

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

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subject: Whether section 265 may be applied to disallow a section 170 charitable contribution deduction allowed under section 512(b)(10).

This chief counsel advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether under section 265(a)(1) of the Internal Revenue Code, the charitable contribution deduction allowed under section 512(b)(10) is allocable to tax-exempt income and therefore not deductible in calculating unrelated business taxable income under section 512(a)(1)?

CONCLUSION

Section 265(a)(1) may not be applied to disallow a section 170 charitable contribution deduction allowed under section 512(b)(10) in calculating unrelated business taxable income under section 512(a)(1). This is because a charitable contribution is not

allocable to tax-exempt income, but instead arises from a donor's charitable intent to voluntarily transfer money or property without receiving any benefit in return.

## FACTS

An organization described in section 501(c)(3) (Organization) files a Return of Organization Exempt from Income Tax (Form 990). Organization also files an Exempt Organization Business Income Tax Return (Form 990-T). Organization files claiming a charitable contribution deduction in calculating unrelated business taxable income (UBTI).

## LAW AND ANALYSIS

Section 265(a)(1) provides that no deduction is allowed for any amount otherwise allowable as a deduction which is allocable to one or more classes of income wholly exempt from the taxes imposed by Subtitle A, Income Taxes.

Section 512(b)(10) provides that in calculating UBTI, the charitable contribution deduction allowed by section 170 is allowed whether or not directly connected with the carrying on of the trade or business, but shall not exceed 10 percent of UBTI.

Section 170(a)(1) allows a deduction for any charitable contribution payment of which is made within a taxable year. A charitable contribution is defined under section 170(c) as a contribution or gift to or for the use of certain qualified donees (which include a section 501(c)(3) organization).

Other than UBTI, Organization's income generally is not subject to tax under section 501(a) and therefore falls within the classes of income considered tax-exempt income for purposes of section 265(a)(1). In order to determine if expenses are allocable to tax-exempt income for purposes of section 265(a)(1), courts have looked to whether the expenses were "intended to be covered" by tax-exempt income or whether the expenses would not exist "but for" the tax-exempt income. See Induni v. Commissioner, 990 F.2d 53 (1993); Dalan v. Commissioner, T.C. Memo. 1988-106. Similarly, Rev. Rul. 83-3 disallows expenses under section 265(a)(1) that were incurred for the purpose of earning or otherwise producing tax-exempt income and expenses that were incurred in carrying out the specific purpose to which the tax-exempt income is earmarked. 1983-1 C.B. 72, modified by Rev. Rul. 87-32, 1987-1 C.B. 131.

In order to establish that a "contribution or gift" has been made under section 170, a taxpayer must show a voluntary and irrevocable transfer of ownership of money or property without the receipt of adequate consideration or a substantial return benefit. See United States v. American Bar Endowment, 477 U.S. 105, 116 (1986); see also Transamerica Corp. v. United States, 902 F.2d 1540 (Fed. Cir. 1990); Singer Co. v. United States, 449 F.2d 413 (Ct. Cl. 1971). In determining whether a taxpayer has

made a contribution without the expectation of any return benefit or *quid pro quo*, the “external features of the transaction in question” are examined. Hernandez v. Commissioner, 490 U.S. 680, 690 (1989). In addition, the taxpayer is required to have charitable intent in making the contribution. See American Bar Endowment, 477 U.S. at 118.

A charitable contribution is, by its nature, not allocable to any source of income, but instead arises from a donor’s charitable intent to voluntarily transfer money or property without receiving any benefit in return. Consequently, section 265(a)(1) may not be applied to disallow Organization’s charitable contribution deduction claimed in computing UBTI under section 512(a)(1).

This advice applies only under the facts and circumstances described herein.

Pursuant to section 6110(k)(3) of the Code, this document may not be used or cited as precedent. Please call (202) 317-7005 if you have any further questions.