

Office of Chief Counsel  
Internal Revenue Service  
**Memorandum**

Number: **201042023**

Release Date: 10/22/2010

CC:PSI:B02:JKeeney  
POSTU-127829-09

Third Party Communication: None  
Date of Communication: Not Applicable

UILC: 642.03-01

date: May 10, 2010

to: Manager, Special Enforcement Program, Gulf States Area  
(Examination, Small Business/Self-Employed)

from: Senior Counsel, Branch 2  
(Passthroughs & Special Industries)

---

subject: Request for Chief Counsel Advice

This Chief Counsel Advice may not be used or cited as precedent.

LEGEND

Trust =  
Date 1 =  
Date 2 =  
Date 3 =  
Date 4 =  
a =  
b =  
c =  
d =  
e =  
f =  
g =  
h =  
i =  
Year 1 =

ISSUE

May Trust take a charitable contribution deduction under § 642(c)(1) based on the fair market value of appreciated property purchased from accumulated gross income of the trust; or, should the charitable contribution deduction be limited to the adjusted basis of the contributed properties?

### CONCLUSION

Trust's charitable contribution deduction should be limited to the adjusted basis of the properties purchased from accumulated gross income.

### FACTS

On Date 1, the Trust filed an amended return requesting a refund of \$a on its Year 1 return. The refund was based on charitable contributions made by the Trust that increased from \$b, as originally reported, to \$c. The Trust represents this increase was due to an error in calculation of the unrelated business taxable income (UBTI) limitations on their Year 1 charitable contribution. This refund case is currently in Examination and is not a docketed Tax Court case.

Trust is a complex trust subject to the provisions of §§ 661-663 of the Internal Revenue Code ("Code"). Trust's agreement provides that "[t]he Trustee may also distribute to charity such amounts from the gross income of the trust as the Trustee determines appropriate to help carry out [its charitable] mission...." Trust represents that all of the properties contributed to charity during Year 1 were purchased with prior years' gross income and can be traced to that gross income.

The charitable contribution deduction was based on the donation of three properties to three different charities and a flow-through deduction from a partnership (which is not at issue in the present case). One of the three properties was a building purchased on Date 2 for \$d and donated in Year 1 for the appraised fair market value of \$e. Another property was purchased on Date 3 for \$f and donated in Year 1 for the appraised fair market value of \$g. The third property was purchased on Date 4 for \$h and donated in Year 1 for the appraised fair market value of \$i. The materials which you have submitted neither explain nor challenge the rapid appreciation of the properties.

### LAW AND ANALYSIS

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(c) provides that, except as otherwise provided in subtitle A of the Code, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property must be recognized.

Section 642(c)(1) provides that a trust (other than a trust subject to §§ 651 and 652) is allowed a deduction in computing its taxable income for any amount of gross income, without limitation, that pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in § 170(c)(2)(A)). This deduction is in lieu of the charitable deduction allowed by § 170.

In *Old Colony Trust Co. v. Commissioner*, 301 U. S. 379 (1937) the Supreme Court , stated that it was not necessary for a trust to prove that contributions of cash to charity arose from gross income that was earned during the same year in which the cash was contributed to charity. Instead, the payment of cash was still considered to have its source in the gross income of a trust if the gross income was earned in prior taxable years.

In *W. K. Frank Trust of 1931 v. Commissioner*, 145 F.2d 411 (3d Cir. 1944), the trustees contributed securities to charity which had been received in a tax-free exchange for securities that made up the original trust corpus. The trust had amounts of gross income which exceeded the value of the securities that were contributed to charity. The Circuit Court, affirming the Tax Court, held that the contribution of securities did not arise from the gross income of the trust and disallowed the deduction.

The Tax Court pointed out in *W.K Frank Trust* that if the trusts had sold the shares which they had contributed to charity and realized the fair market value of the shares at the dates of the gifts they would have been subject to income tax upon the capital gains made. If they had contributed money out of such capital gains, they would clearly have been entitled to deduct the amounts contributed up to the amounts of net income of the trusts. *W.K. Frank Trust of 1931*, 2 T.C.M. 1107 (1943). The present case differs from *W.K. Frank Trust* in that the contributions to charity were not made from property that was initially contributed to the corpus of the trust, but rather property purchased in a previous year from gross income. In addition, Rev. Rul. 2003-123, 2003-2 C.B. 1200, similarly denies a § 642(c) deduction for the contribution of a conservation easement on property owned by the trust since its inception.

In *Crestar Bank v. IRS*, 47 F. Supp 2d 670 (1999), the District Court denied a § 642(c) deduction to an estate on a contribution of stock owned by the decedent at death. The estate argued that under *Old Colony Trust Co.* it did not matter whether the charitable contribution was traceable to gross income so long as there was sufficient gross income to cover the contribution. The District Court disagreed, stating that “[t]he Estate’s reading of *Old Colony Trust Co.* . . . would destroy the tracing requirement of § 642(c).” *Crestar Bank* at 677. The District Court explains that § 642(c)(1) requires that contributions have their source in gross income; therefore, the statute requires tracing to determine the source of the contribution.

A standard treatise on fiduciary income taxation discusses the issue of whether unrealized appreciation should be considered as gross income under § 642(c). M. Carr Ferguson, James J. Freeland & Mark L. Ascher, Federal Income Taxation of Estates, Trusts, and Beneficiaries § 5.9 (Second Edition). The treatise states that the contribution of low-basis property would yield a double tax advantage: (1) avoidance of tax on the potential gain, and (2) the ability to deduct not only the basis, but also the gain, from gross income. As the Circuit Court in *W.K. Frank Trust* pointed out that “[A]ppreciation in value, unrealized by sale or other disposition, [is] not gross income.” (145 F.2d at 413.)

Limiting the deduction to basis (representing amount previously taken into income) on the basis of the Court’s analysis in *W.K. Frank* addresses a substantive question not directly controlled by *Old Colony* (which concerned a cash contribution). *U.S. v. Benedict*, 338 U.S. 692 (1950) offers a useful parallel. In *Benedict*, a contribution under the predecessor to § 642(c) was denied for a contribution of certain capital gains because those gains were excludable from gross income under another provision. The Court stated, citing *W.K. Frank*, that “[w]e treat that percentage of capital gains which expressly is not to be taken into account in computing taxable net income as also excluded from statutory gross income.” (338 U.S. at 699.)

#### HAZARDS AND OTHER CONSIDERATIONS

We find no prior cases or other authority in which the Service has so limited a § 642(c) deduction and there is at least one source of counter-authority. One commentator interprets *Old Colony* as authority for a § 642(c) deduction up to the amount of gross income for that year in any case where the controlling document does not specifically designate the payment as coming from principal, whether made from “prior years’ cash accumulations, principal, or income receipts in hand, such as stock dividends or borrowings, as well as principal assets . . . .” Abbin, Byrle M., Income Taxation of Fiduciaries and Beneficiaries, § 4128.3 (2006). On balance, however, the majority view of the court’s and commentators as well as our own points to the view that *Trust* may not claim a charitable contribution deduction greater than its adjusted basis of the properties purchased from accumulated gross income under § 642(c).

This writing may contain privileged information. Any unauthorized disclosure of these writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call  
questions.

of this office at (202) 622-3060 if you have any further