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THE UNLIMITED DEDUCTION FOR CHARITABLE CONTRIBUTIONS

Clyde W. Wellen* 

FOREWORD

It is the purpose of this paper to discuss § 120 of the Internal Revenue Code. This Section of the Code is not well known and until recently has been relatively unimportant. In essence, it provides that if the taxes paid by an individual in the current taxable year and in each of the ten preceding taxable years, plus the amount of his charitable contributions during such years, exceed 90 per cent of his net income, then the 20-per-cent limitation on the deduction for charitable contributions shall not be applicable. If the taxpayer meets the conditions imposed by this Section, an unlimited deduction for charitable contributions is permitted in the determination of his taxable income. This makes possible large contributions to worthy charities, which otherwise a taxpayer might hesitate to make because of the 20-per-cent limit upon their deductibility for tax purposes.

When first enacted in 1924, this Section was not of great importance, since the maximum tax rate for that year was only 46 per cent. With the maximum tax rate at so low a figure it would have been necessary to make enormous and consistent contributions to charity to meet the conditions imposed by § 120. In recent years, however, the maximum tax rate has been at or around 90 per cent. Since many taxpayers during and since the war years have been paying taxes approaching 90 per cent of net income, § 120 will tend to increase greatly in importance. The combination of these wartime taxes plus even modest charitable contributions would

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seem to place a large number of taxpayers in a position to take advantage of the unlimited deduction.

The following pages present an analysis of problems which will probably be encountered by a taxpayer attempting to take advantage of this Section.

**THE UNLIMITED DEDUCTION**

It is provided in the Internal Revenue Code that in computing net income for tax purposes there shall be allowed a deduction for contributions made to charity by the taxpayer. To qualify for this deduction, permitted by § 23(o) of the Code, the contribution must be to a charity approved by the Commissioner of Internal Revenue. Another limitation imposed by § 23(o) is that the deduction cannot exceed 20 per cent of the taxpayer's adjusted gross income. To this latter limitation there is an exception. This exception is embodied in § 120 of the Code, a Section which is little known and which until recently has been relatively unimportant. Section 120 provides as follows:

**Unlimited Deductions for Charitable and Other Contributions**

In the case of an individual if in the taxable year and in each of the ten preceding taxable years the amount of the contributions of gifts described in Section 23(o) (or corresponding provisions of prior Acts) plus the amount of income (determined without regard to subchapter E, relating to tax on self-employment income), war-profits, or excess-profits taxes paid during such year in respect of such year or preceding taxable years, exceeds 90 per centum of the taxpayer's net income for each such year, as computed without the benefit of the applicable subsection, then the 20 per centum limit imposed by Section 23(o) shall not be applicable.

Section 120 was first introduced into the federal tax structure by § 214(a)(10) of the Revenue Act of 1924 and has been continued as a part of our tax law without substantial modification down to the present. In 1938 the Section was amended slightly to coordinate it with other modifications made in the Internal Revenue
Code at that time. Since the deduction permitted by Section 120 concerns only the current taxable year and the ten preceding taxable years, an examination of the pre-1938 law and the changes made by the Revenue Act of 1938 would serve no useful purpose. It will suffice to state that with but two exceptions the wording of the Section took on its present form after the amendments of 1938 were inserted. The two exceptions concern amendments made in 1950 and 1951.¹

In 1950 most persons classified as self-employed were brought within the coverage of the federal social security legislation. To finance this extended coverage a tax of $1½ per cent on the first $3,600 of self-employment income was imposed. Since these payments are to be returned to taxpayers in later years in the form of social security benefits, it was decided that they should not be included in computing the deduction permitted under § 120. Hence, the 1950 amendment to § 120 provided that computations should be made under this section “without regard to Subchapter E, relating to tax on self-employment income.”

The amendment approved January 11, 1951, was passed to cure a serious defect in § 120. It did this by striking out the words “taxes paid... in respect of preceding taxable years” and by inserting in lieu thereof “taxes paid... in respect of such year or preceding taxable years,” in order to achieve the desired coordination of § 120 with the Current Tax Payment Act of 1943. That Act forgave taxes for 1942 and provided that substantial payments of income tax made during 1943 and subsequent years should be on account of income earned during the current year, but it failed to make an essential amendment to § 120 of the Code to provide that the 90-per-cent limitation applied also to taxes paid with respect to the current year. The 1951 amendment provides that taxes paid not only with respect to the past year but also those paid for the current year may be used as a factor in arriving at the 90-per-cent figure for purposes of § 120. Thus, for example, if during the

¹ 64 Stat. 545 (1950); 64 id. 1244 (1951).
calendar year 1951 a taxpayer makes charitable gifts amounting to 20 per cent of his net income and his payments of current taxes amount to 50 per cent and payments of taxes for prior years amount to 25 per cent, the 90-per-cent requirements of § 120 would be satisfied for such year. This amendment is made retroactive to December 31, 1942, thus antedating the Current Tax Payment Act of 1943.

In its application the meaning of § 120 has not been free from doubt. The first question to arise was whether charitable contributions, plus the described taxes, must exceed 90 per cent of the taxpayer's net income for the current year and for each of the ten preceding years, or whether it would be sufficient if the contributions and taxes averaged 90 per cent over the prescribed period. In *Estate of James H. Post* the taxpayer claimed the unlimited deduction permitted by § 120, but the court held the 15-per-cent limitation to be applicable (15 per cent was the maximum deduction permitted for charitable contribution in 1939), the taxpayer not having made during each of three of the preceding ten years contributions exceeding, with taxes paid for preceding years, 90 per cent of his net income, although contributions and taxes in other years within the ten-year period exceeded the 90 per cent by more than the deficiency below that percentage in three years. Thus, it seems clear that contributions and taxes must exceed 90 per cent of net income for the current year and for each of the preceding ten years.

As more and more taxpayers attempt to take advantage of § 120, doubts are certain to arise concerning the meaning of "net income." The deduction allowed by § 120 is available only if contributions and taxes exceed 90 per cent of "net income." A precise definition of the term becomes a necessity. An examination of the Section and the regulations thereunder sheds no light on this important question; however, in § 21 of the Code "net income" is defined as gross

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income computed under § 22, less the deductions allowed by § 23. Section 22 defines gross income as including gains, profits and income derived from personal services, trades, businesses, or sales, or dealings in property; also from interest, rent, dividends, etc. In computing gross income all the provisions of § 22 should number of exclusions from gross income; that is, it enumerates a number of items that shall not be taken into account for tax purposes. Among these items are life insurance, gifts, bequests, devises, inheritances, tax-free interest, compensation for injuries or sickness, etc. In computing gross income all the provisions of § 22 should be read carefully, and all the items excluded thereunder should be eliminated before the calculations under § 120 are made.

In arriving at the net income figure it is then necessary to take the deductions allowed under § 23. These deductions are numerous and include deductions for business expenses, interest, taxes, depreciation and depletion. In determining a net income figure to be used in the computations under § 120, all the deductions permitted by this Section should be subtracted from gross income as computed under § 22. It would seem to follow from what has been said that the credits permitted by § 25 should not be taken into account in computing net income. These credits, which include the $600 credit for every individual, a $600 credit for blindness and old age and all allowances for dependents, are designated as credits against net income and not as deductions in computing the net income figure.

It has been necessary for the courts to define net income in connection with the application of other sections of the Code. For example, § 23(o) formerly provided that in computing net income there should be allowed a deduction for contributions to charity not to exceed 15 per cent of the taxpayer’s net income. This Section was changed in 1944 by substitution of the words “adjusted gross income” for “net income,” but before the change was made, controversies arose concerning the meaning of “net income.”

Many of these controversies involved the relationship of net
income and capital gains and losses. The law applicable during this period in the computation of tax on capital gains was embodied in § 117. Section 117 provided in part as follows:

(b) Percentage taken into account. In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss and net income:

- 100 per centum if the capital asset has been held for not more than six months;
- 50 per centum if the capital asset has been held for more than six months.

(c) Alternative taxes.

(2) Other taxpayers. If for any taxable year the net long-term capital gain of any taxpayer (other than a corporation) exceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the taxes imposed by Sections 11 and 12, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 50 per centum of such excess.

There has been no question about the inclusion of capital gains in determining "net income" when the taxpayer has elected to be taxed under §§ 11 and 12. If the capital asset has been held for less than six months, 100 per cent of the gain is to be included in net income. If the capital asset has been held for more than six months, only 50 per cent of the gain is to be included in net income. It was once claimed by the Commissioner that if the taxpayer elected to be taxed at the alternative rate (50 per cent as provided by § 117(c)(2)), then none of his capital gains should be included in computing net income. In Helvering v. Bliss, however,

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*293 U. S. 144 (1934), discussed in Fraenkel, The Opinions of United States Supreme Court for the 1934 Term — General Issues, 4 Ford. L. Rev. 416, 421 (1935).*
it was held that the base for the computation of the 15-per-cent limitation (under § 23(o)) is the net income defined in § 21, which includes for this purpose net capital gains, even though the taxpayer elected to be taxed at the alternative and reduced rate. Thus, it was established that 50 per cent of net long term capital gains were includible in computing net income regardless of whether the tax was computed under §§ 11 and 12, or under § 117 (c)(2).

The Internal Revenue Code formerly required the payment of an alternative tax in the case of certain long-term capital losses. Section 117 (c)(2) (eliminated in 1942) of the original Code provided in part as follows:

(2) In case of net long-term capital loss. If for any taxable year a taxpayer (other than a corporation) sustains a net long-term capital loss, there shall be levied, collected and paid, in lieu of the tax imposed by Sections 11 and 12, a tax determined as follows, if and only if such tax is greater than the tax imposed by such sections:

A partial tax shall first be computed upon the net income increased by the amount of the net long-term capital loss, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax minus 30 per centum of the net long-term capital loss.

It was thought that the language of the Supreme Court in the Bliss case indicated that the rule of that decision should also be applied in the case of net capital losses when the alternative rate was used; and such was the interpretation of the Board of Tax Appeals and several of the courts of appeals. In United States v. Pleasants,\(^5\) however, the Supreme Court held that when the tax was computed at the alternative rate (as required under the Revenue Act of 1932), capital net loss was to be disregarded in computing the 15-per-cent limitation on the deduction for charitable contributions. According to a ruling of the Bureau of Internal Revenue,\(^6\)

The reasoning of the Court in the Pleasants case is that (1) since

\(^5\) 305 U. S. 357 (1939).
in computing the special tax under Section 101(b) of the Revenue Act of 1932 [the forerunner of Section 117(d)(2) of the present Code] the “capital net loss” is not allowed as a deduction from gross income, but only as an offset (to the extent of 12½ per cent of such “capital net loss”) against a “partial tax” determined by excluding capital losses from the computation, it follows that the “net income” upon which the tax is actually paid in such cases is the “ordinary net income,” that is, the “net income” with capital losses excluded; and (2) since, when the special tax under Section 101(b) applies, the “net income” upon which a tax is actually paid is the net income with capital losses excluded, it follows that whenever such special tax applies, the term “net income” in the phrase “15 per centum of the taxpayer’s net income” in Section 23(n) (now 23(o)) of the Revenue Act of 1932 must be given a corresponding meaning; and therefore, (3) the taxpayer, whenever the special tax applies may have a deduction for charitable contributions to the extent of not more than 15 per cent of the “net income” upon which his special tax is actually computed, that is, 15 per cent of his “ordinary net income,” which in turn means 15 per cent of his net income computed by excluding all items of capital gain, capital loss, and capital deductions.

In another ruling of the Bureau it was said that the holding of the Pleasants case, which arose under the Internal Revenue Act of 1932, would be equally applicable in cases arising under the Internal Revenue Code of 1938. Although the wording of Code §117(c)(2), which developed from §101(b) of the Revenue Act of 1932, was different from its forerunner, the Bureau of Internal Revenue ruled this difference in no way affected the validity of the decision of the Pleasants case with respect to net long-term capital losses. It seems clear, therefore, according to this ruling, that when the tax was computed at the alternative rate, “net income” as used in §23(o) meant “ordinary net income,” without taking any adjustment for net capital losses. Had the courts been called upon at this time to construe “net income” as used in §120, it is logical to assume the definition would have been the same as that formulated with reference to §23(o), at least if the question had been presented under the laws applicable to years before 1942.

In 1942 § 117(d)(2) was added to the Internal Revenue Code by § 150(c) of the 1942 Revenue Act. This Section, which has remained unchanged until the present, eliminated the alternative method of computing taxes in case of losses from the sale or exchange of capital assets. It further provided that such losses should be allowed only to the extent of capital gains, “plus the net income of the taxpayer of [or] $1,000, whichever is smaller.” This deduction, as computed under § 117(d)(2), is then allowed by § 23(g). Like any other deduction allowed under § 23, capital losses, to the extent permitted under § 117(d)(2), are subtracted from gross income in computing the net income figure as defined in § 21. For these reasons it seems apparent that the elimination of the alternative tax in the case of net long-term capital losses by the Revenue Act of 1942 would restrict the application of the Pleasants case to taxable years prior to the effective date of that Act.

Further important changes in the Internal Revenue Code affecting § 23(o) were made in 1944. Section 8(b) of the Individual Income Tax Act of 1944 amended § 23(o) of the Internal Revenue Code by striking out the words “net income” and by inserting the words “adjusted gross income.” Thus, after the amendment, the Section provided that the deduction for charitable contributions would be limited to 15 per cent of adjusted gross income (in the past year the deduction has been increased to 20 per cent\(^8\)) as defined in § 22(n) of the Internal Revenue Code, a Section which was added to the Code by the same amendment. This change is distinctly favorable to taxpayers since only business expenses, deductions attributable to rents and profits, losses from sales or exchanges of property, and 50 per cent of the excess of net long-term gains over net short-term losses are deducted from gross income in arriving at adjusted gross income. As so computed, adjusted gross income will exceed net income; so the effect is to allow the taxpayer a greater deduction for charitable contributions. Since the adjusted

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gross income figure will with rare or no exceptions exceed net income, it is fortunate for the taxpayer that no similar change was made in § 120.

From the standpoint of § 120 the introduction of the "adjusted gross income" concept may be important because of the provision in § 22(n)(6) to the effect that deductions allowed by § 23 as losses from the sales or exchange of property must be deducted from gross income in computing adjusted gross income. Since it is commonly thought that the determination of adjusted gross income is merely a step in arriving at "net income," this helps substantiate the conclusion reached above that net capital losses to the extent allowed under § 23(g) must first be deducted before net income can be ascertained.

In October, 1951, the method of computing tax on long-term capital gains was changed again. This change is embodied in § 322 of the 1951 Revenue Act. Section 322 has caused rather drastic revisions to be made in §§ 117(b) and 23 of the Internal Revenue Code. While formerly only 50 per cent of the gains derived from the sale or exchange of capital assets held for more than six months were taken into the income account, now it is provided that all such gains after deducting net short-term losses shall be included in determining gross income. Section 117(b) and § 23(ee) (added by the 1951 Act) further provide, however, that 50 per cent of the excess of net long-term capital gains over short-term capital losses shall be a deduction from gross income when the tax is computed under §§ 11 and 12 of the Code.

To better understand the application of these amendments, assume the taxpayer has a long-term capital gain during the year of $40,000 and a net short-term capital loss of $20,000. Under the old law the taxpayer would take 50 per cent of the long-term capital gain, or $20,000, into the income account, and 100 per cent, or $20,000, of the short-term capital loss likewise would be included. The $20,000 loss would be deducted from the $20,000
gain, and, since they would offset each other, the net income account would be unchanged. Under the new law, however, the excess of net long-term capital gains over net short-term capital loss is to be included in gross income. Since, in the example stated, gains exceed losses by $20,000, the taxpayer's gross income account would be increased by this amount. The new law then provides that 50 per cent of the excess of gains over losses may be taken as a deduction from gross income. Fifty per cent of the excess in this example would be $10,000. After this deduction is taken, as permitted by § 23(ee), $10,000 would remain to be included in net income.

Under the old law, $1.00 of short-term capital loss offset $2.00 of long-term capital gain. Under the new law, a short-term capital loss will offset a long-term capital gain dollar for dollar. Under the old law, $1.00 of short-term capital gain offset $2.00 of long-term capital loss. Under the new law, a short-term capital gain will offset a long-term capital loss dollar for dollar. Thus, it may be seen that the new law will benefit the taxpayer in the event he sustains long-term capital losses, but will work to his disadvantage when long-term capital gains and short-term losses are realized. While the method of computing capital gains and losses has been revised substantially, it seems doubtful that these modifications will result in an overall increase in net income accounts.

Section 322 of the 1951 Act has also revised the method of computing the alternative tax on net long-term capital gains. This was accomplished by the amendment of § 117(c)(2) of the Internal Revenue Code. Under the former law an alternative tax of 50 per cent was imposed upon 50 per cent of net long-term capital gains for an overall tax of 25 per cent. Section 117(c)(2) now provides that the tax shall be 25 per cent (26 per cent for taxable years beginning after October 31, 1951) on the excess of the net long-term gain over the net short-term capital loss. It is still provided, however, that the alternative method, as permitted by this Section, is to be used only if the tax imposed is less than that
imposed by §§ 11 and 12. It should be noted that a significant change has been made in this Section insofar as the amount of income taken into account is concerned. Under § 117(c)(2), as now worded, all of the excess of net long-term capital gains over the net short-term capital losses is taken into the income account, and when the alternative method is used, no deduction is permitted under § 23(ee). Formerly only 50 per cent was so included. How will such a revision affect § 120 net income? Will the use of the alternative method in computing a tax on capital gains require that all the excess of net long-term capital gains over net short-term capital losses be included in computing § 120 net income without the benefit of a deduction under § 23(ee)? A close analysis of this Section indicates that such a result must unavoidably follow and that the rule of Helvering v. Bliss, which required that only 50 per cent of such gains be included, will be inapplicable for taxable years beginning after December 31, 1951.

Sections 117(d)(2) and 23(g) of the Internal Revenue Code (relating to the deduction of capital losses) were left undisturbed by the Revenue Act of 1951. It was concluded above in previous discussion of capital losses that to the extent they are allowed under §§ 117(d)(2) and 23(g) as deduction from gross income, capital losses may be deducted in computing net income as defined in § 120. It would seem that none of the revisions made by the 1951 Revenue Act would change the rule with respect to the deduction of net capital losses. Therefore, our prior conclusions with respect to such deductions may remain unaltered.

Another problem encountered in connection with the charitable deduction has involved the joint return by husband and wife. This question has been anticipated by Treasury regulations under § 120, which provide in part as follows:

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(b) In the case of a husband and wife making a joint return for any taxable year, the 15 per cent limitation [now 20 per cent] on
the deduction for contributions or gifts imposed by Section 23(o) shall not be applicable if the aggregate amount of the contributions or gifts described in Section 23(o) (or corresponding provisions of prior Revenue Acts) made by the spouses in the taxable year and in each of the ten preceding years, plus the aggregate amount of income, war-profits, or excess-profits taxes paid by the spouses during such year in respect of preceding taxable years, exceeds 90 percent of the aggregate net income of the spouses for each such year, as computed without the benefit of any deduction for contributions or gifts.9

Under this ruling it seems certain that in computing the deduction allowed by § 120 a joint return by husband and wife must be considered as an entity, and the deduction is available only if the combined charitable contributions of husband and wife exceed 90 per cent of this aggregate net income.

One other possible question in connection with § 120 should be mentioned before this paper is concluded. It is said in § 120 that to obtain the benefits of this Section, charitable contributions, plus taxes, must exceed 90 per cent of net income computed "without the benefit of the applicable subsection." What is meant by the "applicable subsection"? If § 120 is interpreted literally, it would seem to mean that in computing "net income" for the current year and the ten preceding years any deduction permitted under § 120 should not be allowed. In other words, gross income should not be reduced by any deduction allowed under this Section. In the Treasury regulations,10 however, it is stated that net income for the ten preceding years must be computed without the benefit of any deduction for contributions or gifts. Hence, the words "applicable subsection" are construed to include both the deductions under § 120 and any deductions allowed in prior years under § 23(o). For example, if the taxpayer has given 15 per cent of his net income to charity during each of the ten preceding years, then his net income for purposes of the computations under § 120 will be gross income less all the deductions allowed by § 23, except for the deduction for charitable contributions permitted by § 23(o). Logic

10 Ibid.
would indicate that this latter interpretation is the one probably intended by Congress, and while it has little support when § 120 is read strictly, still it seems likely that it will be upheld by the courts.

It has been the purpose of this paper to discuss problems a taxpayer will undoubtedly encounter in attempting to take advantage of the deduction permitted by § 120. It is hoped that the difficulties mentioned above will be the only difficulties faced by the taxpayer in claiming this deduction, but when a concept as broad as "net income" is dealt with, other problems are certain to arise which presently cannot be anticipated. Also, as has already been demonstrated to some extent, the sections contained in the Internal Revenue Code are mutually dependent. A change in one may make a change in another, although the subsequent alteration may be unintended and not realized at the time. For these reasons the taxpayer should analyze § 120 and related sections of the Code carefully from the standpoint of his own return. If the difficult conditions of the Section are complied with and the taxpayer qualifies for the unlimited charitable deduction, the rewards are great. Enormous tax savings can be effected and large donations can be made to worthy charitable causes, which otherwise might not be possible. Because of these attractive possibilities, § 120 is a Section which cannot be overlooked in future tax planning.

EXAMPLES

On the pages which follow are five examples showing how § 120 may be applied in a given fact situation.

I. Assume the taxpayers are husband and wife and that they have a total income of $3,000,000 during the current year derived from the following sources:

1. $1,000,000 net income from taxpayers' business after having taken all allowable deductions for business expenses.
2. $1,300,000 income from oil and gas royalty payments.
3. $ 300,000 income from interest on municipal bonds.
4. $ 300,000 income from dividends on common stock held by the
taxpayers.

5. $ 100,000 income from rental property after taking deductions for expenses in operating the property, including depreciation.

Total $3,000,000

Of the above amounts the following would be taken into account in computing § 120 net income:

1. $1,000,000 all the net income from the taxpayers' business would be included in computing net income under § 120.

2. $ 942,500 all the income from oil and gas royalties would be included except for 27½% which is allowed as a deduction for depletion.

3. $................ the interest on municipal bonds is tax free, see § 22(b) (4), and would be excluded in computing § 120 net income.

4. $ 300,000 all dividends would be includible to the extent paid from corporate earnings and profits.

5. $ 100,000 all income from rental property would be includible after taking deductions for expenses incurred in operating the property (including depreciation).

$2,342,500 total taken into account in computations under § 120.

The following items would be deductible in computing § 120 net income:

1. $ 10,000 interest paid by the taxpayers on personal obligations.

2. $ 22,500 state and local taxes paid by the taxpayers.

3. $ 10,000 losses from casualty or theft not insured.

$2,300,000 This represents § 120 net income. It is the balance remaining after the deductions enumerated above are subtracted from income taken into account in computing § 120 net income.

The taxpayers' income tax liability on their 1951 return may be computed as follows:

1. $2,342,500 This amount derived from the sources above mentioned represents the taxpayers' adjusted gross income for 1951.

Less 2. $ 511,000 Personal deductions permitted the taxpayers (including the charitable deduction) should be subtracted from adjusted gross income to determine net income.
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It should be assumed that, in addition to the deductions enumerated above, the taxpayers will give 20% of their adjusted gross income, or $468,500, to charity, this deduction being permitted by § 23(o).

$1,831,500 Net taxable income before exemptions.

Less 3. $ 1,200 An exemption of $600.00 is allowed each taxpayer.

$1,830,300 Net taxable income for 1951.

At the rate (88%) applicable for taxable years beginning after October 31, 1951, the combined normal and surtax payable by the taxpayers would be $1,610,664.

In determining whether the taxpayers qualify for the unlimited charitable deduction under § 120, the taxes paid by the taxpayers during 1952 should be added to their charitable deductions. Assuming the taxpayers’ income for 1952 was the same, or about the same, as that during 1951, this combined figure would be $1,610,664 (taxes) plus $468,500 (charitable contributions) for a total of $2,079,164.

To qualify for the unlimited charitable deduction it is necessary that charitable contributions made by the taxpayers, plus the taxes paid by them during the current years, exceed 90% of net income. Net income for 1951 was $2,300,000. 90% of this figure is $2,070,000. The taxpayers’ charitable contribution plus taxes for 1951 would exceed 90% of net income by 9,164. Thus, they fully qualify for the unlimited charitable deduction insofar as 1952 is concerned.

After paying their taxes, contributing $468,500 to charity (enough to qualify under § 120) and meeting expenses (depletion not being treated as an expense), the taxpayers have a net balance of $878,336 remaining from their $3,000,000. Let us next assume that our taxpayers have qualified under § 120 during the preceding ten years and that they are now entitled to the unlimited charitable deduction. Instead of giving $468,500 to charity, however, they give $1,898,800 to the charity of their choice in order to take advantage of the unlimited charitable deduction. The question then for determination is whether such a magnificent gift to charity will throw additional heavy financial burdens on the taxpayers? This can only be decided by computing the net balance of income remaining to the taxpayers in the current year based on the assumption that a gift of $1,-898,800 has been made.

$2,342,500 will again be the adjusted gross income figure for the year 1951. From this the taxpayers will be allowed the deduction of $42,500
for interest, taxes and losses. This leaves a net taxable income of $2,300,000 before the charitable deduction is computed. After the charitable deduction of $1,898,800 is taken, net taxable income will be $401,200. From this the exemptions of $1,200 may be taken so that net taxable income will be $400,000. On this amount a tax of $321,432 will be payable. Section 120 net income will remain at $2,300,000 even though the taxpayers have qualified for the unlimited deduction under that section. Thus, it will be necessary that contributions plus taxes exceed 90% of that figure or $2,070,000. Since the taxpayers have given $1,898,800 to charity and will pay taxes of $321,432, their taxes plus charitable contributions exceed 90% of § 120 net income by $150,232, thus assuring that the taxpayers will be entitled to the unlimited charitable deduction in the future years.

To determine whether this large gift to charity will saddle the taxpayers with a heavy financial burden, it is necessary to compute the amount of 1951 income remaining to the taxpayers after taxes and after providing for this much larger gift to charity. The combined total of gifts, taxes and expenses (depletion again not being treated as an expense) as computed above will be $2,262,732, leaving the taxpayers a net balance of $737,268 remaining from their income of $3,000,000 during 1951. This, compared with $878,336 the taxpayers would have if they gave only $468,500 to charity, clearly demonstrates that the taxpayers can give tremendous sums to their favorite charity and at the same time impose only relatively slight financial burdens upon themselves.

II.

Assume that the taxpayer is single and that he has an income of $1,200,000 during the year from the following sources:

1. $ 500,000 net income from business.
2. $ 700,000 from gas and oil royalties.

$1,200,000

Of the above amounts the following would be included in computing § 120 net income:

1. $ 500,000 net income from business.
2. $ 507,500 all royalties after a 27 1/2% allowance for depletion.

$1,007,500 total income taken into account in computations under § 120.
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Less 3. $ 7,500 Assume all personal deductions (interest, taxes, etc.), except the charitable deduction, add up to this figure. 
$1,000,000 This represents § 120 net income.

The taxpayer's income tax liability may be computed as follows:
1. $1,007,500 equals the adjusted gross income of taxpayer.
Less 2. $ 209,000 personal deductions: $7,500 as shown above plus $201,500 for a charitable deduction, it being assumed that the taxpayer gives 20% of adjusted gross income to charity.
3. $ 798,500 net taxable income before exemptions.
Less 4. $ 600 An exemption of $600.00 is permitted each taxpayer.
5. $ 797,900 equals net taxable income.

At the rates applicable for taxable years beginning after October 31, 1951, the combined normal and surtax payable by the taxpayer would be $710,784.

To determine whether the taxpayer qualifies for the unlimited charitable deduction under § 120, taxes paid during the current year should be added to the charitable deduction. Assuming income for the prior year was approximately the same as the current year, this combined figure would be $710,784 in taxes, plus $201,500 in charitable contributions, for a total of $912,284.

To qualify for the unlimited charitable deduction, it is necessary that charitable contributions, plus taxes paid during the current year, exceed 90% of net income. Net income for the current year was $1,000,000. 90% of this figure is $900,000. The taxpayer's contributions, plus taxes, for the current year would exceed 90% of net income by $12,284.

In the current year, after paying his taxes, contributing $201,500 to charity (20 percent and enough to qualify under section 120) and meeting expenses (depletion not being treated as an expense), the taxpayer has a net balance of $280,216 remaining from his $1,200,000. Let us now suppose that the taxpayer has qualified under § 120 during the preceding ten years and that he is entitled to the unlimited charitable deduction. To take advantage of this deduction, assume a gift to charity of $799,400 instead of the customary $201,500. The question then confronting the taxpayer is how this greatly increased charitable contribution will affect the net balance remaining to him from his annual income.

In computing the deduction under § 120, $1,007,500 will remain the
adjusted gross income figure. From this the deduction of $7,500 will be
allowed for interest, taxes and losses as shown above. This leaves a net
income of $1,000,000 before the charitable deduction is computed. After
the unlimited charitable deduction is taken for the $799,400 gift, net income
will be $200,600. From this an exemption of $600.00 may be taken so
that net income will be $200,000. On this amount a tax of $160,716 will
be due. Section 120 net income will remain at $1,000,000 even though the
taxpayer has qualified for a deduction under that Section. Thus, it will
be necessary that charitable contributions, plus taxes, exceed 90% of
that figure, or $900,000. Since the taxpayer here has given $799,400 to
charity and will pay taxes of $160,716, his taxes plus charitable contribu-
tions exceed 90% of § 120 net income by $60,116, thus assuring that the
taxpayer will be entitled to the unlimited charitable deduction in subse-
quent years.

The combined total of gifts, taxes and expenses (excluding depletion)
as computed above will be $967,616, leaving the taxpayer a net balance
of $232,384 remaining from his $1,200,000 income. This, compared to
$280,216 the taxpayer would have if he gave only $201,500 to charity,
demonstrates with clarity that taxpayers can, by qualifying under § 120,
greatly benefit worthy local charities at only comparatively slight addi-
tional cost to themselves.

III.

Assume the taxpayers are husband and wife and that they have a total
income of $1,000,000 derived from the following sources:

1. $ 500,000 net income from business.
2. $ 300,000 income from oil and gas royalty payments.
3. $ 100,000 income from interest on municipal bonds.
4. $ 100,000 income from dividends on common stock.

$1,000,000 total.

Of the above amounts the following would be taken into account in
computing § 120 net income:

1. $ 500,000 all the net income from the taxpayers' business.
2. $ 217,500 all income from oil and gas royalties, except for
   27 1/2% allowed as a deduction for depletion.
3. $................ interest on municipal bonds.
DEDUCTION FOR CONTRIBUTIONS

4. $100,000 all income from dividends.

$817,500 total taken into account in computations under §120.

The following items would be deductible in computing §120 net income:
1. $5,000 interest paid by taxpayers on personal obligations.
2. $5,000 state and local taxes paid by taxpayers.
3. $7,500 losses from casualty or theft not insured.

$17,500 total deductions permitted in computing §120 net income.

$800,000 This represents §120 net income.

The taxpayers’ income tax liability may be computed as follows:
1. $817,500 adjusted gross income of taxpayers.

Less 2. $181,000 less personal deductions. It should be assumed that the taxpayers will give 20% of adjusted gross income, or $163,500, to charity, this deduction being permitted by §23(o).

$636,500 net taxable income before exemptions.

Less 3. $1,200 An exemption of $600.00 is permitted to each taxpayer.

$635,300 net taxable income.

At the tax rate applicable for taxable years beginning after October 31, 1951, the combined normal and surtax payable by the taxpayers would be $537,908.

In determining whether the taxpayers qualify for the unlimited charitable deduction under §120, the taxes paid by the taxpayers during the year should be added to their charitable contributions. Assuming the taxpayers’ income for the prior year was the same, or about the same, as that during the current year, this combined figure would be $537,908 taxes, plus $163,500 in charitable contributions, for a total of $701,408.

To qualify for the unlimited charitable deduction, it is necessary that charitable contributions made by the taxpayers plus taxes paid by them during the current year exceed 90% of net income. Net income for the current year was $800,000. 90% of this figure is $720,000. The taxpayers’ charitable contributions, plus taxes, for the current year would fall short of 90% of net income by $18,592. Thus, to qualify for the unlimited char-
itable deduction, it will be necessary for the taxpayers to make additional charitable contributions of $18,593.

In the current year after paying their taxes, contributing $182,093 to charity (enough to qualify under § 120) and meeting expenses (depletion not being treated as an expense), the taxpayers have a net balance of $262,499 remaining from their $1,000,000. Let us assume that our taxpayers have qualified under § 120 during the preceding ten years and that they are now entitled to the unlimited charitable deduction. To take advantage of this deduction the taxpayers, instead of giving $182,093 to charity during the current year, give $498,800 to the charity of their choice. The question then is whether this larger gift will impose heavy additional burdens on the taxpayers. To determine this, one must compute the balance of the $1,000,000 remaining to the taxpayers, based on the assumption that $498,800 is given to charity.

$817,500 remains the adjusted gross income figure. From this the deduction of $17,500 will be allowed for interest, taxes and losses as shown above. This leaves a net income of $800,000 before the charitable deduction is computed. After the unlimited charitable deduction is taken for the $498,800 gift, net taxable income will be $301,200. From this exemptions of $1,200.00 may be taken so that net taxable income will be $300,000. On this amount a tax of $230,432 will be due. Section 120 net income will remain at $800,000, even though the taxpayers have qualified for an unlimited deduction under that Section. Thus, it will be necessary that charitable contributions, plus taxes, exceed 90% of that figure, or $720,000. Since the taxpayers have given $498,800 to charity and will pay taxes of $230,432, their taxes, plus charitable contributions, exceed 90% of § 120 net income by $9,232, thus assuring that the taxpayers will be entitled to the unlimited charitable deduction in subsequent years.

The combined total of gifts, taxes and expenses (excluding depletion) as computed above will be $746,732, leaving the taxpayers a net balance of $253,268 remaining from their $1,000,000 income. This, compared with $262,499 the taxpayers would have if they gave only $182,093 to charity, shows clearly that the taxpayers can give large sums to worthy charities and at only slight additional cost to themselves.

IV.

Assume the taxpayer is single and has a total income of $500,000 during the year from the following sources:

1. $ 200,000 net income from business.
2. $300,000 income from gas and oil royalties.
3. $100,000 income from dividends on common stocks.
4. ($100,000) net long term capital loss.

$500,000 total.

Of the above amounts the following would be included in computing §120 net income:

1. $200,000 net income from business.
2. $217,500 all royalties after a 27½% allowance for depletion.
3. $100,000 all dividends to the extent paid from earnings and profits.
4. ($1,000) Since $1,000 of net capital loss can be used as an offset against current year’s income, this amount should probably be included in computing §120 net income, see §22(n)(6). Cf., however, United States v. Plaintiffs, 305 U. S. 357 (1939). For years beginning after October 31, 1951, it is clear that this deduction will be permitted, see §23(ee).

$516,500 total income taken into account in computations under §120.

Less 5. $16,500 Assume all personal deductions (interest, taxes, etc.), except for the charitable deduction, add up to this figure.

$500,000 This represents §120 net income.

The taxpayer’s income tax liability may be computed as follows:

1. $516,500 equals adjusted gross income.

Less 2. $119,800 personal deductions, $16,500 as shown above, plus $103,300 for a charitable deduction, it being assumed that the taxpayer gives 20% of adjusted gross income to charity.

3. $396,700 net taxable income before exemptions.

Less 4. $600 An exemption of $600.00 is permitted each taxpayer.

5. $396,100 equals net taxable income.

At the rates applicable for taxable years beginning after October 31, 1951, the combined normal and surtax payable by the taxpayer would be $341,128.
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To determine whether the taxpayer qualifies for the unlimited charitable deduction under § 120, taxes paid during the current year should be added to the charitable contribution. Assuming income for the prior year was approximately the same as the current year, this combined figure would be $341,128 in taxes, plus $103,300 in charitable contributions, for a total of $444,428.

To qualify for the unlimited charitable deduction, charitable contributions plus taxes paid during the current year must exceed 90% of net income. Net income for the current year was $500,000. 90% of this figure is $450,000. The taxpayer's contributions, plus taxes, for the current year would fall short of 90% of net income by only $5,572.

In the current year after paying his taxes, meeting expenses and contributing $108,873 to charity (enough to qualify under § 120), the taxpayer has a net balance of $133,499 remaining from his $600,000. After providing for the $100,000 capital loss, this leaves a final net balance of $33,499. Let us now suppose that the taxpayer has qualified under § 120 during the preceding ten years and that he is entitled to the unlimited charitable deduction. To take advantage of this deduction, assume a gift to charity of $299,400 instead of the customary $108,873. The question then confronting the taxpayer is how this greatly increased charitable contribution will affect the net balance remaining to him from his annual income.

In computing the deduction under § 120, $516,500 will remain the adjusted gross income figure. From this the deduction of $16,500 will be allowed for interest, taxes, etc., as shown above. This leaves a net income of $500,000 before the charitable deduction is computed. After the unlimited charitable deduction is taken for the $299,400 gift, net income will be $200,600. From this an exemption of $600.00 may be taken so that net taxable income will be $200,000. On this amount a tax of $160,716 will be due. Section 120 net income will remain at $500,000 even though the taxpayer has qualified for a deduction under that section. Thus, it will be necessary that charitable contributions, plus taxes, exceed 90% of that figure or $450,000. Since the taxpayer here has given $299,400 to charity and will pay taxes of $160,716, his taxes, plus charitable contributions, exceed 90% of § 120 net income by $10,116, thus assuring that the taxpayer will be entitled to the unlimited charitable deduction in subsequent years.

The combined total of gifts, taxes and expenses (excluding depletion) as computed above will be $476,616, leaving the taxpayer a net balance of $123,384 remaining from his $600,000 income. After provision for the
$100,000 capital loss the final balance remaining would be $23,384, but $99,000 of the capital loss may be used as a capital loss carryover for five successive years. This, compared with the $33,499 (or $133,499) the taxpayer would have if he gave only $108,873, demonstrates clearly that taxpayers can, by qualifying under § 120, greatly benefit worthy local charities and at the same time impose only slight additional burdens upon themselves.

V.

Assume the taxpayer is single and has a total income of $120,000 during the year from the following sources:

1. $ 45,000 net income from business.
2. $ 60,000 income from gas and oil royalties.
3. $ 10,000 income from dividends on common stocks.
4. $ 5,000 long term capital gain.

$ 120,000 total.

Of the above the following would be taken into account in computing § 120 net income:

1. $ 45,000 net income from business.
2. $ 43,500 all royalties after a 271/2% allowance for depletion.
3. $ 10,000 all dividends to the extent paid from earnings and profits.
4. $ 2,500 (possibly $5,000) 50% of net long term capital gain. (This gain may be includible in full in net income under the 1951 Revenue Act, see §§ 117(c) and 23(ee)).

$ 101,000 total income taken into account in computations under § 120.

Less 5. $ 1,000 Assume all personal deductions (interest, taxes, etc.), except for the charitable deduction, add up to this figure.

$ 100,000 This represents section 120 net income.

The taxpayer's income tax liability may be computed as follows:

1. $ 101,000 equals adjusted gross income (including the capital gain).
Less 2. $21,200 personal deductions, $1,000 as shown above, plus $20,200 for a charitable contribution, it being assumed that the taxpayer gives 20% of adjusted gross income to charity.

$79,800 net taxable income before exemptions.

Less 3. $600 An exemption of $600.00 is permitted each taxpayer.

$79,200 equals net taxable income.

At rates applicable for taxable years beginning after October 31, 1951, the combined normal and surtax payable by the taxpayer would be $46,771.00 ($45,471.00 on ordinary income and $1,300 on the long term capital gain).

To determine whether the taxpayer qualifies for the unlimited charitable deduction under §120, taxes paid during the current year should be added to the charitable contribution. Assuming income for the prior year was approximately the same as the current year, this combined figure would be $46,771 in taxes, plus $20,200 in charitable contributions, for a total of $66,971.

To qualify for the unlimited charitable deduction, charitable contributions, plus taxes paid during the current year, must exceed 90% of net income. Section 120 net income for the current year was $100,000. 90% of this figure is $90,000. The taxpayer's contributions, plus taxes, for the current year would fall short of 90% of net income by $23,029.

In the current year after paying his taxes, meeting expenses and contributing $43,230 to charity (enough to qualify under §120), the taxpayer would have a net balance of $28,999 remaining from his $120,000 income. Let us now suppose that the taxpayer has qualified under §120 during the preceding ten years and that he is entitled to the unlimited charitable deduction. To take advantage of this deduction, assume a gift of $85,400 instead of $43,230. The question then is whether the much larger charitable contribution will greatly affect the net balance remaining to the taxpayer from his annual income.

In computing the deduction under §120, $101,000 will remain the adjusted gross income figure. From this the deduction of $1,000 will be allowed for interest, taxes, etc., as shown above. This leaves a net income of $100,000 before the charitable deduction is computed. After the unlimited charitable deduction is taken for the $85,400 gift, net income will be $14,600. From this an exemption of $600 may be taken so that net taxable income will be $14,000. On this amount a tax of $4,646 will be
due. Section 120 net income will remain at $100,000 even though the taxpayer has qualified for a deduction under this Section. Thus, it will be necessary that charitable contributions, plus taxes, exceed 90% of that figure or $90,000. Since the taxpayer here has given $85,400 to charity and will pay taxes of $4,656, his taxes, plus charitable contributions, exceed 90% of net income by $56.00, thus assuring that the taxpayer will be entitled to the unlimited charitable deduction is subsequent years.

The combined total of gifts, taxes and expenses (excluding depletion) as computed above will be $91,056, leaving the taxpayer a net balance of $28,944 remaining from his $120,000 income. This, compared with $28,999 the taxpayer would have if he gave only $43,230.00, demonstrates clearly that taxpayers can, by qualifying under § 120, greatly benefit worthy local charities and at the same time impose only slight additional burdens upon themselves.