. 522, 543 (1979). Accordingly, the availability of some estimate of value for some donated services for some charities that report under GAAP cannot reliably be used to support a tax law that would allow a deduction for donated services.

requirements regarding the amount of time donated by each individual.[43] Such an approach would still suffer from practical difficulties in that charities would need to keep better track of their various volunteers (sometimes an informal and chaotic process). Also, such an approach would not satisfy the second rationale for nondeductibility of service donations—to which we now turn.

The second, and more theoretical, rationale for not allowing a deduction for the value of donated services is to prevent taxpayers from getting a double benefit for donating time. Because our income tax has a broad definition of income, most charitable donations of cash are financed by funds that were taxed.[44] Allowing a deduction for cash donations thus cancels out the taxed income and effectively removes the donation from the tax base. With a donation of time, the taxpayer is not reporting any taxable income for their forgone earnings. Allowing a deduction for such taxpayers would thus create a double benefit: no income included in taxable income for the forgone earnings and a deduction for the volunteered time.

The Haig-Simons normative definition of income, discussed above, does not tackle the issue of time donated to charity.[45] But Henry Simons does note that "income in kind"—in particular income generated from one's own labors—cannot practically be taxed under a normative income tax.[46] That is, the value of goods and services we produce for ourselves—such as growing our own food or mowing our own lawns—is

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[43] See *infra* note 212 for a similar proposal.
[44] See, e.g., I.R.C. § 61(a) (noting that "[e]xcept as otherwise provided . . . gross income means all income from whatever source derived). Of course, not all income is subject to tax. For example, the income donated to charity may have been made with tax-exempt income, such as interest income from municipal bonds (I.R.C. § 103(a)) or the rental of property for less than 15 days (I.R.C. § 280A(g)). Also, the donation may have been funded by a nontaxable gift or inheritance (I.R.C. § 102(a)). Of course, such income tax free transfers may have been subject to gift tax or estate tax. Thus, the theory is not perfect.
[45] See *supra* note 34 and accompanying text.
[46] SIMONS, *supra* note 34, at 110-12.

technically "income" but the value of such income cannot be accurately measured and cannot be policed efficiently by the tax authority. Simons calls income in kind "one of the real imponderables of the income definition" yet one that "considerations of justice, not to mention those of administration, argue" be excluded from taxable income.[47]

William Andrews has taken Simons's thoughts a bit further by analyzing the interaction of the exclusion for imputed income and the charitable deduction rules.[48] In a classic example, adapted here with some modifications, Andrews compares the tax consequences that befall a doctor who treats patients for free at a 501(c)(3) medical clinic with a tax lawyer who donates money to the medical clinic.[49] Assume the doctor and the lawyer each makes $800 per day in doing their regular jobs. The doctor takes a day off from work to provide services at the medical clinic. The lawyer, who has no skills the clinic can use, works an extra day at his job, earning an additional $800, and then donates the $800 (in cash) to the clinic. Under our tax law, the doctor would get no deduction for her charitable work. The lawyer would get an $800 deduction for his charitable donation of cash.[50] While it appears the lawyer is in a better tax position, in reality the doctor and the lawyer are in the same position. This is because the lawyer realized $800 of taxable income from working the extra day while the doctor did not need to include in taxable income the $800 of salary she gave up to work at the clinic.[51] Thus, the doctor and the lawyer are in the same tax position, as follows:

[47] *Id.* at 124.
[48] *See* Andrews, *supra* note 32, at 347-48.
[49] *Id.* Andrews's original example did not include numbers. I have added them—and a few other details—here for illustration.
[50] Assuming the lawyer itemizes his deductions and is not impacted by the limits on deductibility discussed at *infra* Part III.E.
[51] Reg. § 1.61-2(c) (discussed in more detail at *infra* Part III.B.5).

Assignment of Income at the Ivory Tower

	Doctor	Lawyer
Taxable Income	0	$800
Charitable Deduction	0	($800)
Net	0	0

Since the donor of time and the donor of cash end up in the same position, this can justify denying a charitable deduction to the former while granting it to the latter.

While Andrews's example comes out neatly, keep in mind it only shows that the two taxpayers are on the same footing when it comes to income taxes. But the two are not in the same position for payroll/self-employment taxes. The doctor, without any wages, has no payroll tax liability. The lawyer, however, will need to pay FICA (if an employee) or self-employment tax (if self-employed) on his $800 of extra earnings. FICA and self-employment taxes are on gross pay; there is no deduction for charitable contributions from payroll taxes.[52] Furthermore, the lawyer may have limits on his ability to deduct the full $800, as discussed below.[53] Because of the deduction limits that can apply, it is possible that the lawyer (who gets a deduction) is actually worse off tax-wise than the doctor (who gets no deduction). After all, an exclusion from income is almost always preferred to a deduction.

B. Second Possibility: Imputed Income/Deduction

Donating time may result in tax consequences if the donors are viewed as assigning income which they earned to a charity. In such a case, the donors will be deemed to have earned taxable income via their work, and must pay income tax

[52] See more detail at *infra* Part III.E.5.
[53] See *infra* Part III.E.

(including FICA). The donors will then be deemed to have donated the earned income to the charity and may take charitable contribution deductions as if they had remitted cash to the charity. An assignment of income situation can occur when individuals assign their wages to a charity, or (as in Flinty's situation in our opening example) when the donors are employed by a charity but forgo some of their salary.

Because there is no primary authority directly on point, this Part will analogize from authorities in related areas. In the materials reviewed in this Part III.B, two fundamental tax doctrines are invoked: constructive receipt and assignment of income. The constructive receipt doctrine prevents a cash basis taxpayer from postponing the reporting of income "by failure to exercise his or her unrestricted power to collect it."[54] Cash basis taxpayers normally include amounts in taxable income upon actual receipt in cash.[55] But this rule provides the opportunity for manipulation. Cash basis taxpayers might be motivated, for example, to refuse cash they are owed near year end and ask the payor to pay in the new tax year. Unchecked, cash basis taxpayers could post-pone income into a different tax year. The taxpayer will still pay tax on the payment, but has managed to defer the tax a year while only deferring the receipt of the payment by a few days. Deferral of tax is a classic tenant of tax planning that makes the taxpayer better off on an after-tax time value of money basis.[56] To prevent this tax deferral, the tax law requires that cash method taxpayers not only report actual cash received but also cash *constructively* received.[57] The regulations note:

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[54] RICHARD A. WESTIN, WG&L TAX DICTIONARY 132 (2000).
[55] Reg. § 1.446-1(c)(1).
[56] Deferral makes sense if the taxpayer will be subject to the same marginal tax rate in each year. If the marginal rate in the second year is expected to be higher, the taxpayer would balance the additional tax that would be due because of deferral against the time value of money savings associated with deferral.
[57] Reg. § 1.446-1(c)(1).

> Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.[58]

So, if income is available, waiting for the taxpayer to claim it in cash, the taxpayer cannot turn his back on the income and wait until a later tax year to claim it. Regardless of when he claims it, it is taxable in the year it is available to him and within his control to claim. A fitting, but hard to detect, example would be a cash basis plumber who repairs a customer's sink on December 27, 2012 and bills the customer $1,000. The customer is so pleased with the job that he offers the plumber a $1,000 check on December 27. If the plumber refuses the check and asks the customer to mail him the check instead—and the check arrives on January 2, 2013—the plumber may think he has deferred income to his 2013 Form 1040. But under the constructive receipt doctrine, the plumber would be required to include the $1,000 in income on his 2012 Form 1040, despite the fact that he "received" the cash/check in 2013.[59]

The classic case of constructive receipt, explained above, would not appear to apply to a situation like Flinty's. The plumber was trying to defer income by waiting a few days (until the new tax year) to claim his income. At the end of the day, he still gets the $1,000. But Flinty was not trying to game the system. Flinty is never going to receive the $6,000. He was trying to give it away. Even so, Flinty did constructively

[58] Reg. 1.451-2(a).

[59] As noted, this would be hard for the IRS to detect. But the law is the law and the constructive receipt doctrine helps protect the government from these maneuvers on a much larger scale. Given the difficulty that the IRS has in auditing small business like the plumber, we should be thankful the plumber is reporting the $1,000 at all. There is strong incentive to take payment in cash and not report it since there is no third party reporting (1099s, W-2s) like there is in other tax situations. Furthermore, it is not very efficient for the IRS to audit many small businesses like the plumber for a small amount of revenue per audit.

receive the $6,000 because he had control over the funds. Even though the cash never passed through his hands, he did oversee their passage from the university's payroll accounts to the scholarship fund. It is no different from Flinty taking the cash in his paycheck and then sending the cash to the scholarship fund. He cannot avoid the income by simply controlling things from afar. Thus, while the constructive receipt doctrine is not directly on point, its core principle can be applied to donated services.[60]

The second tax doctrine that might be invoked is assignment of income. Like constructive receipt, it does not neatly fit into the donated services context but its principles do apply. The assignment of income doctrine is "a judicial doctrine that treats attempts at gratuitous transfers of income interests as ineffective to shift income to another."[61] As discussed more fully below in connection with the *Earl* case, the doctrine requires that one who earns income pay tax on the income. A taxpayer cannot assign income to another (usually a family member) and escape taxation. In the donated services context, this is not what is going on. Flinty is not assigning his salary to, say, his son—keeping the income in the family. Instead, he is giving the income away to an entity—the university or its foundation—that would not pay tax on it in any event. It does not benefit Flinty from an economic perspective to do this. But it does accomplish his goal of funding a scholarship in honor of his friend.

There is no regulation, case, or ruling that explicitly applies either the constructive receipt doctrine or the assignment of income doctrine to donated services like in Flinty's

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[60] One reviewer has suggested that Flinty might avoid the constructive receipt doctrine because he refused the income *prior to* rendering services. The problem with this conclusion is that Flinty had control over where the saved proceeds were used—they were designated for a particular scholarship program. Even if he avoids constructive receipt under such facts, he would (as discussed in more detail below) be subject to tax under the assignment of income doctrine. See the discussion of the *Giannini* and *Hedrick* cases at *infra* Part III.B.4 for more discussion on this issue.
[61] WESTIN, *supra* note 54, at 54.

case. But as the materials explored below show, it is not a far journey from existing case law, regulations, and rulings to Flinty's situation.

1. Assignment in the Employment Context: **Old Colony Trust**

In *Old Colony Trust*,[62] the American Woolen Company paid the federal and state income tax liabilities on the salaries of its executives for 1918, 1919, and 1920.[63] These payments, approved by the company's board of directors, ensured that the executives would take home their full pre-tax salary.[64] For example, if an executive had a gross salary of $1 million and was in the 35% tax bracket,[65] the company would pay $350,000 to the federal government on behalf of the executive—allowing the executive to enjoy his or her full $1 million cash salary after taxes. The issue before the U.S. Supreme Court was whether the company's payments of employee income taxes ($350,000 in our example) were taxable compensation income to the employee.

The Court ruled that the tax payments were compensation and so were taxable to the employees.[66] Writing for the Court, Chief Justice Taft noted that the tax payments were made under an agreement between the employee and employer—indicating that the payments were intended as compensation.[67] The fact that the company made the payments directly to the government (rather than to the employee) was of no importance: "The discharge by a third person of an obligation to him is equivalent to receipt by the

[62] Old Colony Trust Co. v. Comm'r, 279 U.S. 716 (1929).
[63] *Id.* at 719-20.
[64] *See id.*
[65] For simplicity, 2012 tax rates are used and payroll taxes are ignored.
[66] *Old Colony Trust*, 279 U.S. at 729.
[67] *Id.*

person taxed."[68] In other words, the employee has constructively received the tax payment and thus must include it in taxable income.

Old Colony Trust makes it clear that employees cannot avoid taxation by having their employer pay their personal bills—be they tax bills or otherwise. This rule makes perfect sense and protects the tax system from disguised income techniques. For example, assume that my personal monthly electric bill is $50. I have to pay this bill out of my earnings—most of which, if not all, have been subject to income tax. Thus, I must pay the $50 with after-tax income. Since personal electric bills (like federal income tax payments) are not deductible, I would have no offsetting deduction for making the payment. I cannot change this result by having my employer pay the electric bill for me. If I asked my employer, Boise State University, to hold back $50 of my paycheck and send the $50 directly to the Idaho Power Company to pay my personal electric bill, Boise State would still report the transaction as if I had received the income and then paid the power bill myself. Thus, I would be taxed on the $50, just as if I had received it in cash. The $50 would be subject to income tax withholding and payroll tax withholding. Since payments of personal electric bills are not deductible, I would not get an offsetting deduction for the $50 I would be deemed to have paid to Idaho Power. *Old Colony Trust* thus ensures that the tax treatment of paying a personal expense (be it taxes or electric bills) is the same whether taxpayers pay them directly or have their employer pay them.

It is easy to extrapolate from the tax payments at issue in *Old Colony Trust* to the to the utility bill example because both tax payments and personal utility bills are not deductible. But what if an employer makes a payment on behalf of an employee for an expense that would normally be *deductible* if paid directly by the employee? *Old Colony*

[68] *Id.*

Trust would indicate that the amount paid by the employer is still taxable to the employee (subject to withholding of income tax and payroll taxes). The employee would still be deemed to have paid the expense directly and therefore would be able to claim a deduction on his or her Form 1040. The employee is still in the same position as if he or she had earned the income, paid income and payroll tax on it, and then took an income tax deduction for it.

For example, if I wish to make a $100 charitable donation to the United Way, I could either (1) write a check for $100 to the United Way or (2) ask my employer to withhold $100 from my paycheck(s) and remit it to the United Way. While the two options differ in form, they are the same in substance and thus should lead to the same tax results. And they do. In both options, my normal gross pay is subject to income and payroll tax withholding without reduction by the $100. I then can claim a charitable contribution deduction for $100, assuming I meet all the requirements to do so.

But the analogy between *Old Colony Trust* and the United Way example is not exact. *Old Colony Trust* involved a payment by an employer to an employee's creditor (the federal government). The payment benefited the employee by paying the employee's obligation. In contrast, the donation to the United Way is presumably not obligatory, but rather is gratuitous. Indeed, it *must* be gratuitous to be deductible. As noted previously, a charitable contribution must be given with no expectation of a return benefit; that is, with detached and disinterested generosity.[69] In contributing to the United Way, I, unlike the executives at *Old Colony Trust*, did not receive a benefit from

[69] See *supra* note 26 and accompanying text.

the employer's payment.[70] Does the gratuitous nature of the payment make a difference for tax purposes? To find out, we now turn to a discussion of the assignment of income doctrine and its application in the gratuitous setting.

2. Assignment in the Gratuitous Context: **Earl** *and* **Corliss**

The assignment of income doctrine, one of the key concepts underlying the federal income tax, was established by the U.S. Supreme Court in *Lucas v. Earl*.[71] In an era before spouses had the option of filing joint tax returns, Mr. Earl legally assigned half of his earnings to his wife and claimed that he need only report half of his income on his tax return and that his wife should report the other half that was assigned to her on her tax return.[72] The Court said this was not allowed. Whoever earns the income must pay tax on it. Therefore, Mr. Earl must pay tax on 100% of his income. The assignment of half of such income to his wife, although legally enforceable, represents a gift. In an oft-quoted phrase, Justice Oliver Wendell Holmes noted that "tax could not be escaped by anticipatory arrangements and contracts however skillfully devised…by which the fruits are attributed to a different tree from that on which they grew."[73]

In a subsequent assignment of income case, *Corliss v. Bowers*, the Court held that the grantor of a trust was taxable on the trust's income even though title to the property

[70] *See* Patricia A. Cain, *The Story of* Earl*: How Echoes (and Metaphors) from the Past Continue to Shape the Assignment of Income Doctrine*, *in* TAX STORIES: AN IN-DEPTH LOOK AT TEN LEADING FEDERAL INCOME TAX CASES 275, 299 (Paul L. Caron ed., 2003) (noting that *Old Colony Trust* involved an assignment of income "to a creditor who has provided the taxpayer with value" rather than a gratuitous transfer and noting the argument that "[i]t is not the assignment alone that causes the income to be taxed to the employee, but rather the fact that the income was paid for the employee's benefit").
[71] Lucas v. Earl, 282 U.S. 111 (1930).
[72] *See id.* at 113-14.
[73] *Id.* at 115. Scholars have noted that this metaphor is often inapt, especially where the earner is not entitled to all the income. For example, an associate at a law firm may earn fees in excess of her salary, but she is only taxed on her salary, not on the amount of extra fees she earned for the firm. Cain, *supra* note 70, at 276.

was held by the trust and the income was payable to the trust's beneficiaries (the grantor's wife and children) rather than the grantor.[74] The grantor was unable to shift the income to the trust beneficiaries because he retained the right to revoke the trust.[75] Justice Holmes, writing for the Court, stated that "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed-the actual benefit for which the tax is paid."[76] Combined, *Earl* and *Corliss* make clear that the person earning income or having control over income producing property is taxable on the resulting income. As Holmes stated, "income that is subject to a man's unfettered command and that he is free to enjoy at his own opinion may be taxed to him as his income, whether he sees fit to enjoy it or not."[77] If you earn income by virtue of working for it or via control over income-producing property, you can't avoid paying tax on the income by assigning the earnings or property to another.

A person not familiar with taxation might ask why the government should care who pays the taxes—so long as the taxes are paid. Why should the government care whether Mr. Earl or Mrs. Earl paid the tax on Mr. Earl's earnings or whether a trust grantor or the trust beneficiaries paid the tax on income from trust property, as long as the tax was paid? The reason the government wants to ensure that whoever earns income pays tax on it, is that each of us has different tax attributes. In our progressive tax rate system, if income shifting were allowed then taxpayers in high tax brackets could assign

[74] Corliss v. Bowers, 281 U.S. 376, 377-78 (1930).
[75] *Id.* at 377.
[76] *Id.* at 378.
[77] *Id.*

their income to family members in lower tax brackets—thus reducing the tax.[78] Virtually everyone would end up being taxed at the lowest tax rate.

The tax system's use of the assignment of income doctrine to protect the progressive tax rate structure is necessary regardless of the taxpayer's motives in assigning income to another.[79] Tax avoidance need not be the rationale behind the assignment. Mr. and Mrs. Earl, for example, likely did not have tax planning in mind when they entered into their contract to legally split Mr. Earl's earnings. In fact, the contract assigning income to Mrs. Earl was entered into in 1901, twelve years before the passage of the income tax.[80] Nonetheless, the assignment of income doctrine applied to avoid shifting of income and to protect the progressivity of the income tax.

3. Assignment in the Charitable Context: The Controversy over Eleanor Roosevelt's Radio Broadcasts

While both *Earl* and *Corliss* involved gratuitous transfers, neither involved a transfer to *charity*. Nonetheless, assignment of income principles still apply to assignments to charity. Indeed, the assignment of income doctrine was infamously raised in the 1930s in connection with First Lady Eleanor Roosevelt's radio broadcasts. Mrs. Roosevelt agreed to do a series of radio broadcasts sponsored by Selby Arch Preserver Shoe Company. Under the agreement, for each broadcast Selby paid $1 to

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[78] *See*, *e.g.*, Cain, *supra* note 70, at 279.

[79] *Id*. at 279 (noting that agreements to assign income "should be ignored by the tax collector regardless of the taxpayer's innocent non-tax avoidance motives").

[80] *Earl*, 282 U.S. at 13. The speculation is that Mr. and Mrs. Earl entered into the agreement for estate planning purposes. It effectively created joint property with rights of survivorship. So it would make it easier for all of Mr. Earl's property to pass to Mrs. Earl upon his death—without the need of a probate process. Cain, *supra* note 70, at 285. For more on the *Earl* case and its impact, see generally Cain, *supra* note 70.

Mrs. Roosevelt and $3,000 to a charity, the American Friends Service Committee.[81] Since the transfer to charity was directed by Mrs. Roosevelt, assignment of income principles should have applied to require Mrs. Roosevelt to include the $3,000 in income and then (if she met the requirements) take a deduction for $3,000 transfer to charity. At the behest of President Roosevelt's political rivals, the House Committee on Ways and Means held a hearing about the taxation of Mrs. Roosevelt's broadcasts.[82] Assistant Attorney General Robert Jackson testified he had previously issued an opinion that Selby's payments were not taxable to Mrs. Roosevelt:[83]

> One who earns a salary or wages or has income from invested property cannot assign that income nor order it be paid to a person or corporation so as to avoid tax merely by routing his income so as not to pass through his hands. But this doctrine of constructive receipt of income cannot be used to create income when there is no income, and has never been used to justify a tax on services devoted to charity. Mrs. Roosevelt declined to work for money and was only willing to serve for charity's sake. It was and is my opinion that such benefit broadcasts do not result in taxable income.[84]

Jackson thus drew a line between assigning wages or other income and working for free yet directing where the refused fee should go. So Jackson's opinion would not apply to, for example, a professor diverting some his salary to a particular university fund but would apply to an adjunct agreeing to teach a class for free while doing the same thing (designating where the forgone fee would be used within the university empire).

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[81] JAY STARKMAN, THE SEX OF A HIPPOPOTAMUS: A UNIQUE HISTORY OF TAXES AND ACCOUNTING 324 (2008). Selby also paid a $1,000 commission to journalist Miles Lasker for each broadcast. Lasker, in turn, sent $400 of the commission Nancy Cook—a friend of Mrs. Roosevelt's. *Id.* While the payment of this commission raises assignments of income issues, I ignore them for purposes of this Article to focus on the transfer that was made to charity.
[82] *Id.* at 324-25.
[83] *Id*. Jackson later became Attorney General and then an Associate Justice of the Supreme Court. *Id.* at 325.
[84] BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS ¶ 75.2.4 (2010) (quoting Hearings, Joint Comm. On Tax Evasion and Avoidance, 75th Cong., 1st Sess. 426 (1937)).

While Jackson's opinion put Mrs. Roosevelt's issue to rest, subsequent commentators have made clear that Jackson's opinion was wrong.[85] Under basic assignment of income principles, Mrs. Roosevelt should have been taxed on the income diverted to charity at her request. As one commentator put it, if Jackson's opinion were to hold up, then "we might each designate a few hours rendered to our employers for charity and those wages would escape taxation."[86]

4. Assignment in the Charitable Context: **Giannini** ***and*** **Hedrick*'s Interpretation of*** **Giannini**

The courts had a chance to weigh in on assignment of income issues in the charitable context in the 1940s. In *Giannini*,[87] the taxpayer was the president of a for-profit corporation and was being paid 5% of the corporation's profits in lieu of salary.[88] Upon learning that he had earned nearly $450,000 under this arrangement for January through July of 1927, Giannini informed the corporation that he would refuse any additional compensation for 1927 and asked that the corporation "do something worth while with the money."[89] The salary savings from the refused compensation was approximately $1.4 million.[90] The corporation donated these funds to the University of California to establish a Foundation of Agricultural Economics in honor of Giannini.[91]

[85] *E.g.*, STARKMAN, *supra* note 81 at 325.
[86] *Id.*
[87] Comm'r v. Giannini, 129 F.2d 638 (9th Cir. 1942).
[88] *Id.*
[89] *Id.* at 639.
[90] *Id.*
[91] *Id.*

The IRS claimed that Giannini had in substance been paid the $1.4 million and then donated it to the University of California.[92] The Ninth Circuit, after reviewing the assignment of income cases (including *Lucas v. Earl*[93]), held that Giannini never constructively received, and did not direct the disposition of, the $1.4 million.[94] It was the corporation, and not Giannini, that decided to donate the saved salary to the University of California.[95] The corporation was in control of the funds, not Giannini. Accordingly, Giannini did not realize any taxable income when he refused the $1.4 million in salary.[96]

In a later case not involving a transfer to charity, *Hedrick*,[97] the Second Circuit held that an employee who refused the pension he had earned was nonetheless taxable on the pension payments that his former employer provided to him.[98] The court explicitly applied the constructive receipt doctrine but also cited the *Earl* and *Corliss* assignment of income cases.[99] The court noted that *Giannini* might be distinguished on the facts because Giannini refused his compensation *before he had earned it* and his employer had agreed to honor Giannini's refusal.[100] In contrast, in *Hedrick*, the taxpayer had already

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[92] *Id.* at 640. The focus in the case was on the approximate $1.4 million and whether it was taxable income to Giannini. The court did not discuss the possible deductibility of the subsequent transfer to the University of California.
[93] See discussion at *supra* Part III.B.2.
[94] *Giannini*, 129 F.2d at 641.
[95] *Id.*
[96] *See id.*
[97] Hedrick v. Comm'r, 154 F.2d 90 (2d Cir. 1946).
[98] *Id.* at 91.
[99] *Id. Earl* and *Corliss* are discussed at *supra* Part III.B.2.
[100] *Id.* Presumably the Second Circuit, in *Hedrick*, interpreted the facts of *Giannini* as follows: Giannini accepted the approximately $450,000 he had earned from January through July of 1927, but then (presumably in July of 1927) refused to take any further salary for the work he would do for the corporation for the remainder of 1927. Thus, Giannini refused the approximately $1.4 million of compensation before he earned it. It is not clear, in reading the Ninth Circuit's opinion in *Giannini*, whether the Second Circuit's interpretation of the facts was correct. Indeed, the Second Circuit itself detected some ambiguity in *Giannini* and noted that if it was not correct that Giannini refused the compensation before performing services, then it would refuse to follow the holding of *Giannini*. *Hedrick,* 154 F.2d at 91. (That is, the

earned the pension at issue (through his years of service with his former employer) and the former employer had not acquiesced to the refusal (the employer actually sent the taxpayer the pension checks). The Second Circuit in *Hedrick*, in its interpretation of the Ninth's Circuit's opinion in *Giannini*, thus appears to have carved out an exception to the constructive receipt doctrine where compensation is refused prior to performing services. But it is critical to recall that, in *Giannini* itself, the court found that Giannini exercised no control over the disposition of the saved funds. The combination of *Hedrick* and *Giannini* thus indicates that, to avoid assignment of income, the income must be refused prior to the performance of services *and* the taxpayer can have no direction or control over how the saved funds are used.[101]

5. Assignment in the Charitable Context: Regulations and Rulings

After Jackson and the courts had grappled with the issue, the Treasury finally weighed in on assignment of income in the charitable context in 1957. And it did so in a manner that is hard to reconcile with Robert Jackson's ruling in Mrs. Roosevelt's situation.[102] The key authority is the following regulation:

> The value of services is not includible in gross income when such services are rendered directly and gratuitously to an organization described in section 170(c) [a charitable organization eligible to receive tax-deductible contributions]. Where, however, pursuant to an agreement or understanding, services are rendered to a person for the benefit of an organization described in section 170(c) and an amount for such services is paid to such organization by the person to whom the services are

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Second Circuit would likely have found Giannini taxable on the $1.4 million in refused salary if Giannini had in fact not refused it before he earned it.)

[101] The constructive receipt and assignment of income doctrine are somewhat conflated in both *Giannini* and *Hedrick.* Thus, it is hard to discern how far any "pre-services rendered" exception would apply and under what circumstances. But it seems fairly clear that control over saved funds is what matters in assessing taxation (whether viewed through a constructive receipt lens or an assignment of income lens).

[102] See *supra* Part III.B.3.

> rendered, the amount so paid constitutes income to the person performing the services.[103]

The regulatory language requires some unpacking. First, the regulation validates that donated services do not produce taxable income (and thus do not result in a charitable contribution deduction) as noted in Part III.A, above. Second, the regulation indicates that someone in Mrs. Roosevelt's position would in fact be taxed on his or her forgone income. Mrs. Roosevelt performed services for Selby (radio broadcasts) and then "pursuant to an agreement or understanding" Selby paid the American Friends Service Committee (an organization described in section 170(c)). So, per the regulation, Mrs. Roosevelt should have taxable income equal to the amount Selby paid to the American Friends Service Committee. Presumably, upon including the amount in income, she would be entitled to take a charitable contribution deduction as if she had paid the American Friends Service Committee directly.[104]

The regulation provides guidance in situations like that of Mrs. Roosevelt but does not directly address the situation that is the subject of this Article. Namely, a professor or other employee of a charity who forgoes salary under an "agreement or understanding" that the saved funds will be redeployed for a particular charitable purpose of the employer. The regulation could be read to cover this situation if there was "an agreement or understanding" and the "organization described in section 170(c)" and the "person to whom the services are rendered" could be the same—that is, the college, university, or other charitable organization. This would be straining the language, but in

[103] Reg. § 1.61-2(c).
[104] Subject to the limitations on charitable contribution deductions discussed at *infra* Part III.E.

fact this is how it has been interpreted—at least by cautious college and university counsel.[105]

Specific revenue rulings shed some more light on the meaning of the regulation. Revenue Ruling 58-495 involves employees who entered into an agreement with their employer to aid charity.[106] The employees agreed to give up 5 hours of pay for charity and the employer remitted what it would have paid the employees to the designated charity.[107] The ruling held that the pay for the 5 hours of income paid to charity by the employer was taxable compensation to each employee.[108] This outcome of this ruling is not surprising, given that that the facts are similar to the scenario stated in the regulation itself.

Revenue Ruling 79-121 says that an honorarium due to an elected government official for speaking to a national professional society that was paid to an educational organization at the official's request is taxable income to the official.[109] In addition, the official is entitled to a charitable donation, to the extent allowed by section 170.[110]

Other interpretations of the regulation resulted in no imputation of income—placing the transactions at issue in the no income/no deduction category.[111] Revenue Ruling 68-503, for example, found that an entertainer who performed for no compensation at events planned, organized, promoted, and scheduled by a political fund-

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[105] See *infra* Part III.C.
[106] Rev. Rul. 58-495, 1958-2 C.B. 27.
[107] *Id.*
[108] *Id.*
[109] Rev. Rul. 79-121, 1979-1 C.B. 61.
[110] *Id.* In 1995, the IRS ruled that Revenue Ruling 79-121 was obsolete because it contained references to statutes that have changed. Rev. Rul. 95-71, 1995-2 C.B. 323. But the regulation on donated services that Revenue Ruling 79-121 was interpreting has not changed. So, while Revenue Ruling 79-121 is no longer good law, its conclusion still appears consistent with the regulation it interpreted.
[111] See *supra* Part III.A.

raising organization realized no income from their donated services.[112] The political organization charged admissions to the events and used the funds in the organization's activities, but no amount was paid to the performer.[113] Note that the entertainer donated services directly to the organization benefiting—which makes the entertainer look like any other volunteer. The Eleanor Roosevelt situation, in contrast, did not involve a direct donation of time to a charitable organization.[114] Instead, Mrs. Roosevelt worked for Selby (the sponsor) who then paid the charity at Mrs. Roosevelt's request.

In addition, Revenue Ruling 71-33 found that a taxpayer who transferred all his interests in a manuscript (his memoirs) to a charity and then gratuitously assisted the charity in preparing the manuscript for publication did not realize any income from the charity's use or sale of the memoirs.[115] The situation can be distinguished from an assignment of income arrangement because the taxpayer essentially made an outright contribution of property (the manuscript)—entitling the charity to all subsequent income from the property—followed by a contribution of services (getting the memoirs ready for publication).[116]

C. Current Practice In Higher Education

As noted above, there is no specific ruling in the charitable context where employees of a charity volunteer time with their employer and are deemed to have imputed income. But, by extension, the materials reviewed above show a great risk of income imputation where the employee is giving up a specific amount of salary and there

[112] Rev. Rul. 68-503, 1968-2 C.B. 44.
[113] *Id.*
[114] See *supra* Part III.B.3.
[115] Rev. Rul. 71-33, 1971-1 C.B. 30.
[116] *See id. See also* Rev. Rul. 76-20, 1976-1 C.B. 22 (coming to the same conclusion under slightly different facts).

is an agreement or understanding about how the salary savings will be deployed in the charitable organization.

Applying the above rules in the higher education context can be somewhat tricky, given the unique legal structure and internal political structures that can predominate. Most colleges and universities that are aware of this issue proceed cautiously, requiring that either donated time be included in income or allowing the "donor" absolutely no say over how the "saved" funds resulting from their volunteer work will be spent.[117] Indeed, university counsels who have opined on the donated services issue conclude that income must be imputed, unless the employee disclaims all right to any income prior to rendering services and there is no binding agreement about how the savings will be used.[118]

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[117] A graduate assistant spoke informally with executives at several large universities (or their supporting foundations) who confirmed that they take this approach. (Notes on file with author). This small, unscientific survey indicated that, perhaps due to the tax impediments, colleges and universities are not actively seeking donations of time from their employees. (Being unable to include donated time in capital campaign goal reports was also a factor.) One university used to actively seek donations of employee time and required that employees sign a contract (on file with author) waiving all right to determine where the salary savings would be used. The university would then not include the forgone salary in the employee's income. But the university stopped this practice, in an abundance of caution, upon being audited by the IRS. Because the donated time program was suspended, it never became an issue in the IRS audit. Given that our informal survey showed little encouragement of donated services, it is doubtful that a full blown empirical survey would shed additional light on current practice. The hope is that a well-crafted tax rule that removes some of the impediments to donating time might encourage donations of time by faculty and greater use by university development offices in taking advantage of this resource. Anecdotal evidence suggests that many faculty would be interested in donating time (especially towards the end of their careers) if they had a say over where the funds would go (e.g, a scholarship fund in honor of the faculty member's family).

[118] *E.g.*, Campus Legal Information Clearinghouse, Q&A on Tax, at http://counsel.cua.edu/tax/questions/index.cfm (last visited Nov. 26, 2012). The Campus Legal Information Clearinghouse included two questions and answers regarding donated services:

> Donation in Lieu of Salary?
>
> Q: We pay emeritus faculty $7,500 per course to teach for us. One such retired professor wants to teach two courses, but only wants to receive $6,000 total ($3,000 per course), for purposes of Social Security. He wants the University to give the remaining $9,000 that he would have received to our foundation's alumni scholarship fund. Any problems here with the 501(c)(3) status of our foundation or with the IRS generally?
>
> A: It is taxable income to the recipient (and reportable on the faculty member's IRS Form W-2 and subject to income/employment tax withholding) by this exercise of control and dominion over the payment. This assignment of income to the foundation/charity does

University tax counsel who advise against allowing donated services without imputing income have cause to take a conservative approach. Colleges and universities,

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not work to avoid the recipient's tax liability on it; the good news is that he may be entitled to a charitable contribution deduction (depending upon the status of the foundation).

To avoid incurring the taxable income, an individual must disclaim any right to the income BEFORE any services are performed and the person vests and otherwise has a right to receive payment. Also, if the person would like the money to go to some pet charity or a particular purpose, the disclaimer should not make the payment contractually binding. For example, the individual could say he hereby irrevocably and forever disclaims any right, title or interest in the payment and, the person respectfully requests, but does not require, that the payment be made instead to XYZ charity.

Answer courtesy of Sean P. Scally, University Counsel and Tax Attorney, Vanderbilt University

Gift with Pretax Dollars

Q:Can an employee make gifts to the university with pretax dollars, and only be taxed on the net amount received as income?

A: The concept is that an employee earning, say, $10,000 [from] the University could reduce his/her salary to, say, $9,000, and the difference of $1,000 be a gift to the University. If legally permissible, those advocating this arrangement note that the employee would be taxed only on $9,000, but would not be entitled to a charitable contribution deduction for the gift amount, i.e., $1,000. You asked if this arrangement is legally permissible.
After undertaking such research and analysis as is necessary, we have concluded that the arrangement is not legally permissible, but rather is a legally impermissible assignment of income. As a general income tax principle, income is taxed to the person who earns it. I cannot, for example, assign a portion of my income to my son or daughter to take advantage of their being taxed at a lower bracket. I cannot assign a portion of my income to a needy relative or friend who may not otherwise have income. And, similar to what you have asked, I cannot assign a portion of my income to my church to take advantage of its tax exemption.

In the example above, the individual employee earned $10,000 and even though he/she assigned $1,000 of that to the University, the employee earned, and is taxable on, the full $10,000. The individual would be entitled to a charitable contribution deduction of $1,000. Certain assignments are specifically authorized by statute, i.e., the authorization for employees to assign a portion of their income, pretax as salary reductions, to the University's pension plan as an employee contribution. There is no statutory or other authorization to allow pretax assignments for charitable gift purposes. The arrangement being proposed would be strongly resisted by the IRS and, if implemented, could cause the University to be subject to penalties and fines.

Answer courtesy of Thomas Arden Roha, Esquire, Roha & Flaherty, Washington, D.C. Attorney Roha serves as tax counsel for The Catholic University of America.
Id.

by their nature and because of their tax-exempt status, were, in the past, often left alone by the government and could engage in informal transactions (like allowing donated services without income imputation) without much consequence. No more. IRS scrutiny of colleges and universities has increased substantially in the past few years. Indeed, in October of 2008, the IRS sent compliance check questionnaires to 400 private and public colleges and universities.[119] Based on the questionnaire responses, and information available on Forms 990, the IRS began audits of more than 30 colleges and universities.[120] The audits targeted executive compensation issues and reporting of the unrelated business income tax (the tax that nonprofits must pay on their commercial income).[121]

While the audits were not aimed at donated services/assignment of income issues,[122] the audits send a signal that colleges and universities are subject to scrutiny and should be scrupulous in complying with the tax law (including the law of donated services). As one sociologist put it, "*higher education is one of the last revered Western institutions to be 'de-churched'*; that is, it is one of the last to have its ideological justification recast in terms of corporatization and commodification and to become subject to serious state surveillance."[123] With scrutiny by the IRS the new reality, colleges and universities are likely to shun donated services unless income is imputed.[124]

[119] IRS Exempt Organizations Colleges and Universities Compliance Project Interim Report 1 (May 7, 2010) *available at* http://www.irs.gov/pub/irs-tege/cucp_interimrpt_052010.pdf
[120] *Id.* at 5.
[121] *Id.*
[122] *See generally id*. (not raising the assignment of income issue).
[123] GAYE TUCHMAN, WANNABE U: INSIDE THE CORPORATE UNIVERSITY 41 (2009) (emphasis in original).
[124] Keep in mind that the IRS can hold the employer (here the college or university) liable for any taxes that should have been withheld from the employee, but were not. In addition, failure-to-deposit penalties may also apply, although waivers may be granted for if the failure is due to reasonable cause and not willful neglect. The imposition of tax and penalties can get complicated and will vary by circumstance. A

But taking the imputed income/charitable contribution deduction approach has negative tax consequences—as we are about to discover—sufficient to deter faculty volunteerism.[125]

D. Justification for Current Rules: Control and Horizontal Equity

It all comes down to control. The justification for treating some donated service situations as resulting in no income/no deduction (as discussed above in Part II.A) and others as resulting in imputed income coupled with a possible deduction (as discussed above in Part II.B) is based on control of the saved funds. Volunteers in the former category control the services they provide, but do not control how the saved funds will be used.[126] Volunteers in the latter category control both the services they provide and have a say in how the saved funds will be used. Volunteers in the latter category are like donors of cash, and in theory they should be taxed as if they had given cash.

An effective tax system should strive to achieve horizontal equity—that is, tax individuals in the same position the same.[127] If horizontal equity is lacking, taxpayers may judge the tax system to be unfair, lose respect for the tax system, and perhaps not strive to comply with the law. Lack of horizontal equity thus undermines the ability of a tax system to effectively generate revenues.

The current rules on donated services appear to achieve horizontal equity between donors of cash and donors of time in most situations. Assume Professor Pendant, who

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detailed review of the penalty provisions is beyond the scope of this Article. For more detail, see generally IRS PUBLICATION 15, (CIRCULAR E), EMPLOYER'S TAX GUIDE (2013).

[125] See *infra* Part III.E.

[126] See, for example, the discussion of the *Giannini* case at *supra* Part III.B.4.

[127] SLEMROD & BAKIJA, *supra* note 41, at 89.

works for Metro-State University, donates $1,000 to Metro-State, designating that the donation help fund scholarships for business students.[128] Pendant would have to earn income at Metro-State, which would be taxable (and subject to FICA) sufficient to generate a net amount of $1,000 and then he would take a deduction (if he gets past the limits on deductibility discussed below in Part III.E) of $1,000. He would also have control over how the donation was used (scholarships for business students versus some other Metro-State program). If Pendant instead donates time to Metro-State, and designates the use of the saved funds, then he is in the same position as if he had donated cash: he has taxable income and (perhaps) an offsetting deduction. If Pendant wants to fall into the no income/no deduction category in donating time to Metro-State, he can only choose the nature of his services (e.g. the class he will teach for free). He cannot choose how the saved funds will be allocated. While he is in a better position tax-wise, he is in a different position from a donor of cash because he has no control over how the cash resulting from his gift of time is used.

Likewise, consider the following examples:

Example #1: Professor Overwhelmed works "overtime" without pay. There is no imputed income in this case and no deduction. In a sense, Overwhelmed has contributed something.[129] But the exact value cannot be quantified; only the salary

[128] The fact Pendant is donating to the same organization at which he is employed makes no difference. The cash donation could have been made, for example, to the United Way and designated for a particular United Way program (say, homeless shelters). An employee donating cash to his charitable employer is treated the same as any other donor of cash.

[129] Indeed, just working for a charity is in effect a charitable action, since the employee is likely forgoing a higher salary that might be available from a for-profit employer. *See* David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information, and the Private Pursuit of Public Goals*, 62 TAX L.REV. 221, 257 (2009) (indicating that senior managers in nonprofit organizations and government are often personally committed to the cause of the organization and are thus willing to work for below-market wages). The willingness of the employee to accept a lower salary in working for a charity might be because of altruism, but is likely more the "warm glow" that one receives from doing noble work for a

negotiated at arm's length between Overwhelmed and the university can be quantified. Even if the value could be quantified, Overwhelmed would have no say over how any saved funds were redeployed in the university.

Many professors would argue that they are already donating quite a bit of time to the cause.[130] They have often nine month contracts,[131] but end up working twelve months to get the job done and often work overtime.[132] But a professor's work redounds to the

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nonprofit. *See* Brian Galle, *Keep Charity Charitable*, 88 TEX. L. REV. 1213, 1223 (2009) (indicating that "[j]ust as giving to a charity produces a warm glow, so too may working for one" and that warm glow is really "noncash compensation" that may well "lower the actual cost of wages for nonprofits"). See also James R. Hines, Jr., et al., *The Attack on Nonprofit Status: A Charitable Assessment*, 108 MICH. L. REV. 1179, 1197 (2010) ("Although nonprofit managers are certainly motivated by money, they may have intrinsic motivation that generally requires fewer financial incentives for high performance than do their for-profit counterparts. Nonprofit employees may be more loyal to their employers than for-profit employees, if, as is often alleged, nonprofits provide 'more pleasant amenities on their job, such as flexible hours, more stable job prospects,. . .a slower pace of work' or control over their working environments." (internal citations omitted)). This would fit neatly with higher education—tenure, a connection and long-term shared sense of mission with the school, flexible schedules, and job stability. It would be ridiculous to try to put a value on, and tax, warm glow and these intrinsic rewards, and so the tax system does not even try. One commentator put the issue as follows:

> First, if consumption—or income—is ultimately a mental or psychological concept, **the tax base no longer follows precisely from observable transactions.** Rather, an accurate determination of tax liability on this theory would require knowledge of each person's capacity for pleasure, because identical objects purchased for identical prices would almost surely give rise to different amounts of psychic income in different psyches. There apparently could also be a kind of manna under this view, in that a pleasurable sensation arising without an increase in social product would presumably be income. The psychological nature of this concept plainly makes it unworkable as a touchstone for taxation, because it requires calculation of amounts that are totally unknowable.

Alvin Warren, *Would a Consumption Tax Be Fairer Than an Income Tax?*, 89 YALE L.J. 1081, 1096 (1980)

Of course, in the higher education context, warm glow may be harder to identify and quantify in an "observable transaction". While there are for-profit schools that might offer more in the form of immediate or "upside" compensation (stock options, etc.), such positions also lack tenure or other forms of long-term job security. Also, the effect of warm glow may be more easily discernible in certain disciplines where highly compensated for-profit work is available (accounting, law, sciences). Nonetheless, individuals may seek out academic or charitable employment for a variety of reasons, despite the often lower pay—such as intellectual challenge, flexibility, etc.

[130] *See, e.g.*, JACQUES BARZUN, TEACHER IN AMERICA 29 (1944) *reprinted in* BIRNBAUM, *supra* note 1, at 131 ("Teaching in America is a twenty-four-hour job, twelve months in the year; sabbatical leaves are provided so you can have your coronary thrombosis off campus").

[131] Martin J. Finkelstein, *The Power of Institutional and Disciplinary Markets: Academic Salaries in the United States*, *in* PAYING THE PROFESSORIATE: A GLOBAL COMPARISON OF COMPENSATION AND CONTRACTS 318, 324 (Philip G. Altbach et al. eds., 2012) (noting that most faculty are on nine or ten month contracts).

[132] Well, I do anyway. But maybe I am just a slow worker. In any case, many faculty members work a great deal, devoting a lot of their "leisure" time to their professional activities. Yaroslav Kuminov,

benefit of the institution (and thus the students, community, and other stakeholders the institution serves) *and* to the benefit of the professor's career. The benefit to the professor's career may not be in the form of cash, but via an enhanced reputation in the broader academic community.

Early career professors, of course, must work more than their contracts call for—in the hopes of keeping their job (i.e., attaining tenure). This might be viewed more as an investment rather than a donation. After all, tenure provides not only guarantees for the professor, but also an attachment between the professor and the institution. The bottom line is it is often difficult to separate the selfish motives of professors from genuine concern for the institution to which they have devoted their labors. Professors act as both business folks (in the business of being an employee) and as charitable workers. Drawing the line between the two can be difficult.

Example #2: Professor Dedicated works for City State University with a salary of $80,000. He could work for Corporate University for $100,000. We don't impute $20,000 to him and consider it a donation. We don't try to measure Dedicated's cost versus his value. Perhaps he remains at City State out of a sense of mission. Perhaps he stays for the intrinsic, psychic benefits of the job—freedom, flexibility, time off, etc.[133] He gets, therefore, essentially a tax benefit—in that he is not taxed on the $20,000 he

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Academic Community and Contracts: Modern Challenges and Responses, *in* PAYING THE PROFESSORIATE: A GLOBAL COMPARISON OF COMPENSATION AND CONTRACTS 331, 332 (Philip G. Altbach et al. eds., 2012).

[133] *Id.* (noting that professors are often willing to settle for less than market pay for the unique working conditions and free-time that a university job provides). These intangible benefits may become less alluring as they become more prevalent in jobs outside of academia—that pay more. *See id.* at 339.

never earned.[134] The $80,000 is the negotiated, arm's length price that will be respected by the tax law.

Example #3: Professor Livewood works for City State University with a salary of $80,000 and tenure. He could work for Corporate University for $100,000 without tenure. We don't try to impute $20,000 in income to Livewood as the intangible value of tenure. But it is becoming easier to estimate the monetary value of tenure, as some schools offer salary premiums to faculty on multi-year contracts in lieu of the protections of tenure.[135] In fact, at one least commentator has even suggested taxing the value of tenure.[136]

Example #4: Professor Entitled works for City State University with a salary of $80,000 and tenure. He could move to Flagship State University and make $100,000 with tenure, given current market values, his reputation, and a shortage of qualified people in his field. Entitled decides to stay at City State. We don't tax him on the $20,000 difference and call it a donation. [137]

[134] Commentators critiquing recent calls for "for-profit charities" or L3Cs (new legal entities under state law that can both earn a return to investors and pursue a charitable mission at the same time) have identified an analogous situation: organizations (nonprofit or for-profit) that forgo profits by pursuing a charitable goal receive an implicit tax subsidy even if their income is generally taxed: "as is well known, the tax system effectively subsidizes any investments that produce subpar returns, whether or not undertaken with social goals in mind. Stated another way, there is no tax on the pleasure that comes from making an investment that advances charitable goals, whereas the commercial alternative generates a return that the government taxes. The tax benefits would be greater still if investors were permitted full deductions for their investments in social purposes, but investors nonetheless reap a substantial portion of the tax benefits available to nonprofits simply by virtue of not having to pay taxes on returns they have not earned." Hines, Jr., et al, *supra* note 129, at1189-90 (2010). This is similar to the case here: Professor Dedicated is giving up $20,000 in potential compensation, and is not taxed on it.
[135] *See* Finkelstein, *supra* note 131, at 321.
[136] James Lileks, Let's Invent New Vindictive Forms of Taxation for Fun, Aug. 11, 2010, at http://ricochet.com/main-feed/Let-s-invent-new-vindictive-forms-of-taxation-for-fun.
[137] In some disciplines, individuals are effectively donating their time by staying put. Accounting departments, for example, often have "salary inversion" whereby the newest faculty member is likely paid more than the more senior professors. This is because there might be money to hire new faculty at a market salary, but it is harder to tap into resources to bring current faculty into line with current market salaries. This is pretty rare—only affecting disciplines with shortage of new, credentialed faculty, such as in the accounting discipline. Nonetheless, a senior professor could cash in on current market salaries by jumping

Example #5: Professor Entitled works for City State University with a salary of $80,000 and tenure. He could move to Flagship State University and make $100,000 with tenure, given current market values, his reputation, and a shortage of qualified people in his field. Entitled tells City State about the offer, and City State offers to increase his salary to $95,000 to keep him around.[138] Entitled stays at City State.[139] He is taxed on the $15,000 raise, of course, but not on the theoretical $5,000 he gave up by staying at City State.

Example #6: Flagship State University furloughs all employees, requiring them to take ten days "off" without pay.[140] Since the furlough is required and the employees have no say over how the savings is used, there is no imputed income and no deduction. But if the furloughs are voluntary and the employees are giving up what they are entitled to under their employment contracts, income will be imputed.[141]

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ship to another school. (Indeed, we have all run into academic "gypsies" or "drifters" who do just that every few years.) This is not practical for most people, given that changing jobs involves a lot of costs—moving with a family, establishing a new reputation at the new institution, being at the lower end of the seniority list (which might not be that big of a deal—maybe your office won't be as nice or you'll be a bit further down the list for summer teaching preferences, etc.) Still, it is possible, and quantifiable. Yet, we don't impute income for the forgone wages and treat it like a charitable donation.

[138] Perhaps using a secret fund reserved to reward disloyalty. *See* Dilbert Comic Strip, June 29, 1997.

[139] Much to the chagrin of his colleagues. Professor Entitled is no doubt the first one to whine in the faculty lounge about how underpaid he is.

[140] Technically, professors are not supposed to work on these days. But they must. They still have to prepare for classes, grade papers, advise students, work on committees, and conduct research. So, professors on furlough are really donating their time (but must remain quiet about it). Perhaps one situation where a furlough really does result in a reduction in workload is when the furlough involves shortening the semester by a week or so. That does reduce some work. But then you are short-changing the students (not that they'll complain).

[141] An ironic example in the non-academic setting involved the Idaho State Tax Commission not understanding the tax ramifications of taking voluntary furloughs. In 2009 the State of Idaho required employees of the Idaho State Tax Commission to take furloughs. The furloughs did not apply to the four Commissioners at the head of the Commission, since their salaries are set by the legislature. The four Commissioners took furloughs anyway, in sympathy with their rank and file employees. As it turned out, the sympathy furlough was in violation of state law, and the Commissioners were required to be paid the salaries and report them in income. They were then free to donate the money to the state or another charity (or keep it). John Miller, *Idaho Tax Collectors Try to Take Pay Cut but Can't*, ASSOC. PRESS, June 23, 2010, available at http://www.kboi2.com/news/local/97023724.html.

Recently, President Obama, in solidarity with federal workers facing furloughs, announced he would forgo $20,000 of his $400,000 salary. Because the President's pay is set by statute and cannot be

All of the above examples follow the arm's length principle. For whatever reason, the professor has decided to settle for less pay. The tax law does not question these arrangements. Also, in all of the above examples, the professor does not control how the cost savings from their volunteerism is used in the university. Thus, these volunteers are on par with volunteers who, for example, spend the day raking up a park or volunteering with Habitat for Humanity.

In contrast, volunteers whose compensation is negotiated at arm's length but then is voluntarily surrendered—with the volunteers designating where the saved funds will be used—are treated like a donors of cash. The assignment of income doctrine is triggered, and the volunteers have taxable income and (perhaps) a deduction. By these lights, it appears that the current tax treatment of donated services achieves horizontal equity. But, as will be discussed below,[142] this is not always the case. Furthermore, just because the rules make some sense does not mean they should be beyond scrutiny. As we are about to find out, the imputed/income deduction tax treatment often stifles volunteerism at colleges, universities, and other charitable organizations.

E. Illustrating the Difference Between No Income/No Deduction and Imputed Income/Deduction—The "Wash Preventers"

At this point, a person blissfully unfamiliar with the intricacies of the tax law might reasonably ask, "What is the practical difference between the rules noted in Part II.A (no income/no deduction) and Part II.B (imputed income/deduction)?" In either

changed during his term, the $20,000 he gives up is still taxable to him. But, he is entitled to a charitable contribution for the $20,000 given to the federal government—a deduction the White House has stated the President will not claim. Laura Saunders, *Obama Won't Deduct Returned Pay*, WALL ST. J., Apr. 5, 2013.

[142] See *infra* Part IV.C.

case, won't the taxpayer end up in the same place—with no income and no deduction in Part A and income offset by a deduction in Part B? Isn't the imputed income/deduction scenario just a wash? The answer is no. The following describes the "wash preventers" in the tax law. These wash preventers illustrate a basic tenant of tax planning: exclusions from income are normally more beneficial than deductions from income.

1. Taxpayers Need to Itemize to Claim a Deduction

As previously noted, individuals can deduct charitable contributions only if they itemize deductions rather than take the standard deduction.[143] In 2012, the standard deduction is $5,950 for a single filer and $11,900 for a married couple, filing jointly. Taxpayers with total itemized deductions, like charitable contributions, mortgage interest, real estate taxes, and state income taxes that do not exceed the standard deduction will opt to deduct the standard deduction. Taxpayers taking the standard deduction, therefore, receive no benefit from the charitable contributions they make. A faculty member who does not itemize and has donated services and been imputed income, like Flinty in the opening example, will not get an offsetting deduction. In fact, only about one-third of taxpayers have sufficient deductions to itemize.[144] Normally, itemizers live in high-tax states (like New York or California) or have homes with mortgages. Taxpayers close to retirement, like Flinty, may well have paid off their mortgage and no longer itemize. It is often faculty that are close to retirement, like Flinty, that are in the best financial position

[143] See *supra* note 7.
[144] *See* Tax Policy Center, Tax Facts: Type of Deduction 1999-2009 at http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?DocID=392&Topic2id=30&Topic3id=34.

to volunteer their time[145]—and yet are the least likely to itemize. Volunteers subject to the general rule of no income/no deduction don't have to worry about whether they itemize—since there is no deduction to begin with.

But note that if a taxpayer donates a sufficient amount of time, the taxpayer may end up itemizing just on the basis of the charitable contribution alone. This could occur, for example, where faculty members donate their full salaries to the institution. That is, they are working for free—normally in their last year on the job. If income is imputed, then presumably there would be enough of a deduction to allow the faculty members to itemize. But such retirement-minded faculty will likely run afoul of the next wash-preventer: deduction ceilings based on adjusted gross income.

2. Charitable Contribution Ceilings Based on Adjusted Gross Income

Even faculty members who itemize may not be able to deduct the full amount of their salary donations. Charitable contribution deductions are generally limited to 50% of the taxpayer's adjusted gross income (AGI).[146] Amounts in excess of the limit may be

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[145] *See* Rebecca Nesbit, *The Influence of Major Life Cycle Events on Volunteering*, 41 NONPROFIT & VOLUNTARY SECTOR Q. 1153, 1155 (2012) (noting evidence that people increase volunteering as they enter retirement and are more likely to volunteer during retirement than earlier in their lives).

[146] See *supra* note 8. The theoretical justification for the 50% of AGI limit is unclear. Miranda Perry Fleischer has suggested a "dual-majority" theory to explain the limit, opining that the limit likely exists less out of concern for over-benefiting the wealthy (charitable contribution deductions do that naturally—since they increase in value along with the taxpayer's income level and marginal tax rate) than to ensure that the wealthy don't use their generous giving to completely wipe out their taxable income. Without the limit, wealthy taxpayers could give away 100% of their income and avoid all federal income taxes. Taxes pay for government services which presumably benefit society. Donations pay for good works by charities that also presumably benefit society. Society needs both government and charity. Taxpayers can reduce their taxes to the government if they give to a charity of their choice. This gives the taxpayer more say over exactly how they will aid society—by directing their funds to a school, a museum, a homeless shelter or some other charity they care about—rather than to the general coffers of the government. But at some point this flexibility needs to give way for the need for the government to get tax revenue to carry out its functions (determined by lawmakers representing the majority). So, wealthy donors are given some latitude to decide how their "society" money is spent—but only up to a point. A 50% limit seems like a

carried forward and deducted within the next five years (subject to the 50% limit applying in each of those years).[147]

AGI equals a taxpayer's gross income (from wages, interest, dividends, capital gains, etc.) less a limited number of enumerated deductions (normally business-related expenses).[148] The government uses AGI to gauge a taxpayer's income level for purposes of limiting tax benefits (like certain itemized deductions and credits) to taxpayers below certain AGI thresholds.[149]

While the AGI limit is unlikely to affect a taxpayer giving up part of their compensation (like Flinty in the opening example), consider the impact on faculty members donating their entire salary during their final year before retirement. If the imputed income from the donation is the only item of income for the year, they will likely only be able to deduct 50% of the income as a charitable contribution. They may even have difficulty deducting the rest over the five year carryover period if, as is often the case, they have low AGI after retirement since most of their income will be the form of pensions and (perhaps nontaxable) social security benefits. Even if the faculty members could ensure enough AGI in the carryover period (for example, by taking more distributions out of their retirement accounts than is legally required), they still have a significant problem. In the year of the donation, they must pay tax on about one-half of their forgone salary. This creates a cash-flow problem. The faculty member will have to pay the tax—perhaps via taking money out of savings or perhaps by reducing the

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reasonable place to draw the line. For further discussion on these points, see Miranda Perry Fleischer, *Generous to a Fault? Fair Shares and Charitable Giving*, 93 MINN. L. REV. 165, 168-69 (2008).

[147] I.R.C. § 170(d)(1).

[148] I.R.C. § 62. AGI appears as the last line (line 37) on page 1 of Form 1040 and the first line (line 38) of page 2 of Form 1040.

[149] For more on the impact of AGI on the service donations, see *infra* Part III.E.3.

contribution. That is, the faculty member may need to exclude the tax bill on the non-deductible donation from their donation. This makes Flinty's problem (from the opening example) seem like small potatoes—and ultimately is likely to prevent some faculty from volunteering their time in the first place.[150] Indeed, they could save a lot of headache by just working for their normal salary and then donating as much as they could (economically) in cash over a period of time that would maximize their deduction. That is, they might spread out the contributions over a few years to reduce the impact of the 50% of AGI limit. Volunteers subject to the general rule of no income/no deduction need not worry about the limit—since there is no income increasing their AGIs and no deductions to worry about.

3. The General Problem of Increases in AGI

In addition to the specific 50% of AGI ceiling on charitable deductions, another wash preventer is the broader impact of imputed income on AGI. As noted above, many tax deductions and credits are limited based on a taxpayer's AGI.[151] Donors of time may view imputed income as artificial increases in their AGI that trigger reductions in their tax benefits.

One could argue that a time donor is no worse off because their AGI is the same as it would have been in the absence of the donation. With the donation, the faculty member has imputed income. Without the donation, the faculty member has an equal amount of actual income. Either way, AGI would be the same. The difference is really

[150] I have a couple of colleagues who had long spoke of working their last year before retirement for no salary and asking that the salary savings be used to establish a scholarship fund. Knowing the tax ramifications—and the impact of the AGI limits—they are no longer planning to do so.
[151] The list of AGI-dependent tax benefits is too long to be reproduced here. A good example, however, is the Pease limits on overall itemized deductions discussed at *infra* Part III.E.4.

one of cash flow. Without the donation, faculty members may have an AGI that limits tax breaks, but at least they have after-tax cash from their salary to pay their bills—including their tax bills. Faculty members donating their time, however, end up with the same AGI, but no after-tax cash to pay their bills—including their tax bills.

A good example relates to Social Security benefits. Social Security benefits are generally exempt from tax unless the taxpayer exceeds certain AGI thresholds.[152] The thresholds start at relatively low AGIs ($32,000 for married couples filing jointly and $25,000 for other taxpayers).[153] Donors at or near retirement—the ones in the best position to donate time—may be collecting Social Security benefits.[154] Such donors would be sensitive to increases in the their AGI—which would result in a greater amount of their Social Security benefits becoming subject to income tax. Although the same amount of Social Security benefits would be taxed with or without the donation, the donating faculty member may realistically only be able to donate their time because of having the Social Security income to provide sustenance. If such benefits were taxable, it could make the cost of the donation prohibitive. Faculty members of a certain age contemplating donating time would be choosing among 1) working for free and having taxed Social Security benefits, 2) working for pay and having taxed Social Security benefits, and 3) not working at all (retiring) and having nontaxable (or lighter-taxed) Social Security benefits. Framing the choice this way makes options 1 or 3 more

[152] I.R.C. § 86.
[153] I.R.C. § 86(c).
[154] Keep in mind that there is no mandatory retirement age for faculty. A faculty member in her 70s, for example, may be working full time and collecting Social Security benefits at the same time. Such a faculty member would be more inclined to donate their salary—since they can use their Social Security benefits for day to day sustenance.

palatable than option 2—thus causing the general AGI wash preventer to stifle donations of time.

4. The "Pease" Limits on Itemized Deductions

Effective January 1, 2013, the American Taxpayer Relief Act of 2012 resurrected and modified the "Pease" limitations on the overall deductibility of itemized deductions—including charitable contributions.[155] In general, itemized deductions are reduced by the lesser of: (1) 3% of the excess of the taxpayer's AGI over $300,000 for married couples filing jointly and $250,000 for single filers or (2) 80% of the itemized deductions otherwise allowable for the year.[156] Because of the high AGI thresholds, the Pease limits are likely to have limited impact on professors or other employees of charities who donate time.[157] Indeed, the Pease limitations are expected to affect fewer than the top 2% of households.[158] Even if it applies in a particular case, unlike the other wash preventers, it probably won't—standing alone—influence an employee's decision whether to donate time.[159] But it could, in some cases, increase the tax cost of donating

[155] I.R.C. §68.

[156] I.R.C. § 68. The AGI thresholds are for 2013 and will be adjusted for inflation starting in 2014. I.R.C. § 68(b)(2).

[157] In the donated services context, the Pease limits would be most likely to strike executives (like a university president), high-salaried professors in certain fields (like medicine or law), or professors with modest salaries with spouses with high incomes.

[158] CHYE-CHING HUANG, ET AL., "PEASE" PROVISION IN FISCAL CLIFF DEAL DOESN'T DISCOURAGE CHARITABLE GIVING AND LEAVES ROOM FOR MORE TAX EXPENDITURE REFORM 2 (CENTER ON BUDGET AND POLICY PRIORITIES, JAN. 29, 2013).

[159] As the Center on Budget and Policy Priorities has pointed out, except in very rare cases the Pease limits are based on the amount of a taxpayer's income (AGI), not on the amount of their itemized deductions (including the amount they give to charity). *Id*. at 3. Since the Pease limit increases with income, not with deductions, it should not be a disincentive to give to charity. *See id.* But the Center on Budget and Policy Priorities did not analyze the Pease limits in the context of donated services—where imputed income increases both AGI and deductions. Thus, taxpayers donating time and being imputed income may experience greater impacts on their Pease limits. Nonetheless, the impact of the Pease limits on donated services should be rare. Since (let's face it) faculty members normally make less than the threshold for limitation, I did not include the limitations in the numerical examples at *infra* Part IV.A.

time—just as it would reduce the tax benefit of donating cash. The Pease limits would not affect donations of time that fall under the general rule of no income/no deduction, since in such a case there would be no deduction to limit.

5. Payroll Taxes

Taxable imputed income is subject to state and federal income tax withholding, which must somehow be paid in cash. But income tax withholding can be reduced if the employee files an updated Form W-4 to reflect the expected charitable contribution deduction. What cannot be avoided, however, are the payroll taxes due on the imputed income. There is no charitable deduction available to reduce or eliminate the income subject to payroll taxes.

Under the Federal Insurance Contributions Act (FICA), employees must pay 6.2% of their taxable wages to fund Old Age, Survivors, and Disability Insurance (OASDI/Social Security) up to a wage cap ($110,100 in 2012) and 1.45% of their taxable wages to fund Hospital Insurance (HI/Medicare) with no wage cap.[160] For 2011 and 2012, Congress declared a payroll tax "holiday" and reduced the OASDI rate on the employee portion of the tax to 4.2% as an economic stimulus. The holiday expired December 31, 2012, and so the OASDI rate returned to 6.2% on January 1, 2013.[161] Employers—including otherwise tax-exempt charitable employers like colleges and universities—are required to withhold the payroll taxes from the employees and remit it to the government and to match employee contributions.

[160] IRC §§ 3101-02, 3111, 3121-28 (Federal Insurance Contributions Act—including employee and employer portions of Social Security and Medicare taxes); §§ 3401-06 (withholding from wages).
[161]Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, §601 (2010).

Volunteers falling under the no income/no deduction rule escape not only income tax, but FICA assessments as well. But volunteers with imputed income end up paying the FICA taxes and need to find a way to fund the required FICA withholding. This might be enough to stifle the donation from ever occurring.

If the tax law is going to impute income in the donated services context, it makes sense to impose FICA. Income from services, after all, is the classic type of income taxed under FICA. Indeed, wages are taxable under FICA when "they are actually or *constructively* received."[162]

One could argue that FICA is not so much a "tax" as a payment for social insurance (pension payments and medical care in retirement). If viewed as an insurance payment, the only issue would be the cash flow problem of making the payment—since the payment is going to buy (in theory) additional benefits. But, as discussed below, there are good reasons to view FICA as a true tax.[163]

6. A Possible Wash Preventer on the Horizon

The wash preventers noted above are the ones most likely to create a hardship on the donating employee sufficient to stifle the donation. As of this writing, another item may be poised to further dirty the wash: a proposal to limit the tax benefits of itemized deductions to 28% for those with income over $200,000, regardless of the taxpayer's marginal tax rate.[164] This would further reduce the benefit of the charitable contribution deduction, leaving some income in the tax base that, in theory, should not be there. It is

[162] Reg. § 31.3121(a)-2(a) (emphasis added).
[163] See *infra* Part V.C.
[164] CCH TAX BRIEFING, 2012 TAX POLICIES OF THE MAJOR PRESIDENTIAL CANDIDATES, SPECIAL REPORT 3 (Sept. 11, 2012)

unclear whether such a proposal will become law, but deduction limitations of one kind or another have been a frequent topic of conversation during the 2012 presidential race. Like the Pease limitations, the limit would affect donations of time involving imputed income and donations of cash. But it would not disturb donations of time that fall under the general no income/no deduction rule—since there would be no deduction to limit.

IV. THE CASE FOR RELAXING THE RULES

This Part reviews the reasons to relax the imputed income/deduction approach when employees of charities donate time to their employers. Part A provides some numerical examples, showing the negative impact of the current rules on donors of time. Part B reviews how the current rules discourage employee volunteerism at colleges, universities, and other large, complex charitable organizations, given the unique political environment in which those organizations operate. Part C shows that the current rules can create horizontal equity problems. Part D gives examples of analogous areas of the tax law where the rules have been relaxed. Part E gives examples of analogous areas of the tax law where scholars have *proposed* the rules be relaxed.

A. Numerical Examples

This Part IV.A. provides examples to show the impact of the assignment of income doctrine on donors of time. In doing so, these examples illustrate some of the wash preventers that have been discussed earlier.

Assignment of Income at the Ivory Tower

Numerical Example# 1: Professor Cranky teaches for City State University. He agrees to teach a summer course for no compensation and asks that the saved funds be used to fund a scholarship for art students. Under a standard summer contract, Cranky would earn $10,000 from teaching the summer course. Cranky earns his normal salary based on a nine month contract, but is paid his normal salary over twelve months under state law. (So, he gets a regular pay check all summer.) For simplicity, and to focus on the tax aspects, the impact of retirement plan contributions and other benefits that vary with salary level are ignored. Assume Prof. Cranky has not reached the OASDI wage cap. Also, the impact of temporary payroll tax holiday is ignored. Cranky is the 25% federal tax bracket. State income taxes are ignored. Cranky elects to itemize his deductions and his charitable contributions for the year will be less than 50% of his AGI.

	Impact on Taxable Income	**Tax Cost**	**Notes**
Income Added to Cranky's Form W-2	$10,000		
Payroll Taxes at 7.65%		$765	Since Cranky is not getting any cash for his summer pay, the $765 will reduce his take-home pay from his normal salary. City State University will also need to pay an additional $765 in payroll taxes under the employer match.
Charitable Contribution Deduction	($10,000)		
Net Impact on Taxable Income	0		
Federal Tax at 25%		0	
Extra Cost of the Donation to Cranky		**765**	

In this example, Cranky is in the best possible position a donor of services can be. He itemizes and the only wash preventer at issue is FICA. Even so, Cranky would likely get, well, cranky about all this business and simply donate cash. In that way, he won't see his normal take-home pay reduced and will be able to better manage the cash flow aspects of the donation. The problem with donating cash is that once he earns the money—and sees it in his bank account—it is hard to be generous after the fact and follow through on the donation. Things get even worse if Cranky is out of pocket *income tax* on the donation, as we see in the next example.

Numerical Example #2: Same as Numerical Example #1, except that Cranky does not itemize:

	Impact on Taxable Income	**Tax Cost**	**Notes**
Income Added to Cranky's Form W-2	$10,000		
Payroll Taxes at 7.65%		$765	Since Cranky is not getting any cash for his summer pay, the $765 will reduce his take-home pay from his normal salary. City State University will also need to pay an additional $765 in payroll taxes under the employer match.
Charitable Contribution Deduction	0		Cranky does not itemize
Net Impact on Taxable Income	$10,000		
Federal Tax at 25%		2,500	Since Cranky is not getting any cash for his summer pay, the $2,500 will reduce his take-home pay from his normal salary.
Extra Cost of the Donation to Cranky		**3,265**	

Cranky's tax bill would go up (and this take-home pay on his regular salary would go down) by $3,265. Prof. Cranky will be discouraged from doing this, since he might not be able to afford it. He would experience the same result if he gave cash that he generated via his taxable salary. But then he would have more control over the cash flow—deciding perhaps not to give the whole $10,000 but only the after-tax amount or perhaps timing the cash donation in a year when he will be able to itemize.

Numerical Example #3: Prof. Overhill works for City State University for free his final semester before retirement. His normal gross pay for a semester is $50,000. City State University has agreed to use the $50,000 to establish a graduate assistantship in the university's center on aging. Overhill has no other income from any sources and will live off of his savings. He does not yet collect Social Security benefits. The donation of his time will be his only charitable contribution for the current tax year. Assume (unrealistically) he has no other itemized deductions for the year. For simplicity, and to focus on the tax aspects, the impact of retirement plan contributions and other benefits that vary with salary level are ignored. Assume Overhill has not reached the OASDI wage cap. Also, the impact of temporary payroll tax holiday is ignored. Overhill is in the 25% federal tax bracket. State income taxes are ignored.

	Impact on Taxable Income	Tax Cost	Notes
Income Added to Overhill’s Form W-2	$50,000		Since he is waiving his entire salary, this would also equal the total amount on his W-2.
Payroll Taxes at 7.65%		$3,825	Since Overhill is not getting any cash for his work, he will need to withdraw this amount from savings and give it to City State University to remit to the government. City State University will also need to pay an additional $3,825 in payroll taxes under the employer match (just as they would with a cash salary).
Charitable Contribution Deduction	($25,000)		Since Overhill’s only income is $50,000, that is also his AGI. Cash donations to charity are limited to 50% of AGI or $25,000. He can carry the rest forward.
Net Impact on Taxable Income	25,000		
Federal Tax at 25%		$6,250	Since Overhill is not getting any cash for his work, he will need to remit this to City State University.
Extra Cost of the Donation to Cranky		**$9,075**	

So, it cost Overhill $9,075 out of pocket to fund the donation. This cost is the same as it would have been had he given cash, but he could have better managed the cash flow. Also, he may get some of the $6,250 in taxes back by carrying forward the $25,000 over the next five years. But he still has a cash flow issue initially. Had he given cash, he could have spread the cash donations over a number of years to maximize his deduction and avoid the AGI limits.[165] This is probably not something that Overhill would want to do. And he may be reluctant to give cash after retirement. Still, for $9,075 or something less he gets "credit" and "warm-glow" for a $50,000 donation—enough to get him invited to the big donor banquets and such—at least this year.

This may not seem like much of a hardship—after all, these are the same results (although hidden) that he would get with cash donations. While the assignment of income process depicted here ensures horizontal equity between cash donations and time donations, it has other horizontal equity problems—as will be discussed below at Part IV.C.

B. Encouraging Volunteerism at Colleges, Universities, and Other Complex Charities

"The university is a collection of departments tied together by a common steam plant."[166]

"In an area where heating is less important and the automobile more, I have sometimes thought of [the university] as a series of individual faculty entrepreneurs held together by a common grievance over parking."[167]

At this point, it should be apparent that the tax law, while validly trying to prevent assignment of income, stifles the donation of time by employees of charities when there is an agreement about how the saved funds will be used. It would seem there is a simple solution: just take control of the saved funds away from the employee. Have no explicit or implicit agreement about how the saved funds will be used. If done carefully and

[165] Alternatively, he could elect to take part of his salary in cash sufficient to pay the tax, but this would reduce his charitable contribution as well.
[166] Attributed to Robert Maynard Hutchins (former president of the University of Chicago) in GEORGE DENNIS O'BRIEN, ALL THE ESSENTIAL HALF-TRUTHS ABOUT HIGHER EDUCATION 30 (2000), *reprinted in* BIRNBAUM, *supra* note 1, at 185.
[167] CLARK KERR, THE USES OF THE UNIVERSITY 20 (1963), *reprinted in* BIRNBAUM, *supra* note 1, at 185. (Kerr was a long-time president of the University of California).

truthfully, this should put the donating employee in the no income/no deduction category—avoiding all the tax limitations and headaches noted above in Part III.E.[168] If an employee of a charity is truly charitably-minded/dedicated to the cause, he or she should be glad to help out without needing to direct the funds to a specific use within the charitable organization.

But as anyone who has worked in the academic setting—or in any large, complex charity—can tell you, internal politics and budget priorities are constant worries.[169] Control matters. The use of the redeployed funds matters. If anything is darker than the specter of the tax law, it is the specter of faculty politics—especially when it comes to money.[170]

Even among the most collegial faculty, disputes arise over funding. For example, a cash-strapped accounting program may look askance when a graduate of the accounting program is induced by a slick marketing professor to fund an endowed marketing chair instead of contributing to the accounting program. In such an environment, it is understandable that an accounting professor (like Flinty in the opening example) would want to ensure that his donations (in cash or service) are channeled into programs that benefit accounting students rather than the liberal arts, athletics, or other areas. Likewise,

[168] See *supra* note 118 for university counsel advice to this effect.
[169] *See, e.g.*, BENJAMIN GINSBERG, THE FALL OF THE FACULTY: THE RISE OF THE ALL-ADMINISTRATIVE UNIVERSITY AND WHY IT MATTERS 8 (2011) (describing how the administration at one school devoted funds to establish a graduate college of business without consulting faculty—even faculty that might be expected to teach in the new college).
[170] As Henry Kissinger has noted, "University politics are vicious precisely because the stakes are so small." BIRNBAUM, *supra* note 1, at 187. *See also* Erik M. Jensen, *Planning for the Next Century or the Next Week, Whichever Comes First*, 117 PENN ST. L. REV. PENN STATIM 7 (2012) (presenting a hilarious story or "farce" about a fictional law school faculty meeting and the politics involved).

English professors presumably would want to see their donations benefiting their department or college rather than the business school.[171]

The same concerns motivate volunteer adjunct faculty from the professional community. A Chief Financial Officer (CFO) of a local business, for example, may agree to teach a basic accounting course for free. If the university had cut funding to the course the CFO is teaching, the CFO's time itself benefits the department. But, in theory, the CFO's services should free up accounting department funds (say $3,000) that the college had allocated to the course but was not spent. The reality is that perhaps the $3,000 will be swept into the general college budget when the funds are not spent for their designated purpose.[172] The college or university will thus redeploy the funds to causes outside the department the CFO was attempting to support. This may seem petty, but in these lean times this is the reality. Internal budget and governance procedures may dictate how well these arrangements work. These political issues are removed if the CFO is allowed to designate that the saved $3,000 is deposited into an account benefiting the accounting department.[173] This is not possible under current law without taxing the CFO and then having him take a deduction as if he donated cash. This seems like an unnecessary amount of hassle.[174]

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[171] Similarly, outside donors of cash are well-advised to designate the specific program or project they want to support, rather than giving unrestricted cash. *See* GINSBERG, *supra* note 169, at 216 (advising against unrestricted gifts "which will almost certainly flow into the coffers of the deanlets and improve the quality of food served during administrative retreats more than the quality of the education offered by the school"). Most professors would like to see the saved funds going to something worthwhile, like cancer research in a science department or a subscription to *Tax Notes Today* in an accounting department.

[172] It would make life easier to claim that there was no imputed income if the amounts we paid for adjuncts were not so "one size fits all." If the salary wasn't a flat $3,000 (regardless of whether the instructor is teaching astro-physics, international tax, or into to business), then it would be harder to settle on a specific number for income imputation.

[173] At a state university, the academic department likely controls specific accounts at the university's foundation which cannot be tapped by the dean or central administration.

[174] But see *infra* Part VI.A regarding the possible use of gross ups to address this problem.

Because of the politics involved and the motivations of faculty members, it would seem that allowing generic donations would offer little incentive to donate services without the ability of some say in where those donations go. Indeed, scholars have noted that volunteers enter into various types of psychological contracts with the charities they are assisting.[175] Under one type of psychological contract, known as a value-based psychological contract, volunteers perceive that they are giving time to a charity in exchange for the charity continuing to support the specific programs or principles that motivated the volunteers to give.[176] If a volunteer gives time and the charity later ends the specific program that the volunteer cared about, the volunteer will perceive that the charity has breached the psychological contract.[177] Breach can lead to anger, frustration, and decreased satisfaction with the charity.[178] A volunteer whose trust has been violated in this manner is unlikely to donate time or money to the charity in the future. When the charity is also the volunteer's employer, such a scenario could even poison the workplace. Thus, Flinty in the opening example, the CFO as adjunct in the above example, and other faculty members would not be likely to volunteer time unless they could ensure the saved funds would go to designated uses without negative tax consequences.

To get around these issues, and put the donation in the no income/no deduction category, there is no doubt subterfuge—wink and nod arrangements between donating faculty members and the administration.[179] After all, if the administration wants to

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[175] Tim Vantiborgh et al., *Volunteers' Psychological Contracts: Extending Traditional Values*, 41 NONPROFIT & VOLUNTARY SECTOR Q. 1072, 1072 (2012).
[176] *Id.* at 1074.
[177] *Id.*
[178] *Id*. at 1073-74.
[179] Similar arrangements are sometimes made with respect to expense accounts. Faculty earning supplemental income (such as via an internal research grant or an endowed chair) sometimes have the

encourage volunteerism, it should be motivated to use the funds as the volunteers desire.[180] But this hardly aids transparency and such arrangements reek of secret back room, faculty lounge, or deanery deals. Such deals may have been more acceptable in an earlier age, but not at a time when universities have been "de-churched" and are subject

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option of taking $x in additional taxable compensation or taking $x plus y if the amounts are placed into an account to pay for research expenses (books, travel, etc.) The "plus" arises because the university saves money on benefits that go along with additional salary benefits (retirement contributions, etc.) when the funds are taken in a nontaxable form. For this choice to avoid assignment of income issues, the amount placed in the "account" really cannot belong to the faculty member; the administration is free to sweep the account at any time. While the promise of the account funds is normally honored, so long as the money is spent on bona fide business expenses within a reasonable time period, there is always the possibility that the administration will take the funds away in tight budgetary times (and I have witnessed this occur). *See, e.g.*, Allie Bidwell, *At Marshall U., President's Raid on Department Funds Sparked Ire, Then a New Approach*, CHRON. HIGHER EDUC., Apr. 19, 2013 (reporting how central administration transferred balances from departmental accounts to a central university account to address budgetary issues). The faculty must accept this risk to avoid assignment of income. One could question whether the substance of these accounts is really compensation, but this issue does not appear to have yet hit the radar screens of colleges and universities or the IRS. *But see* PLR 9325023 (ruling that a manager who forgoes future compensation in consideration of his employer's agreement to reimburse expenses of an equal amount has made an anticipatory assignment of income and must include the reimbursement in income.) Indeed, in the higher education context, tax advisors suggest that faculty forsake salary in favor of reimbursed expenses when the opportunity arises. *E.g.*, John A. Miller & Robert Pikowsky, *Taxation and the Sabbatical: Doctrine, Planning, and Policy*, 63 TAX LAW. 375, 406-07 (2010). Engaging in some speculation, let's consider the consequences if the IRS were to successfully argue that these expense accounts are in fact taxable to the faculty member. My guess is that expense arrangements would cease and the faculty would simply receive the compensation in cash (rather an account). Any business expense a faculty member incurs would be deductible as an unreimbursed employee business expense—meaning the faculty member would need to itemize and the deduction would only be allowed to the extent it exceeds 2% of the faculty member's adjusted gross income. *See* I.R.C. § 67. (So the "wash preventers" are worse here than is the case with charitable contributions. See *supra* Part III.E.) If amounts are still put into an expense account for the faculty member's use (despite being taxable), no charitable contribution deduction (which is not subject to the 2% of adjusted gross income rule) would result. This is because the account is earmarked for the "donating" faculty's use—which indicates a lack of charitable intent and a lack of "indefiniteness of bounty." Indeed, it would be hard to see how the amount deposited in the account could be viewed as being given with "detached and disinterred generosity." See generally *supra* Part II for a discussion of the requirements for the charitable contribution deduction. If amounts are still put into an expense account and are taxed, what happens if the funds are subsequently taken away by the university? My guess is claim of right principles would come into play—allowing a refund of the taxes paid on the account. *See* I.R.C. § 1341. (Again, this is speculation and would depend on the specific facts of how the account was set up and the circumstances under which it was taken away.) A charitable contribution deduction upon the loss of the account would not be appropriate, since the loss would be forced (not voluntary) and thus could not be viewed as a "gift" given with "detached and disinterested generosity." While the expense account issue raises similar issues to donated services, it is worthy of separate analysis. Therefore, further discussion of the expense account issue is beyond the scope of this Article.

[180] Indeed, one of the anonymous reviewers of this Article pointed out that such wink and nod agreements are quite common—and "suggestions" about how saved funds should be used are almost always honored. Such arrangements obviously raise classic substance over form issues and colleges and universities would be well-advised, given the IRS's increased scrutiny of higher education, to avoid them.

to more public and IRS scrutiny. Furthermore, we faculty members are supposed to be modeling ethical behavior for our students, and wink and nod arrangements to avoid taxes and control funds are hardly the way to go about doing so.

C. Horizontal Equity Issues

As discussed above in Part III.D, the current tax rules governing donated services do a fairly good job of maintaining horizontal equity. But, in certain situations, singling out donating professors that are explicit and honest about how the saved funds should be spent violates horizontal equity as compared with other donors of time. This occurs when control over the saved funds arises not by an agreement made between the institution and the employee, but by the inherent powers of the donor's position in the university.

For example, consider the increasingly common situation in which university presidents reduce their salaries in times of fiscal distress.[181] If a president of a university takes a voluntary 10% pay cut when renegotiating his contract, no one questions that he has provided value to the institution, yet he has no imputed income.[182] This is true even though as president, he likely has a lot of say over how the savings gets used in the institution's operations. He might direct it to a pet project, a favored department, a new

[181] *See, e.g.*, Jack Stripling & Andrea Fuller, *Presidents Defend Their Pay as Public Colleges Slash Budgets*, CHRON. HIGHER EDUC., Apr. 2, 2011 (listing university presidents who have voluntarily reduced their pay).

[182] The president would have imputed income, however, if he voluntarily donated a portion of a salary that he was already entitled to by contract. Presidents sometimes do this when their compensation goes up, but the rest of the university employees have their wages frozen. These "sympathy" pay cuts are normally still taxable. For example, E. Gordon Gee, President of the Ohio State University, "used his bonus to finance scholarships and other university efforts" in fiscal 2009-10. *Id.* Presumably this resulted in taxable income to Mr. Gee and then a charitable contribution deduction. See *supra* note 141 (for a similar situation involving the leaders of the Idaho State Tax Commission).

program he is keen on, etc. He, the donor, is in control of the funds not because there were strings attached to his donation, but because he is the president.

A similar result occurs when a president negotiates her salary, perks, and working conditions. Perhaps she gets a "slush" fund to use for university expenses at her discretion—perhaps to fund pet projects and unexpected opportunities. No one imputes that income to her even if she could have negotiated for a higher salary in the absence of the slush fund. The president avoids imputed income, and has effectively made a donation to the university, the use of which she controls.

When those who control the budget donate their time, they control how the funds will be used. This means that such individuals are not on par with those who donate time and don't have control over budgetary matters. Unlike university leaders, faculty members who donate their time and want to fall into the no income/no deduction category have no control over how the saved funds will be used. This creates a horizontal equity problem and indicates that some relaxation of the law of donated services may be in order.

A similar horizontal equity problem occurs between employees of small charities with focused missions and large charities with multiple programs and layers of administration. Employees of a homeless shelter, for example, who reduce their salary in times of need know where the money is going—to help the homeless. In contrast, employees at larger charities with multiple programs, such as the Red Cross or a college or university, can never be sure where the funds resulting from their work ends up. Allowing some relaxation would restore horizontal equity between these two groups.

D. Precedents—Other Examples of Relaxed Donation Rules

Relaxed rules for donated earnings are not unprecedented. This Part presents examples of where the tax law has been relaxed when it comes to donations to charity. First, there is the donation of leave time. Second is the donation of employer matching contributions. Third is the donation of certain prizes and awards. Fourth is the donation of certain distributions of individual retirement accounts. Fifth is the special rule for members of religious orders who have taken a vow of poverty.

1. Donation of Leave Time

Some employers allow their employees to donate their accrued sick, vacation, or leave time to charity. Generally, the donating employee would recognize income equal to the cash value of the leave under the assignment of income doctrine.[183] Presumably, the donating employee would then be allowed a charitable contribution deduction for the amount included in income.[184]

But, on occasion, the IRS will relax these rules in order to encourage donations of leave time in hardship situations. Most recently, in the wake of Hurricane Sandy (which hit the northeast in October of 2012) the IRS issued Notice 2012-69,[185] explaining the tax treatment when employees forgo vacation, sick, or personal leave in exchange for cash

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[183] See *supra* Part III.B. A similar assignment of income problem arises when employees are allowed to donate their unused sick or vacation time to a fellow employees who need additional leave, but have exhausted their own leave time and will suffer financially if forced to take unpaid leave. IRS Letter Ruling 2007720017 notes that such arrangements would normally generate taxable compensation income to the donating employee equal to the cash value of the donated leave. But there are exceptions for leave sharing plans where the leave is donated to employees with personal or family medical emergencies (Rev. Rul. 90-29, 1990-1 C.B. 11) or who are victims of a major disaster as declared by the President (Notice 2006-59, 2006-2 C.B. 60). If the employer leave-sharing plan meets one of the exceptions, then the donating employee will neither recognize taxable compensation income nor get a deduction upon donating leave.

[184] Subject to the wash preventers discussed at *supra* Part III.E.

[185] 2012-51 IRB 712.

payments their employer makes to charities that aid the victims of the hurricane. Specifically, the IRS will not treat the forgone benefits as constructive receipt of gross income or wages for the employees and will not view the cash donation made by the employer as income to the employees if the donations are made to qualified charitable organizations for the relief of victims of Hurricane Sandy before January 1, 2014.[186] Under this approach, the employee will not be allowed a deduction for the forgone benefits, but will have no imputed income. Accordingly, the employee effectively gets to deduct the benefits donate via this exclusion. Thereby, FICA taxes are avoided, along with the charitable deduction limitations. Notably, the IRS provided this relief "in view of the extraordinary damage and destruction caused by Hurricane Sandy."[187] The IRS had previously issued such relaxed rules when "extreme need" dictated, such as after the September 11, 2001 terrorists attacks and Hurricane Katrina in 2005.[188]

The donation of leave time such as this shows that it is not unprecedented to allow employees to donate to charity by forgoing earned income. However, the connection to donated services by employees of charities is not perfect. Donated leave involves donations for a specific cause (here, hurricane relief) rather than a blanket license to donate. Second, the relief is provided in the wake a specific disaster rather than a general problem (lower funding for education or charity in general). Third, the relief is provided to all employers offering such a plan—whether nonprofit or for-profit. In contrast, relaxing the assignment of income rules for donated services would only involve employees of charities.

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[186] *Id.*
[187] *Id.*
[188] *See id.*

2. Employer Matching Contributions

Some employers offer an employee benefit whereby they agree to match donations the employee makes to a charity. In general, employer matching contributions are not considered compensation income to the employees because the employees "are merely performing administrative duties for the corporation by suggesting specific qualified recipient organizations."[189] The matching contributions are considered charitable contributions by the employer, rather than by the employee.[190]

The result of the matching contribution tax rules is that the employee has no income and no deduction from the employer's matching contribution. This result is similar to the no income/no deduction treatment of donated services that obtains when there are no assignment of income issues. Why are there no assignment of income issues when it comes to matching contributions? The employee picks the charity, presumably can designate how the donation will be used within the charity's operations, and is getting an employee benefit (something that would normally be taxable as compensation absent a specific exclusion in the Code) via the employer match. This appears to be no different from a professor donating time to a university and asking the university to allocate the saved funds to a particular unit or operation of the university. Yet, assignment of income principles are not applied in the case of the matching contributions but likely are applied in the case of the professor's donated services. The difference

189 Rev. Rul. 67-137, 1967-1 C.B. 63. *See also* Gen. Couns. Mem. 39877, Sept. 8, 1992 (finding no income to employees where an employer donates an amount to a charity of the employee's choosing equal to the amount the employee donated to the employer's Political Action Committee in the previous year).

190 Rev. Rul. 67-137, 1967-1 C.B. 63. A similar result occurs when shareholders control a corporation's choice over which organizations will receive its charitable donations. The shareholders do not recognize a constructive dividend as a result of the corporate donations unless the shareholders receive a property or economic benefit in return. Knott v. Comm'r, 67 T.C. 681 (1977); Rev. Rul. 79-9, 1979-1 C.B. 125.

between the two, in the eyes of the IRS, is that the latter involves a situation in which the "donation" is made "in return for specific and identifiable services [the professor's teaching of a particular course], so that the payment represents a mere assignment of income."[191]

The distinction between matching donations and service donations may be easy to identify, but it is questionable whether they are, in substance, different enough to call for radically different tax results.

3. Donation of Certain Prizes and Awards

Generally, prizes and awards are taxable to the recipient.[192] An exception is provided for prizes and awards which are "made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement" if the recipient did not take any action to apply for the award, is not required to provide substantial future services in order to receive the award, and the prize or award is transferred by the payor to a governmental unit or charitable organization selected by the recipient.[193] In the absence of this exception, presumably the recipient would have taxable income and then would be able to deduct any subsequent contribution of the proceeds to charity—subject to the wash preventers discussed above in Part III.E.

Thus, this exception is another example of where the tax law turns off the assignment of income concept and puts the recipient of the income in the no income/no

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[191] Gen. Couns. Mem. 39877, Sept. 8, 1992.
[192] I.R.C. § 74(a).
[193] I.R.C. § 74(b).

deduction category. The assignment of income doctrine is cast aside, despite the fact that the award recipients control the direction of the funds to specific charities of their choosing. Indeed, President Barack Obama used this exception when he received the 2009 Nobel Peace Prize.[194] He directed the Norwegian Nobel Committee to split the prize amount among ten different charities—even going so far as to designate, in broad terms, how the charities were to use the funds.[195] By complying with the exception, President Obama did not need to recognize any taxable income from the Nobel Prize and did not claim any charitable contribution deductions for the transfer of the prize to the designated charities.

While this exception provides another example of ignoring assignment of income in the charitable context, it does not neatly fit within the fact pattern of donated services. First, the exception is very narrow,[196] and cannot be used in the case of awards provided by an employer to an employee.[197] Second, the exception relates to awards for work done in the past, not work done concurrently with the donation (as is the case with donated services). Third, donated services reflects earned income (subject to

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[194] *See* Portion of the President and First Lady's returns related to the Nobel Prize (PDF), at http://www.whitehouse.gov/sites/default/files/president-obama-2010-nobel-charity.pdf .

[195] *See id.* The charities with the amounts and designations were: Fisher House Foundation, Inc. ($250,000, program expenses), Clinton-Bush Haiti Fund of the Clinton Foundation ($200,000 plus any remaining funds, program expenses for the Clinton-Bush Haiti Fund), American Indian College Fund ($125,000, scholarships), Appalachian Leadership and Education Foundation ($125,000, program expenses), College Summit ($125,000, program expenses), The Posse Foundation ($125,000, program expenses), Hispanic Scholarship Fund ($125,000, scholarships), United Negro College Fund ($125,000, scholarships), Africare ($100,000, program expenses), and Central Asia Institute ($100,000, program expenses).

[196] Indeed, it seems to have been tailor made for the Nobel Prize—where a university professor can donate the award to his or her university. *See* Reg. § 1.74-1(b) (noting the exception can apply to the Nobel Prize or the Pulitzer Prize). The university would presumably have an incentive to direct the funds back to the professor's department or lab, allowing the professor the use of the funds for his or her work while helping retain the prestigious, award-winning professor on the faculty. For more on the workings of the exception in the context of the Nobel Prize, see Bridget J. Crawford & Jonathan G. Blattmachr, *The Tax Man Wins the Nobel Prize*, TAX NOTES, Dec. 12, 2011, at 1421.

[197] Reg. § 1.74-1(b) (indicating that the exclusion does not apply to "prizes or awards from an employer to an employee in recognition of some achievement in connection with his employment").

employment taxes) while awards generally are not subject to employment taxes.[198] Thus, the exclusion for awards transferred to charity does not provide a FICA tax benefit, since the award would not have been subject to FICA tax in the first place. The award exclusion does, however, remove the other wash preventers discussed above in Part III.E.[199]

4. Charitable Distributions from Individual Retirement Accounts

A temporary provision of the tax law allows individuals aged 70 ½ or older to transfer up to $100,000 per year in otherwise taxable distributions from their individual retirement accounts (IRAs) to charity without incurring any taxable income.[200] While taxpayers using this provision recognize no income from the distribution, they also are denied a deduction for the donation.[201] Thus, taxpayers using this provision are like a service donor in the no income/no deduction category. They get to pick the charity they support—and the specific activity of the charity they support—yet avoid income and

[198] This assumes that the awards are not provided as compensation for services. That is they are "unearned." This also assumes that the employer did not provide the award (since taxable awards provided by employers are subject to FICA). But this will not be an issue, since employer awards are not eligible for the exclusion. See *supra* note 197.

[199] Another point should be noted. The current law exclusion for awards transferred to charity originally was a complete exclusion for such awards—whether or not the awards were donated to charity. The rule was changed to require a transfer to charity for exclusion as part of the base-broadening approach of the Tax Reform Act of 1986. *See* THE STAFF OF THE JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986 30-38 (1987). By adding the requirement that the award be donated to charity, the exclusion was greatly narrowed. In contrast, this Article is proposing expanded exclusions in the case of donated services.

[200] I.R.C. § 408(d)(8). Unless extended, this provision, first put into the law in 2006, expires (as of this writing) on December 31, 2013. I.R.C. § 408(d)(8)(F). The age of 70 ½ years is significant because that is the age at which individuals are required to begin withdrawing taxable funds from their individual retirement accounts.

[201] I.R.C. § 408(d)(8)(E).

most of the wash preventers noted above.[202] This IRA provision is expected cost the Treasury $1.28 billion if extended through 2022.[203]

The IRA provision is hardly a perfect model for relaxing the assignment of income rules in the donated services context. First, because this is a temporary provision of the tax law that only applies to individuals over age 70 ½ with means sufficient to not need some of the funds in their IRAs, it is quite narrow. Relaxing the rules in the donated services context would have much wider application. Second, the IRA provision does not result in a forgiveness of payroll taxes. The income being transferred from the IRA to charity is most likely a mix of earned income (which was already subject to payroll taxes when earned) and accrued investment income (which is not subject to payroll taxes in any event).[204] But an effective relaxation of the assignment of income rules for donated services would need to provide relief from payroll taxes. In the case of the IRA, the payroll taxes were paid years ago and do not present a cash flow problem at the distribution to charity. With donated services, the payroll taxes are due along with the imputed income—creating a salient tax barrier to the donation. Despite the differences, the IRA relaxation provision at least provides a precedent for having the tax law get out of the way of charitable contributions.

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[202] See *supra* Part III.E. Notably, the payroll tax wash barrier is not eliminated, as discussed below.

[203] JOINT COMMITTEE ON TAXATION, ESTIMATED REVENUE EFFECTS OF THE REVENUE PROVISIONS CONTAINED IN AN AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 8, THE "AMERICAN TAXPAYER RELIEF ACT OF 2012," AS PASSED BY THE SENATE ON JANUARY 1, 2013 4 (JCX-1-13, JAN. 1, 2013).

[204] Well, if one ignores the new Medicare Contribution Tax on investment income of high-AGI taxpayers, which is beyond the scope of this Article.

5. Income Earned by Members of Religious Orders Who Took a Vow of Poverty

Members of religious orders who take a vow of poverty usually agree to turn over all of their earnings to the order. Such promises are legally enforceable.[205] Normally, assignment of income principles would require the members to pay taxes on their earnings, even though they have been legally assigned to their order.[206] But when members work for their church or an affiliated organization, they are considered agents of the order and the salary that is remitted to the order is not taxable to the member who earned it.[207] In contrast, the general assignment of income rule applies when members work for another employer—one that is not their church or an affiliated organization.[208] In that case, members are taxed on their salary even though the wages are turned over to the order.[209]

The exemption for wages earned by vowed religious who work for the order or an affiliated organization and turn over their income to the order seems to fit neatly with professors donating their time to a college or university. In both cases, the worker is

[205] Samira Alic Omerovic, *Improper Taxation of the Vowed Religious: How* Glenshaw Glass *Principles Can Reestablish Horizontal Equity*, 51 B.C.L. Rev. 1247, 1257 (2010) (reviewing Supreme Court cases finding that vows of poverty are legally enforceable).
[206] See *supra* Part III.B.
[207] Rev. Rul. 77-290, 1977-2 C.B. 26.
[208] Perhaps one might think of an American version of Fraulein Maria being dispatched by the Abbey to work as a governess for the Von Trapp children, with the Captain remitting Maria's fee to the Mother Abbess. *See* THE SOUND OF MUSIC (20th Century Fox 1965). Although Maria had not yet taken her final vows to become a nun, she did report that when she joined the Abbey all her worldly goods were given to the poor. Except, that is, for the clothing she was wearing—which the poor did not want. *See id.*
[209] Rev. Rul. 77-290, 1977-2 C.B. 26. For a review of the case law in this area, see Omerovic, *supra* note 205, at 1255-66. Omerovic opines that the government applies the assignment of income doctrine to vowed religious who work for outside employers to combat "personal church" tax avoidance schemes. *Id.* at 1258. "The schemes involved protesters becoming ordained as ministers of mail order churches, taking vows of poverty, assigning their income to the fictitious churches, and then receiving access to this income for living expenses." *Id.* Omerovic notes that undercover police officers are not taxed on the income they earn and turn over to the police department while undercover—and that members of religious orders who have taken a vow of poverty should be afforded similar tax treatment since they—like the police officers—have no dominion and control over the wages they earn. *Id.* at 1250.

essentially turning over their wages to their charitable employer or an affiliate of their charitable employer.[210] Of course, the analogy is not perfect. Professors, unlike the vowed religious, have more control over whether they take salary or donate time. The vowed religious agree to give up their income for life; a professor agrees on a case by case, course by course basis. Although some might say that professors take a vow of poverty just by being in the professorate.[211]

E. Other Relaxation Proposals

This Part IV.E will discuss proposals made by scholars to relax the normal charitable contribution rules in other contexts. First is a proposal to allow the donation of unused flexible spending accounts to charity free of tax consequence. Second is a proposal to allow an exclusion for lottery winnings given to charity. These two proposals simply turn-off the assignment of income doctrine and allow taxpayers to exclude income that is transferred to charity.[212]

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[210] In the case of the professor, the wages are turned over to their university or a foundation that supports the university. See the discussion of university/foundation relationships at *supra* note 17 and accompanying text. As for the similarity between being a member of the professoriate and being a member of a religious order, see *supra* note 123 and accompanying text (regarding the de-churching of higher education). Presumably religious orders have not been de-churched—yet.

[211] I used to joke that, as a professor at a state university, I was on a "fixed income" (raises are rare). I stopped saying that when I found Idaho State Board of Education Policy § II.G.1.c., indicating that tenured and untenured faculty salaries are not guaranteed from year to year; the salaries may be "adjusted" because of financial exigency or through furlough or work hour adjustments. Perhaps adjusted to zero? Now I am glad to have maintained a fixed income.

[212] Other proposals, not reviewed in detail here, go further and advocate an exclusion from income *and* a deduction for donated services. As discussed at *supra* Part III.A, allowing both exclusion and deduction provides a double tax benefit to volunteers. *See, e.g.*, Alice M. Thomas, *Re-envisioning the Charitable Deduction to Legislate Compassion and Civility: Reclaiming Our Collective and Individual Humanity Through Sustained Volunteerism*, 19 KAN. J.L. & PUB. POL'Y 269 (2010)(calling for a deduction or refundable tax credit for time given to charity or in helping individuals directly—assuming verification—and capped at $2,000 per individual per year). The relaxation proposals suggested in this Article are more modest, only calling for the partial shut-off of the assignment of income doctrine and only for employees of charitable organizations. (See *infra* Part V.A).

1. Donation of Unused Healthcare Flexible Spending Accounts

Adam Chodorow has proposed that taxpayers be allowed to donate their unused Flexible Spending Account (FSA) balances to charity without assignment of income consequences.[213] FSAs allow employees to put aside a portion of their salary—capped at $2,500 per year[214]—in an account which can be used to pay for out-of-pocket medical expenses.[215] Amounts contributed to an FSA are exempt from income and payroll taxes.[216] But an employee must spend the funds in the FSA on qualified medical expenses by the end of the plan year or forfeit any unused amounts left in the FSA.[217] Chodorow suggests that, rather than forfeiting the unused FSA balance, employees should be allowed to donate it to charity.[218] Under Chodorow's proposal, an employee who donated their unused FSA balance would realize no income and have no deduction.[219] Since the original contribution to the FSA was excluded from income, the employee would, in effect, get a 100% deduction for the amounts that went to charity without worrying about the wash preventers discussed above.[220]

Chodorow's proposal is a good, but imperfect match with the donated services relaxation proposals suggested in this Article.[221] In both cases, earned income is diverted, in an income tax and payroll tax-free manner, to charity. In both cases, the

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[213] Adam Chodorow, *Charitable FSAs: A Proposal to Combine Healthcare and Charitable Giving Tax Provisions*, 2011-4 BYU L.REV. 1041 (2011).
[214] I.R.C. § 125(j). The $2,500 limit is for 2013 and will be adjusted for inflation in future years. *Id.*
[215] Prop. Reg. § 1.125-5.
[216] *See* I.R.C. § 105 (employer reimbursements of employee medical costs excluded from taxable income); I.R.C. § 125 (allowing health benefits to be offered via cafeteria plans); Prop. Reg. 1.125-5 (including FSAs within the cafeteria plan structure); I.R.C. § 3121(a)(5)(G) (excluding amounts paid under a cafeteria plan from wages).
[217] Prop. Reg. 1.125-5 (c) ("use-or-lose rule").
[218] Chodorow, *supra* note 213, at 1043.
[219] *Id.* at 1075.
[220] See *supra* Part III.E.
[221] See *infra* Part V.A.

employee would get to designate the cause to which their funds would be directed.[222] Chodorow's proposal is both narrower and broader than the donated services proposal. It is narrower because it has a built-in limitation—the maximum amount allowed in a health FSA ($2,500). There is no such built-in limit in the donated services context—although I will suggest some possible limits below in Part V.A. It is broader because it would encompass all employees who work at companies with FSAs. By contrast, the donated services proposal would apply only to employees of charities.

Chodorow's proposal arguably will not cost the Treasury much revenue. Taxpayers are already contributing to FSAs and doing their best to spend all the money in them by the plan deadlines. All Chodorow's proposal does is shift some of the funds from medical payments to charitable donations. Either way, the Treasury is already out the tax savings (for both income and payroll tax purposes) that result from the existence of FSAs.[223] In contrast, the donated service proposal could produce revenue losses for the Treasury.[224]

2. Exclusion for Donated Lottery Winnings

Lottery winners who wish to donate some of their winnings to charity must include the winnings in income and then take a deduction for the donation—subject to the wash preventers discussed above.[225] To avoid this result, the lottery winner would need

[222] In the case of the FSA, Chodorow envisions (for administrative reasons) allowing each employee to designate one charity to receive the leftover FSA balance. Chodorow, *supra* note 213, at 1074. In the case of donated services, the saved funds would be deployed within the charitable employer as the employee designated.
[223] Of course, FSAs could become more attractive if employees knew that unused amounts would go to charity instead of being forfeited. In that case, the estimated revenue cost to the Treasury might increase. *See* Chodorow, *supra* note 213, at 1082.
[224] The issue of lost revenue is discussed at *infra* Part V.C.
[225] See *supra* Part III.E.

to legally assign the ticket (or part of the ticket) to the charity at purchase (or at least before winning)—something that would be very difficult to do given the costs and the slim odds of winning.[226]

C. Eugene Steuerle has recommended changing the law to allow lottery winners to donate some or all of their winnings to charity within a certain period of winning without tax.[227] Effectively, this would turn-off assignment of income with respect to lottery winnings given to charity. In fact, Steuerle's proposal goes further than the donated services relaxation proposals suggested in this Article in that Steuerle would allow the lottery winners to actually receive cash (the lottery winnings) and then have a period of time to donate. By contrast, no actual cash would flow through the hands of the donating charitable employee.

The lottery proposal provides further evidence that relaxing the rules for donated services would not be radical and may help encourage giving. But, the analogy between the lottery proposal and donated services is not perfect. In particular, lottery winnings are not subject to payroll taxes, while constructively-received wages are. Thus, while the donated services proposal would result in a loss of revenue via payroll taxes, Steuerle's lottery proposal would not.

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[226] C. Eugene Steuerle, *The Tax Treatment of Charities & Major Budget Reform*, *Testimony Before the U.S. Senate Committee on Finance*, Oct. 18, 2011, at 9. Other countries take a different approach. In Canada, for example, a couple that won the Canadian lottery was able to donate 98% of their $11.2 million prize to charity without tax consequence because Canada does not tax lottery winnings. Canadian Couple Who Gave $11.2 million Lottery Winnings to Charity Would Have a U.S. Tax Problem, http://taxprof.typepad.com/taxprof_blog/2010/11/good-thing.html (Nov. 6, 2010).

[227] Steuerle, *supra* note 226, at 9.

V. RELAXATION POSSIBILITIES AND THEIR BENEFITS AND COSTS

This Part V discusses the various ways that the rules governing donated services can be relaxed to allow donations of time without tax consequence. While this might be accomplished via IRS rulings or Treasury Regulations, given the current guidance it would most effectively be accomplished via an amendment to the Internal Revenue Code.[228]

Less important than the actual form or extent of relaxation is that there be some relaxation provided in a way that provides certainty to colleges, universities, and their faculty and staff. In today's environment, college and universities are under too much scrutiny to be engaging in aggressive tax strategies or wink and nod arrangements. Many schools are likely still in the process of professionalizing their tax reporting, are understandably taking conservative approaches to tax matters, and would need clear, certain rules before allowing donated services without assignment of income.

As noted above, anecdotal evidence suggests that few universities have active, advertised volunteer programs—likely due to the possible adverse tax consequences.[229] Therefore, it is unclear what impact a relaxed rule might have. Because of the uncertainties, perhaps a relaxed rule might be implemented for a test period—say two to four years—with Treasury conducting a study to quantify the costs incurred (lost revenue) and benefits realized (increased donations).[230]

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[228] See discussion at *supra* Part III.B, noting that most of the guidance in this area comes from rulings, regulations, and court decisions.

[229] See *supra* note 117.

[230] The problem with a temporary approach is that arguably too much of our tax law is already temporary—resulting in many provisions being in need of periodic extensions. In this case, however, with a few years of study presumably we should be able to judge whether the provision should be scrapped or made permanent. Admittedly, the track record for temporary provisions is not good. They often end up being extended without much study. For example, in 2006 Congress relaxed the tax treatment of income § 501(c)(3) organizations earn from their for-profit subsidiaries. The relaxed rules were put in place in 2006

This Part proceeds as follows. Part A reviews the possibilities for relaxation from strong to weak. Part B summarizes the possible benefits from relaxation and Part C addresses possible objections.

A. Relaxation Possibilities

1. Deep Relaxation: Turn Off the Assignment of Income Doctrine

One relaxation possibility is to simply turn off the assignment of income doctrine when employees of charities give up some of their compensation to their charitable employers and designate how the savings will be used. This would be similar to the current rules allowing charitable contributions from IRAs and the proposal to allow donations of unused health flexible savings accounts.[231] This could be accomplished via a new Code provision that states that gross income does not include the value of services donated to a charity by an employee of that charity under an agreement between the employee and charity.[232] The employee and the charity would have to finalize the agreement prior to the rendering of services, the employee would be allowed to designate how the saved funds are redeployed within the charitable organization, and it would be made clear that the employee would not be entitled to a charitable contribution deduction. To ensure horizontal equity between private nonprofits and public institutions (like state colleges and universities) the savings may be allowed to go not just to the employing

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on a temporary basis pending study by the Treasury. But the relaxed rules have been periodically extended (as of this writing through December 31, 2013) and it appears that no study of the provision has been released. *See* I.R.C. § 512 (b)(13)(E).

[231] See *supra* Parts IV.D.4 & IV.E.1.

[232] This new provision likely belongs in the exclusion section of the Internal Revenue Code. Section 139F, for example, is currently available.

institution itself, but also to its affiliated and supporting organizations—such as a university's supporting foundation, alumni association, or athletic booster association.[233] Allowing affiliated organizations to participate would also avoid discrimination against charities based solely on their legal structure. Even outside of the higher education context, charitable structures can vary. Some charities operate through one legal entity, while others have multiple affiliated organizations—like supporting foundations—to carry out their missions.[234] The relaxation rule, therefore, should be broad enough to extend not just to the employing charity, but to its related charities as well. In all cases, the saved funds ultimately flow to the charitable class of the employing charity or one of its nonprofit affiliates.

If there is concern that the new provision would primarily benefit highly compensated employees, like the university president and other executives, then a nondiscrimination component (like those included in qualified cafeteria and pension plans) could be included.[235]

The advantages of deep relaxation are that it is simple, easy to understand, and would be most effective at encouraging charitable employees to donate time. It would, in most cases, completely remove the specter of imputed income, and eliminate worries about the wash preventers. Deep relaxation would take care of the problem for all

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[233] See *supra* note 17 and accompanying text for discussion of these supporting organizations. For those concerned about the commercialization of college sports programs, the new Code provision might exclude supporting organizations—like athletic booster associations—that primarily benefit athletic departments.

[234] For example, the Idaho Youth Ranch, a charity that runs thrift stores and programs for high-risk youth in Idaho, has a separate organization to manage its endowment funds. See Idaho Youth Ranch Foundation, at http://www.youthranch.org/IYRFoundation.aspx.

[235] A nondiscrimination rule may not be entirely effective, however, for employees of independent means. Employees who are wealthy yet earn modest salaries (putting them beyond the reach of nondiscrimination rules) may be tempted to give their entire salary back—effectively giving them a tax advantage in their giving programs. But such individuals are likely to be few. Such individuals may already be working for zero salary under a no income/no deduction regime if they have given up control over where the saved funds will be spent.

employees—including those donating their entire salary or those contributing a portion of their salary (like their compensation for teaching a summer course).

But deep, near-complete relaxation carries disadvantages. First, it would be too broad. It would allow charitable employees to effectively enter into salary reduction agreements with their employers. Employees would fund all their donations to their employers with pre-tax dollars, something that is not allowed to employees of for-profit enterprises. While employees of nonprofits likely give to a variety of causes, they are under particular pressure to give to the employer. This pressure is particularly acute in higher education.[236] After all, the administration and the professionals in the development office want to be able to advertise to outside stakeholders (and potential contributors) that a high percentage of university faculty and staff contribute to the institution. With complete relaxation, it is possible that employees of charities would no longer give cash donations; they would give time. In the for-profit world, employees are likewise under pressure to give to the employer's charity of choice (for example, the United Way), but they would not have the pre-tax option that their counterparts in the nonprofit world would enjoy with deep relaxation of the assignment of income doctrine.

Thus, while deep relaxation would be easiest, some sort of limiting principle is needed. To that issue we now turn.

2. Gentle Relaxation: Partial Turn Off of the Assignment of Income Doctrine

Instead of turning off the assignment of income doctrine for all services contributed by employees of charities, Congress could restrict the relaxation to discrete

[236] *See* Gene C. Fant, Jr., Give a Little Bit … More, On Hiring Blog Post, chroinicle.com, Oct. 8, 2012.

amounts of income. For example, many faculty members are paid a base salary based on a nine-month (academic year) contract. Faculty members often have the opportunity to earn additional income from the college or university by teaching a class on an overload basis (in excess of their assigned teaching load), teaching during the summer or intersession, teaching in executive education programs run by the school, participating in certain faculty development programs, being assigned extra income via an endowed professorship, receiving a cash award for teaching, research, or service, or receiving summer research support. [237] A limited relaxation proposal might only allow such supplemental, non-base salary income to be contributed without assignment of income. Further, the relaxation might be limited to a fixed dollar amount—say $10,000 of this extra income, indexed to inflation. [238] This limit could also be applied to adjunct salaries for professionals who teach a course and want to donate the usual compensation back to the university and designate how the funds will be spent.

This gentle relaxation proposal might not translate easily outside of the higher education context. But it could encompass, for example, bonuses or other supplemental compensation that employees of charities may be entitled to from time to time. This would extend the relaxation beyond the landscape of higher education.

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[237] According to a 2004 survey, over half of faculty members get such supplemental pay from their employing institution. Finkelstein, *supra* note 131 , at 326. But many faculty members need these funds to make ends meet—and thus would not be in a position to donate their time. *Id.* at 327.

[238] Indexing to inflation is important to keep the limited tax benefit from slowly being wasted away by the ravages of inflation. Some limits put into the tax code without the protection of inflation adjustments become less and less important over time. *See* GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 65-68 (1982) (noting that non-indexed amounts in statutes may reflect a provision designed to satisfy a vocal interest group to gain their support for broader legislation while ensuring that the impact of the non-indexed provision lessens with the passage of time); Richard Schmalbeck & Jay A. Soled, *The Cultural Symbolism of the Deductible Skybox*, TAX NOTES, Mar. 22, 2010, at 1524, 1528 n. 35 (noting how, in 1964, Congress enacted an exclusion from income for employer paid premiums on up to $50,000 of group term life insurance for employees without indexing—and how the value of that exclusion is becoming less and less important over time). The proposal described here is structured as an improvement to the tax system rather than a one-time reaction to a problem. As such, indexing of any cap that is chosen would be appropriate.

This more limited relaxation approach would have the advantage of encouraging volunteerism by employees of charities without creating an unlimited loophole. This eliminates the problem of satisfying normal employee campaign donations out of the regular paycheck. The proposal would also offer clear rules (limited as they are) that colleges and universities could openly use to encourage volunteerism by their employees and potential employees (like adjuncts drawn from the community).

3. Weak Relaxation: Waiving the AGI Limits

An even weaker relaxation option would be, rather than turning off the assignment of income doctrine, eliminating one of the wash preventers—the 50% of AGI limit—for donated services. This would allow faculty to donate an entire year's salary (say their final year's salary) with less of a tax consequence.[239] They would still have income and pay payroll taxes, but could more easily deduct the contributions. This would allow the funding of more scholarships or endowments for other projects. Such a provision is not unprecedented. A similar rule was put in place, on a temporary basis, to encourage charitable contributions in the wake of Hurricane Katrina.[240]

This weaker option would still help encourage deductions, but would not help smaller donors who do not itemize. Therefore, a combination of a capped limit with no assignment of income and a waiver of the 50% limit for those over the limit—or those paid out of base salary—might be ideal.

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[239] I am ignoring the implication of wage and hour laws and am assuming most employee volunteers would be considered non-classified employees under state law—like faculty members, executives, and managers. This might taint the proposal as benefiting high income elites, but I think the proposal could be extended to classified staff so long as the donations do not violate the wage and hour laws of the jurisdiction. Further discussion is beyond the scope of this Article.

[240] I.R.C. §1400S(a) (suspending the 50% of AGI limit on qualified charitable contributions made between August 28 and December 31, 2005).

Regardless of the specific relaxation option enacted, the key is to clarify the rules to allow donors to contribute services and allow universities and other charities to allow it, certain of the tax consequences that will occur. This would allow these arrangements to take place in the open, with solid agreements in place. In any case, the rules should not be structured to cast doubt on current transactions that are already squarely within the no income/no deduction rule.

B. Benefits of Relaxation

Regardless of the form chosen—deep, gentle, or weak—relaxation would result in more donations going to colleges and universities when they are most needed. If the proposal is not enacted, the specter of taxation will cause even the most generous faculty to forgo donations of the magnitude that can result from donated services. While relaxation will cost the government revenue,[241] it will cause giving to increase. Relaxation would have the salutary effect of ending the subterfuge; the wink and nod arrangements where the professor agrees to teach and not have any formal say over where the money goes yet the decision maker (Dean, President, Provost or whoever controls the purse strings at issue) just happens to fund the professor's preferred project. Relaxing the rules would get these arrangements out in the open, let everyone be honest, transparent, and avoid misunderstandings. Colleges and universities would be free to set up donation policies that fit within the relaxed tax rules—freely promoting the ease of giving by faculty. Faculty who donate time can even be treated as if they had donated cash and be initiated into the "club" levels of giving—entitling them to invitations to events where the

[241] See discussion at *infra* Part V.C.

big-ticket donors are feted. Furthermore, faculty contributions of time could "count" towards capital campaign drives, highlighting faculty support for the institution.

Relaxation of the tax rules governing donated services would also vest more control over the saved funds in the donor, rather than the institution. This is the same control that cash donors enjoy. Faculties, historically self-governing, are increasingly left out of decision making by the corporatization of the university.[242] Administrators with access to private benefactors and control over budgets normally determine funding priorities. Allowing faculty members to donate time free of tax headaches gives them a say, in a small way, over where funds go and what gets prioritized. This could be empowering.[243] That empowerment should increase donations—making the cost of forgoing taxes worth it given the additional funds flowing to the colleges and universities.[244]

Studies have shown that taxpayers respond to tax incentives for charitable giving.[245] Taxpayers will decrease contributions as the after-tax cost of giving increases and will increase contributions as the after-tax cost of giving decreases.[246] Relaxation would clearly reduce the after-tax cost of giving by moving the donation from the

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[242] *See generally* GINSBERG, *supra* note 169.

[243] It might even help alleviate faculty grievances. Or not:

> If one listens to academics, one might make the mistake of thinking they would like their complaints to be remedied; but in fact the complaints of academics are their treasures, and were you to remove them, you would find either that they had been instantly replenished or that you were now their object. The reason academics want and need their complaints is that it is important to them to feel oppressed, for in the psychic economy of the academy, oppression is the sign of virtue….The essence of it all is…*Academics like to eat sh[**], and in a pinch, they don't care whose sh[**] they eat*.

STANLEY E. FISH, THERE'S NO SUCH THING AS FREE SPEECH, AND IT'S A GOOD THING, TOO 276, 278 (1994) *reprinted in* BIRNBAUM, *supra* note 1, at 219 (emphasis in original).

[244] Of course, some (many) faculty members may have odd ideas about how funds should be used. But odd, inefficient allocations of donated funds results from cash donors as well. Such is the nature of having an independent third sector. Efforts may be wasted, but pluralism and freedom are fostered. *See* FISHMAN & SCHWARZ, *supra* note 19, at 61 (internal citations omitted).

[245] PRESENT LAW, *supra* note 28, at 3.

[246] *Id.*

imputed income/deduction category into the no income/no deduction category. With increased publicity, clearer rules, the tax barriers removed, and faculty control over the saved funds, relaxation will cause giving to increase. Indeed, a faculty member who would never dream of taking $10,000 out of savings to donate to the university may be more than willing to do something he or she loves (teaching) for free—resulting in $10,000 being donated to the university. But only if there are no adverse tax consequences and the faculty member has some say over which programs would benefit from the saved funds. When deciding whether a new tax law will be good policy, the general test is to see if the benefits from taxpayer behavior caused by the law change will exceed the costs in revenue loss to the government.[247] Relaxation of the tax law of donated services passes this policy test because, as shown here, there is a strong likelihood that the increase in giving caused by relaxation will exceed the revenue costs of relaxation.[248]

C. Problems with Relaxation

One could raise objections to relaxing the rules for donated services. The first is the revenue loss to the government. Deficits are currently a paramount concern of politicians and the public, with talk of cutting spending and enhancing revenues by reducing tax breaks and "loopholes." In such an environment, policymakers may well object to supporting yet another relief provision that could reduce revenue. In reality, however, the income tax revenue impact would likely be difficult to measure. Loss of

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[247] *See, e.g.*, *id.*

[248] For more discussion on lost revenue from relaxation, see *infra* V.C. For public schools, relaxation to some extent involves using federal dollars (via lost tax revenue) to make-up for state reductions in higher education spending. For private schools, relaxation can be viewed as substituting federal dollars (via lost tax revenue) for federal dollars (in terms of financial aid). In any case, this issue is beyond the scope of this Article.

income tax receipts would only occur to the extent the wash preventers currently apply. [249] The Tax Expenditures Budget does not attempt to capture the revenue losses that occur from no income/no deduction situations. Even though the government is theoretically losing revenue because volunteers in the no income/no deduction category are forgoing income in the name of charity, such losses cannot be easily measured. They are not tracked.[250] Relaxation of the donated services rules would simply help more donors avoid the wash preventers and land in the currently unmeasured no income/no deduction category. Furthermore, some of the relaxation would simply be legitimizing arrangements that were previously accomplished by subterfuge. If so, the government really has not "lost" any revenue over the pre-relaxation baseline—it is just that the revenue "loss" will have been acknowledged and made more salient.

If relaxation occurs, the revenue loss could be measured by having charities report the known value of volunteer time that falls under the relaxation rule on their Forms 990. This is another reason to perhaps enact the relaxation rules on a temporary basis to study their impact. Reporting on Form 990 could help the government track trends in volunteering under the relaxation rules and better reckon the costs. But given the cloudy revenue impact now, it is worth giving relaxation a chance.

The most significant revenue loss is likely not via the income tax, but via payroll taxes. Payroll taxes are the most pernicious of the wash preventers and likely the single biggest roadblock to donated services. Indeed, payroll taxes will apply every time

[249] See *supra* Part III.E.
[250] Likewise, the Tax Expenditures Budget makes no attempt to measure revenue losses from those who choose not to work.

income is imputed for donated services.[251] Relaxing the rules thus has the potential to remove a great deal of payroll tax revenue at a time when the long-term viability of Social Security and Medicare is causing concern. But any notion that these dedicated revenue sources are sacred was thrown away when Congress declared a payroll tax holiday—reducing the OASDI rate by 2% for 2011 and 2012.[252] Although Congress directed the Treasury to make up for the revenue losses suffered by the OASDI Trust Fund from the payroll tax holiday,[253] its tampering with the dedicated revenue stream that supports Social Security shows that payroll taxes are not as inviolable as once thought. Indeed, the promised benefits will likely need to be funded out of general Treasury funds should the dedicated revenue source (payroll taxes) prove inadequate.[254] Also indicative of the lack of sacredness is the fact that the government does not currently prepare a tax expenditures budget to track revenue losses for payroll taxes.[255]

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[251] But the impact may be limited to the HI/Medicare portion of FICA if the donating employee is already over the OASDI wage cap.
[252] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, §601 (2010).
[253] *Id.* at § 601(e).
[254] One might view the Social Security and Medicare taxes not as "taxes" but as payments for specific benefits (i.e., a future pension, disability insurance, and future medical insurance). *See* JULIAN E. ZELIZER, TAXING AMERICA: WILBUR D. MILLS, CONGRESS, AND THE STATE, 1945-1975 14 (1998), (explaining how Social Security was originally set up as an insurance program specifically financed by payroll "contributions" rather than a welfare program financed out of general tax revenue to ensure that the system would have its own funding source sufficient to "withstand the anti-statist culture of the United States"). Today, however, there is strong case for viewing the employment taxes as just that: taxes. *See id*. at 343-46 (discussing the expansion of Social Security benefits which began in the early 1970s and which were not coupled with appropriate increases in the contribution rate); *see also* LEONARD E. BURMAN & JOEL SLEMROD, TAXES IN AMERICA: WHAT EVERYONE NEEDS TO KNOW 54 (2013) (noting "[a]s the connection between payroll taxes and benefits becomes more and more attenuated, the programs [Social Security and Medicare] may come to seem more like welfare and less like insurance"); Charles Murray, *Tax Withholding is Bad for Democracy*, WALL ST. J., Aug. 13, 2009, at A15 (calling on Congress to fold payroll taxes into the general income tax because it "will tell everyone the truth: Their payroll taxes are being used to pay whatever bills the federal government brings upon itself, among which are the costs of Social Security and Medicare").
[255] See TAX EXPENDITURES, *supra* note 35 at 3 (indicating that the Joint Committee on Taxation does not track employment tax expenditures in its income tax expenditures report); *see also* Tax Policy Center, The Tax Policy Briefing Book, Tax Expenditures: What is the tax expenditure budget? at http://www.taxpolicycenter.org/briefing-book/background/expenditures/budget.cfm (indicating that the "government could, but does not, formulate tax expenditure budgets for Social Security and other taxes").

The second objection to relaxation is the possibility of resentment. Faculty members already enjoy special tax and nontax benefits that are being scrutinized in today's troubled economic environment. Many (but a dwindling number) have or can attain tenure, a form of job security unheard of outside of academia and the federal bench. Many universities allow employees or their dependents to take courses at a discounted tuition or even tuition free. These tuition benefits are generally not taxable to the employee.[256] This tax break has been criticized because it is only enjoyed by employees in higher education.[257] But the relaxation proposals introduced here would benefit all employees of charities, not just those in higher education. The relaxation may be more palatable if viewed as a charitable helper rather than a special break for pampered faculty.

Beyond perk resentment, higher education has been experiencing broad criticism because of its high cost. Donors and federal policymakers are starting to reconsider the efficacy of support for higher education in light of tuition increases, higher student debt loads in the face of a soft job market, the commerciality of college athletics, and "hoarding" of endowment earnings.[258] This is yet more evidence of the "de-churching" of higher education and shows that now may not be an ideal time to ask for yet another special rule that benefits higher education and costs the public treasury. But the relaxation scheme presented here could potentially lower costs if volunteering faculty members covered needed courses and asked that the funds saved be used in a manner that

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Many employee benefits that are excluded for income tax purposes are also excluded from payroll taxes, yet the impacts are not tracked.

[256] I.R.C. § 127(d) (known as a "qualified tuition reduction").

[257] *See*, *e.g.*, STAFF OF THE JOINT COMMITTEE ON TAXATION, OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES 44-46 (JCS-02-05, Jan. 27, 2005).

[258] For a general overview of some of these issues, see Mark J. Cowan, *Taxing and Regulating College and University Endowment Income*, 34 J.C. & U.L. 507, 508 n. 10 (2008).

aids students—like for scholarships.[259] Indeed, the increased frequency and visibility of faculty volunteerism made possible by relaxation may show efforts to reduce costs and may even create goodwill in the community and with policymakers.

The third objection to relaxation is the possible collateral effects on non-tenured faculty, especially adjuncts. Universities are already heavily relying on the cheap teaching labor that is available in fields with an oversupply of PhDs.[260] If more faculty members start donating time, in theory colleges and universities might reduce positions for low-paid adjuncts trying to stitch together a living. It is easy for those of us that teach in professional fields like accounting or law, and work with highly-paid professionals interested in teaching on a part-time, adjunct basis to forget that the poor pay, benefits, and working conditions for adjuncts in many other fields is well-documented.[261] It would be difficult to build in safeguards for adjuncts in a relaxation statute. Ideally this issue would be best addressed at the institutional level, with each school adopting policies—approved by the faculty senate or a similar faculty governance body—to ensure that donated services will not crowd-out adjunct faculty. But even if policies are not put in place, most full-time faculty would likely donate salary for courses they were going to teach already (like summer courses) or were forced to teach because of a critical need (like classes on overload). In most cases, those courses would have been taught by the faculty member anyway, and thus the mere relaxation of the donated services rules is unlikely to crowd out the adjuncts.

[259] The relaxation proposal might be tailored so that donated services could avoid assignment of income only if the savings are redirected to programs that directly benefit students—like scholarships. But this would add needless complexity to the relaxation rules. Most donation-minded faculty would want their donations to fund scholarships or other programs that directly or indirectly benefit the students.
[260] This is particularly true in certain areas of the humanities. By contrast, my field (accountancy) has an undersupply of credentialed faculty applicants. See *supra* note 137.
[261] *See, e.g.*, Audrey Williams June & Jonah Newman, *Adjunct Project Reveals Wide Range in Pay*, CHRON. HIGHER EDUC., Jan. 4, 2013.

A fourth problem with relaxation is the possibility for precedent and peer pressure. If Professor X teaches Course A for free, then when he retires his replacement, Professor Y, may well be under pressure to do the same. If Professor Y refuses, perhaps because of this personal financial situation, Y might be viewed as miserly in comparison to his benevolent predecessor.[262] But such fears are likely misplaced. Presumably there is general understanding that individual faculty members each have different financial positions and views on donations. Some are in a better position to give time than others. Furthermore, a relaxed donated services regime could *reduce* peer pressure. Relaxed rules would allow professors to designate where the cost savings go—and different professors have different views on which programs need support. Professor X, for example, may teach a course for free and designate that funds go to the X Family Scholarship. No one would expect his replacement, Professor Y, to teach for free and donate it to the X Family Scholarship. Relaxation, by providing tracing of funds, would thus make clear that giving goals are not portable from one faculty donor to another.

A fifth problem with relaxation are the possible collateral effects on funding. One issue is measurement of resources. As budgets contract, faculty lines may be eliminated. If professors pick up the slack by donating teaching time and the essential classes are still being taught, then the pain of the lost line would not be as salient.[263] Administration may get the misperception that the faculty position does not need to be restored, because it

[262] Anecdotal evidence suggests that a somewhat analogous situation can occur in K-12 public schools. Sometimes union rules prohibit teachers from teaching without compensation. A teacher who wants to run a summer program for which there is no funding, for example, may be prohibited by the union from running the program for no compensation. These rules presumably prevent peer pressure and avoid setting precedents that the administration may attempt to exploit.

[263] Research and service associated with the lost position are not salient to begin with—at least in the short term. It is really the teaching load associated with the lost faculty line that would cause the institution immediate pain.

appears that the department is doing just fine with less resources. But this is already occurring—with high-cost tenure track positions being replaced by less expensive adjunct labor. In such an environment, relaxing the donated service rules would likely not add very much to the problem.

Likewise, visible donations of time may induce states to reduce funding for state colleges and universities. But states are already doing this even without evidence of increased donations. It is unlikely that a relaxed donated services regime would tip the scales towards even less state support.[264] In any case, if funding is in fact cut—by the administration of the institution or by the state—the problem is easily corrected. Once the problem is identified or even threatened, the faculty members can simply stop donating their time.

In addition, one could argue that if relaxation is too successful in encouraging donated time, cash donations may decrease as faculty substitute their labor for cash donations. Some of this could happen, but the effect is not likely not to be great. Indeed, studies have shown that volunteering and cash donations are complements rather than substitutes.[265] Even if a faculty member does cut back on their cash donations,[266] their service donations are likely to be more lucrative for the institution. As noted earlier, a faculty member who would normally not consider taking $10,000 out of savings to donate to the university may be willing to do something he or she enjoys (teaching) for

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[264] Increased donated services would also have little impact on donor support at both public and private institutions. External donors are unlikely to reduce their contributions simply because the faculty are pitching in. In particular, the faculty may not be donating to the same programs that external donors wish to support. Increased faculty donations of time should not crowd out giving by external donors. In fact, it may even encourage more external donations if donors are inspired by, and feel solidarity with, those faculty that are donating their time.

[265] Ellen P. Aprill, *Churches, Politics, and the Charitable Contribution Deduction*, 42 B.C. L. REV. 843, 863 (2001).

[266] See *supra* Part V.A.1 (noting that a problem with *complete* relaxation is that it would result in faculty members being able to essentially donate cash on pre-tax basis by donating time).

free—resulting in $10,000 being donated to the university. Accordingly, relaxation of the donated services tax rules should result in new donations, not cannibalize current cash donations.

VI. SELF-HELP MEASURES

While Part V, above, makes a compelling case for reform, the reality is that forces are going in the other direction. Looming budget deficits have drawn calls for tax reform and spawned many thoughtful ideas for raising revenue along the way. In the vast configuration of things, Congressional action on reforming the tax treatment of donated services is slight. Accordingly, this Part VI suggests ways that colleges and universities can remove the tax barrier to donated services: via a gross up or by changing their policies regarding salary savings.

A. The Gross-Up Alternative

Gross ups have long been used by for-profit employers to shelter employees from adverse or unseemly tax consequences. Indeed, the facts of *Old Colony Trust*, discussed earlier, involve a gross up that occurred nearly a century ago.[267] Because our income tax system's definition of income is so broad,[268] many items that an employer provides to an employee are taxable. If an employer gives an employee a set of golf clubs as a bonus for increasing sales, the value of the golf-clubs is taxable to the employee and is subject to income tax withholding and payroll taxes. Since the government wants its withholding in cash (and not in the form of, say, a nine iron), the employer will need to take the

[267] See *supra* Part III.B.1.
[268] *See* I.R.C. § 61(a) (stating that "gross income means all income from whatever source derived").

withholding on the value of the golf clubs out of the employee's normal cash pay. Doing so will cause the employee's take-home pay to go down in the pay period in which the value of the golf clubs is included. This puts the employer in the awkward position of saying: "Thanks for all your hard work. Here are some nice golf clubs. Oh, by the way, your paycheck will be a little light next week. Don't go spending all your cash on club dues and greens fees just yet."

The employer could avoid this awkward and morale-sapping predicament by paying the employee's tax on the compensation related to the golf clubs. But, as *Old Colony Trust* teaches, that tax payment would itself be taxable.[269] Therefore, if the employer wants to hold the employee harmless from tax on the golf clubs, it must not only pay the tax on the golf clubs but also the tax on the tax on the golf clubs, and then the tax on the tax on the tax on the golf clubs, and so on.[270] Because there are several layers of payments involved, the amount the employer must pay will be greater than simply the employee's tax rate times the value of the golf clubs and the process of absorbing the employee's tax is called a "gross up" rather than simply a "tax payment." The basic gross-up formula is:

1/(1 – Tax Rate) x After-Tax Amount = Pre-Tax Amount

The after-tax amount is the value the employer wants the employee to receive free and clear of tax. Here, that would be the value of the golf clubs. The pre-tax amount is the total cost to the employer of providing both the golf clubs and the gross-up payments.

[269] Old Colony Trust Co. v. Comm'r, 279 U.S. 716, 729 (1929).
[270] The Court in *Old Colony Trust* referred to this as the "tax upon a tax" problem. *Id*. at 730. A problem which the Court did not resolve. *See id.* at 731.

The tax rate is the employee's tax rate—which can sometimes be hard to determine given state taxes, progressive tax rates, etc.[271]

Grossing-up is a relatively simple way to provide taxable benefits to employees while reducing the tax consequences to the employee. Overall, more tax is paid to the government, but the employee is held harmless. In fact, other than some unusual numbers (a higher than normal gross pay and higher than normal withholdings) flowing through the pay stub, the employee is unlikely to notice the taxable golf clubs or the gross up—since the employee's take-home pay remains the same.

While gross ups have long been used in industry, they are less common in colleges and universities. In fact, one rarely sees any mention of gross ups in discussions of campus tax issues.[272] This may be because colleges and universities were traditionally less sophisticated about payroll reporting and are now tightening their policies as colleges and universities are being put under greater IRS scrutiny.[273] As colleges and universities develop tax awareness and sophistication, they should also consider adopting for-profit techniques for dealing with the tax law, such as gross ups.

Deploying tax gross ups in situations where donated services result in imputed income would remove the tax barrier to giving and encourage employee donations of

[271] If the tax rate is too hard to estimate, the employer and the employee can simply agree on a rate that might over- or under-compensate the employee, but is close enough to avoid a hardship.
[272] Except when it comes to compensation contracts for campus executives. Jack Stripping, *Senator Grassley Denounces Tax-Free Perks for College Chiefs*, CHRON. HIGHER EDUC., Dec. 11, 2012 (noting that about half of the 50 highest paid private-college presidents in the U.S. receive some sort of tax gross up—often related to bonuses, their children's tuition, or other benefits). The practice of grossing up significant compensation items for executives in both the nonprofit and for-profit worlds has caused some controversy—indicating that there is a separate set of rules for highly-paid executives. Despite the controversy, gross ups are perfectly reasonable ways to address the tax issues associated with noncash compensation (including the imputed income that comes from donated services) for rank and file employees.
[273] See *supra* Part III.C.

time. But the cost of the gross up would reduce the benefit to the university. The following two examples illustrate the use of gross ups in the donated services context.

Gross Up Example #1: Same as Numerical Example # 1 in Part IV.A, above, but with a gross up. The basic facts are as follows. Professor Cranky teaches for City State University. He agrees to teach a summer course for no compensation and asks that the saved funds be used to fund a scholarship for art students. Under a standard summer contract, Cranky would earn $10,000 from teaching the summer course. Cranky has not reached the OASDI wage cap. The impact of temporary payroll tax holiday is ignored. Cranky is the 25% federal tax bracket. State income taxes are ignored. Cranky elects to itemize his deductions and his charitable contributions for the year will be less than 50% of his AGI.

Based on these facts, any imputed income is offset by a charitable deduction for income tax purposes. The only tax (wash preventer), therefore, at issue is the 7.65% FICA rate. In this case, the gross-up formula is: 1/1-7.65% x 10,000 = $10,828.[274] Of the $10,828, the $10,000 represents the imputed income and $828 represents the gross up (tax on the $10,000, tax on the tax, tax on the tax, etc.).[275] Removing the payroll tax

[274] One who views FICA as a purchase of social insurance rather than a "tax" might find grossing up for FICA objectionable. But there is a good case to be made that FICA is in fact a tax. See discussion at *supra* Part III.E.5 and *supra* note 254.

[275] I am making the assumption that Cranky can deduct not only the $10,000 of imputed income donated to the university, but the $828 gross-up payment as well. Only then would his taxable income be fully offset by a charitable contribution deduction. One might argue that $828 is really a return benefit made by the university in connection with Cranky's $10,000 donation. See *supra* Part II for a discussion of return benefits. Return benefits reduce the charitable contribution deduction. But, in this case, Cranky must include the gross up *in his taxable income*, just like he includes the $10,000 in his taxable income. It would seem that any amount included in his taxable income should also appear as a charitable contribution deduction. Otherwise, he would be counting the $828 "benefit" twice—once in his taxable income as compensation and a second time as a reduction in the charitable contribution deduction. This is not free from doubt, however. One might still view the gross up as providing a return benefit in the form of increased Social Security benefits (see more on this at *supra* note 254). But the impact is likely to be small. If I am incorrect about the gross up adding to the charitable contribution deduction, then the numbers in the

barrier while letting Cranky decide how the saved funds will be used would encourage Cranky to donate his time. The following shows the net impact on the university:

Salary savings from Cranky's Donated Time	10,000
Less: Cost of Gross Up	(828)
Less: Additional university match for Payroll Taxes (7.65%) on the gross up of $828[276]	(63)
Net Savings to the University	**9,108**

The university does not get the full $10,000 but comes fairly close. And it probably never would have received anything from Cranky in the absence of the donation—which would not have occurred without the gross up. Therefore, the gross up makes a lot of sense, despite the cost to the university.

Gross Up Example #2: The cost of the gross up can go up significantly if the faculty member is subject to more wash preventers. Assume, for example, that Cranky has the same facts as in Gross Up Example #1, above, except that he does not itemize deductions[277] and his combined federal, state, and FICA tax rate is 37.65%. The gross-up formula is 1/1-37.65% x 10,000 = $16,038. Of this, $10,000 represents the imputed income from the donated services and $6,038 represents the tax gross up. The impact on the university would be as follows:

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example could be adjusted to include a gross up for the income tax on the difference between Cranky's income and his deduction.

[276] Only the additional match on the gross up is considered. The university would have incurred the match on the payroll taxes on the $10,000 base pay whether donated or paid in cash.

[277] Of course, if the value of the donated services increases much more, he will become an itemizer (from charitable contributions alone), which would gradually (as Cranky exceeds the standard deduction) lower the required gross up. The required gross up could then go back up once Cranky hits the 50% of AGI ceiling. The amount the gross up would need to increase would depend on Cranky's predictions about using the carryover and the university's agreement with Cranky's estimates.

Salary savings from Cranky's Donated Time	10,000
Less: Cost of Gross Up	(6,038)
Less: Additional university match for Payroll Taxes (7.65%) on the Gross up of $6,038[278]	(462)
Net Savings to the University	**3,500**

In this case, a lot of value is lost in the gross up and Cranky would be working quite a bit for the university to save $3,500. But that is still $3,500 more than the university would have had in the absence of the donated services. The university and the employee would need to decide whether the donated services would make sense in this case. Cranky's decision about where the saved funds would go and the administration's view of that use may well decide whether the university will agree to a donated services and gross-up arrangement with Cranky.

Like nearly everything else in higher education, there would no doubt be political issues to navigate. Perhaps the central administration will not want to implement a gross-up program, because of the potential cost and because control of any saved funds would shift from the administrators to the donating faculty members. If central administration could be convinced, however, that a gross up would lead to more overall service donations (freeing up cash—regardless of who gets control of that cash) they might be more willing. This would be especially true if the cost of the gross up (including perhaps an administrative fee) could be charged back to the department, unit, or center that is benefiting from the donated services. Of course, if a donated service program becomes too successful—providing a steady stream of income—then perhaps central administration may reduce the department's overall budget—effectively capturing the

[278] Only the additional match on the gross up is considered. The university would have incurred the match on the payroll taxes on the $10,000 base pay whether donated or paid in cash.

benefit of the donated services for its own use. Such maneuvers, if salient, would likely put a damper on faculty donations of time even with gross ups.

Regardless of the politics involved, the issue of whether and to what extend a gross up should be offered—unlike the tax law—is within the control of the university. This makes gross ups an attractive way for colleges and universities to use self-help to encourage donated services.

B. Changing Salary Savings Policies

Another self-help measure would be for colleges and universities to change their policies to give more comfort to service providers. For example, they can specify that donated salary savings will automatically and in all cases go to the department of the donating faculty member, rather than to the college or university as a whole. This would lessen the chance of diversion to programs the service provider does not want to support—like the online program for underwater basket weaving management in the opening example. Of course, to avoid taxation the employee would need to relinquish control and rely on the policy to ensure that the funds are being directed at causes the donor wishes to support. That may cool off some of the warm glow that normally comes with giving. Also, the donating faculty members would not be able to specifically designate the use of the funds. They might know that it will be returned to their departments, but are not sure how it will be used (maybe for a scholarship, travel, etc.). This could further cool off the warm glow or could lead to more wink and nod arrangements. In any case, there could be political barriers to such policy enactments. Such policies should only be enacted if they advance the school's mission (which could involve attracting more time-donors in teaching) rather than merely to get around an inconvenient tax rule.

VII. CONCLUSION

In summary, tax rules may frustrate something that should be encouraged in these tough budgetary times: the donation of services by employees of colleges, universities, and other charities. The tax law should be changed to remove this frustration. Otherwise, individual colleges and universities hoping to expand their volunteer programs should implement gross-up procedures or consider clarifying internal funds allocation policies. Either approach would have the benefit of allowing the university (or other charities) to openly advertise (on its giving website or otherwise) that it is open to accepting donations of time and that such donations could occur unembarrassed by the tax system. By changing the law or engaging in self-help, we can let faculty like Flinty be free of taxes and faculty like Clement rest in peace.