No. 16-6371

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

MART D. GREEN, TRUSTEE OF THE DAVID AND BARBARA GREEN 1993 DYNASTY TRUST,

Plaintiff-Appellee

v.

UNITED STATES OF AMERICA,

Defendant-Appellant

ORAL ARGUMENT REQUESTED

ON APPEAL FROM THE JUDGMENT
OF THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA
No. 5:13-cv-01237
JUDGE TIMOTHY D. DEGIUSTI

BRIEF FOR THE APPELLANT

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STATEMENT OF RELATED CASES

Pursuant to Tenth Circuit Rule 28.2(C)(1), counsel for the United States state that they are unaware of any prior or related appeals.

GLOSSARY

Acronym	Definition
Aplt. App.	Separately bound record appendix
Doc.	Documents contained in the record on appeal, as numbered by the Clerk of the District Court
Hobby Lobby	Hobby Lobby Stores, Inc.
Hob-Lob	Hob-Lob Limited Partnership
I.R.C.	Internal Revenue Code of 1986 (26 U.S.C.)
IRS	Internal Revenue Service
The Trust	The David and Barbara Green 1993 Dynasty Trust
The Trustee	Plaintiff-Appellant Mart D. Green
Treas. Reg.	Treasury Regulation (26 C.F.R.)

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Defendant-Appellant

ON APPEAL FROM THE JUDGMENT
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BRIEF FOR THE APPELLANT

STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

On October 15, 2005, the David and Barbara Green 1993 Dynasty Trust (the Trust) filed its income tax return for the year 2004. (Aplt. App. at 169.)[1] On October 15, 2008, within three years of filing its

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[1] "Aplt. App." references are to the separately bound record appendix. "A-" references are to the attachments to this brief. "Doc." references are to the documents contained in the record on appeal, as numbered by the Clerk of the District Court.

original return, the Trust filed an amended return, timely requesting an additional refund. (*Id.*); I.R.C. § 6511(a). The IRS denied the Trust's claim for an additional refund in December 2011. (Aplt. App. at 169.) In November 2013, within two years of the disallowance of its claim, the Trust filed a timely refund suit in the United States District Court for the Western District of Oklahoma. (*Id.*, 11-13); I.R.C. § 6532(a). The District Court accordingly had subject matter jurisdiction pursuant to I.R.C. § 7422(a) and 28 U.S.C. § 1346(a)(1).

Following motions for summary judgment and a jury trial, the District Court entered a judgment in favor of the Trust on November 4, 2016. (Aplt. App. at 389-90; A-19 to A-20.) That judgment was a final order, resolving all claims of all parties. On December 28, 2017, within 60 days of the entry of judgment, the United States filed a timely notice of appeal. (Aplt. App. at 391-92); 28 U.S.C. § 2107(b); Fed. R. App. P. 4(a)(1)(B). This Court has jurisdiction over the appeal under 28 U.S.C. § 1291.

STATEMENT OF THE ISSUE

I.R.C. § 642(c)(1) allows a charitable deduction to a trust for "any amount of the gross income." In this case, the Trust donated parcels of

appreciated real property to charity and claimed deductions for each property's fair market value at the time of donation. There is no dispute that the Trust is entitled to a charitable deduction to the extent of its adjusted basis in the donated property. The issue presented is whether the District Court erred in allowing the Trust to deduct the unrealized appreciation of the properties, notwithstanding that such amounts were not included in its gross income.

STATEMENT OF THE CASE

A. The nature of the case and course of proceedings in the District Court

Mart D. Green, in his capacity as trustee of the Trust, brought this suit in District Court, seeking a refund of $3,194,748 in federal income taxes paid by the Trust for the year 2004. (Aplt. App. at 11-13.) The Trust alleged that the IRS had erroneously disallowed charitable deductions attributable to donations of three parcels of appreciated real properties, as well as donations of cash.[2] (*Id.*)

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[2] The Trust acknowledged that the amount of its allowable charitable deduction was limited pursuant to I.R.C. § 681(a) and the accompanying regulations to 50 percent of its unrelated business taxable income. (*Id.*, 75.)

With respect to the donations of real property, the Trust alleged that it was entitled to a deduction for the properties' fair market value (which it alleged was approximately $30.3 million), not merely the Trust's adjusted basis in the properties (approximately $10.7 million).[3] (Aplt. App. at 12-13, 172-74.) The Government contended, however, that the deduction was limited to the Trust's adjusted basis in the properties, and that no part of the unrealized appreciation of the properties was deductible, because I.R.C. § 642(c), as well as the trust instrument itself, limit the Trust's charitable deduction to amounts included in the Trust's gross income. (*Id.*, 219-28, 251-53, 305-11.)

Regarding the cash donations, the Trust alleged that it was entitled to a deduction of approximately $6.6 million (*id.*, 12), including $4.75 million that was paid from the accounts of Hobby Lobby Stores, Inc. (Hobby Lobby), a corporation in which the Trust had no ownership

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[3] Adjusted basis refers to the purchase price of an asset, increased for certain expenditures (such as capital improvements) and reduced for others (such as depreciation deductions). I.R.C. §§ 1011, 1012(a), 1016; Treas. Reg. §§ 1.1016-2(a), 1.1016-3. This approach is used to calculate gain or loss in order to allow the taxpayer to recover his investment in the property tax-free or to recognize a loss if he does not. *See* Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates and Gifts*, ¶ 41.1 (2017).

interest (*id.*, 275-76, 401). The Trust maintained that, but for a clerical error that had subsequently been corrected, the $4.75 million should have been paid from the account of Hob-Lob Limited Partnership (Hob-Lob), in which the Trust had a 99-percent interest (and, concomitantly, a like share of Hob-Lob's deductions, which were passed through to the Trust under I.R.C. § 704). (*Id.*, 170, 275-76.) The Government argued that the Trust was bound by the manner in which the donations had actually been made and could not recast the transactions after the fact. (*Id.*, 228-30, 313-14.)

The Government filed a motion for summary judgment, and the Trust filed a cross-motion for partial summary judgment. (Docs. 37, 38, 42, 43, 46, 47.) The District Court denied the Government's motion and granted the Trust's motion. (Aplt. App. at 328-45, 346-52; A-1 to A-18.)

Regarding the gifts of appreciated property, the District Court issued an opinion, reported at 144 F. Supp. 2d 1254 (W.D. Okla. 2015), holding that I.R.C. § 642(c)(1) permits an estate or trust to claim a charitable deduction for the fair market value of donated property, even if such a deduction exceeds the amount included in its gross income, so long as the amount donated is "derive[d] from" an amount included in

its gross income. (Aplt. App. at 335-44; A-8 to A-17.) Regarding the disputed cash donations, the District Court issued a further opinion that is not officially reported (but is available at 2016 WL 552964 (Feb. 10, 2016)). It held that although a taxpayer is bound by the form of a transaction that is intentionally chosen, the result would be different if Hob-Lob could demonstrate that the way the contributions were initially made resulted from a clerical error. (Aplt. App. at 350-51.)

Because the parties had agreed to the fair market values of two of the three properties, one in Oklahoma and the other in Texas (*id.*, 173-74), the District Court's grant of partial summary judgment to the Trust was dispositive of the amount of the charitable deduction attributable to those properties. The fair market value of the third parcel, however, located in Virginia, remained in dispute. (Aplt. App. at 344; A-17.) Whether a clerical error had initially caused Hobby Lobby to make the cash contributions instead of Hob-Lob was also contested. (Aplt. App. at 314.) A jury trial was held on those issues.

The jury returned a verdict determining that the fair market value of the Virginia property was $28.5 million when donated. (*Id.*,

387.) The jury further determined that Hob-Lob was entitled to deduct the full $4.75 million of cash donations drawn on the accounts of Hobby Lobby. (*Id.*, 387-88.) In accordance with the summary judgment rulings, the jury verdict and certain stipulations of the parties, the court entered a judgment in favor of the Trust for $2,754,514, plus interest. (*Id.*, 389-90; A-19 to A-20.)

The United States now appeals from the District Court's determination that the Trust was entitled to a charitable deduction for unrealized appreciation on the donated real properties that was not included in its gross income. Reversal of this determination, standing alone, would require judgment to be entered in its favor, with the Trust recovering nothing.[4]

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[4] On its original return, the Trust claimed charitable deductions of approximately $20.5 million. (Aplt. App. at 75.) If the Trust's charitable deduction is allowed only to the extent of its adjusted basis in the real properties, then the maximum charitable deduction to which it would be entitled is approximately $17.3 million, consisting of approximately $10.7 million adjusted basis in the real properties, plus approximately $6.6 million in cash donations (which are no longer being contested on appeal). As a result, the Trust would have already received a greater refund than it was entitled, no matter how the other issues in the case were resolved. Notably, the cap on charitable deductions imposed by I.R.C. § 681 and the accompanying regulations, equal to 50 percent of the Trust's approximately $58.7 million in

B. The relevant facts

1. Creation of the Trust

In December 1993, David M. Green and Barbara A. Green executed an instrument creating the Trust for estate planning and business succession purposes. (Aplt. App. at 168, 403-04.) The trust instrument provided that Mart D. Green would serve as trustee and administer the Trust for the benefit of David and Barbara Green's children and grandchildren, including distributing some or all the Trust's net income and principal for their health, education and maintenance. (*Id.*, 17, 20.) The Trust held a 99-percent ownership interest in Hob-Lob, which operated retail stores under the brand name "Hobby Lobby," and the Green family held the remaining one percent. (*Id.*, 170, 395-98.) In 2004, the Trust reported total income of approximately $58.8 million, largely attributable to its ownership interest in Hob-Lob. (*Id.*, 70, 171.)

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unrelated business income (or approximately $29.35 million) (*id.*, 175), would not be implicated in the event the Government prevails in this appeal, because the maximum charitable deduction the Trust can obtain ($17.3 million) is a lower amount.

In addition to providing that the Trustee could distribute the Trust's net income and principal for the benefit of the Green family, the trust instrument provided that the Trustee had discretion to "donate to charity such amounts from the gross income of the Trust as the Trustee determines appropriate . . . ." (*Id.*, 20.) In practice, the Trust made charitable donations both in the form of real properties and in cash through Hob-Lob. (*Id.*, 12, 400.) With respect to the former, the Trust created a wholly owned subsidiary, GDT CG1 LLC, for the ostensible purpose of purchasing real properties to donate to charity. (*Id.*, 169, 399.) For simplicity, we refer to the Trust and its subsidiary simply as the Trust, because it is immaterial whether the relevant actions were taken by the Trust or its subsidiary.[5]

2. Donations to charity

In 2004, as relevant to this appeal, the Trust claimed charitable deductions based on donations of real property. (Aplt. App. at 12, 400.) First, in 2002 and 2003, the Trust used approximately $10.6 million of

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[5] As a single-member limited liability company wholly owned by the Trust, the subsidiary was disregarded for federal tax purposes. (*Id.*, 169 (citing Treas. Reg. § 301.7701-3).) All of its income, deductions and credits were passed through to, and reported by, the Trust. (*Id.*)

its gross income to purchase three real properties, one in Virginia, one in Oklahoma and one in Texas. (*Id.*, 172-74, 399.) In 2004, the Trust donated some or all of each property to charity. (*Id.*, 172-74.) The Trust then filed an income tax return for 2004 reporting that, at the time of donation, each of the properties was worth at least two to three times its purchase price, as set forth below. (*Id.*, 108-10.)

In February 2003, the Trust purchased approximately 109 acres of land and two industrial buildings in Lynchburg, Virginia, for $10.3 million. (*Id.*, 172.) The Trust donated 73 acres of the land and both buildings to charity in March 2004, retaining approximately 36 acres for its own use. (*Id.*, 172, 402.) On its return, the Trust claimed that its adjusted basis in the land and buildings was $10,368,113 and that the property donated, not including the acreage that the Trust had retained, had a fair market value of $29.5 million. (*Id.*, 108, 172.)

In August 2002, the Trust purchased several buildings in Ardmore, Oklahoma, for $150,000. (*Id.*, 173.) The Trust donated the buildings to charity in October 2004. (*Id.*) On its return, the Trust claimed that its adjusted basis in the buildings was $160,477 and that the buildings had a fair market value of $355,000. (*Id.*, 109, 173.)

In June 2003, the Trust purchased approximately 3.8 acres of land in Dickinson, Texas, for $145,000. (*Id.*, 174.) The Trust donated the land to charity in October 2004. (*Id.*) On its return, the Trust claimed that its adjusted basis in the land was $145,180 and that the land had a fair market value of $458,000. (*Id.*, 110, 174.)

In sum, the Trust reported that its total adjusted basis in the real properties was approximately $10.7 million and that the properties' total fair market value at the time of donation was approximately $30.3 million. The Trust was not required to, and did not, report as income the properties' unrealized appreciation, which was approximately $19.6 million (*i.e.*, the claimed fair market value of $30.3 million, less $10.7 million in adjusted basis). (*See id.*, 214, 276.) By asserting that it was entitled to charitable deductions for the claimed $30.3 million fair market value of the properties, rather than its $10.7 million adjusted basis therein, the Trust claimed deductions that far exceeded what it could have claimed had it simply donated the funds used to purchase the properties.

C. The refund claims submitted by the Trust

In October 2005, the Trust filed its income tax return for 2004, reporting income of approximately $58.8 million, of which $58,712,171 was unrelated business income for purposes of the limitation on the charitable deduction imposed by I.R.C. § 681(a) and the accompanying regulations. (*Id.*, 70, 169, 175.) The return reported charitable donations of approximately $36.9 million, consisting of the approximately $30.3 million alleged fair market value of the donated real properties and 99 percent of the approximately $6.6 million of donated cash. (*Id.*, 76-77, 108-110.) Based on these donations, the Trust claimed charitable deductions to partially offset its income. (*Id.*, 75.) Because it was using the deductions to offset unrelated business income, however, the Trust was required to limit its charitable deductions to a particular percentage of that income, as set forth in I.R.C. § 681 and Treas. Reg. § 1.681(a)-1. The Trust therefore reduced its charitable deductions to 30 percent of its income, or approximately $20.5 million. (*Id.*)

In October 2008, the Trust filed an amended return for 2004. (*Id.*, 169.) In relevant part, the amended return increased the charitable

deductions claimed by the Trust from approximately $20.5 million to approximately $29.7 million. (*Id.*, 75.) The Trust's rationale for increasing its charitable deductions was that its original return had erroneously limited those deductions to 30 percent of its unrelated business income, rather than 50 percent. (*Id.*) As a result of this increase in charitable deductions, the Trust claimed that it was entitled to an additional refund of approximately $3.2 million. (*Id.*, 169.) The IRS denied this refund claim. (*Id.*, 161-62.)

D. Proceedings in the District Court

The Trust filed this suit for refund in the District Court, contesting the denial of its refund claim. (*Id.*, 11-13.) During the course of the proceedings, the Government no longer disputed that the Trust's amended return was correct insofar as it applied a 50-percent limit under I.R.C. § 681 and the accompanying regulations (against its unrelated business taxable income for the year) for its charitable deductions, rather than the 30-percent limit applied in the original return. But it still contested the claimed charitable deductions. As relevant to this appeal, the Government challenged the Trust's position that it could claim a deduction for the fair market value of the donated

real properties, rather than its adjusted basis in the properties. (*See id.*, 162.)

1. The motions for summary judgment

The parties filed cross-motions for summary judgment. (Docs. 37, 38, 42, 43, 46. 47.) The Government sought a determination that the Trust was not entitled to any refund, while the Trust sought a determination, with respect to its donation of real properties, that its charitable deduction should be calculated based on the properties' fair market value. In its motion, the Government explained that I.R.C. § 642(c)(1) limits a trust's charitable deductions to "amount[s] of the gross income" donated to charity. (Aplt. App. at 218-19, 248-51.) It further explained that I.R.C. § 642(c)(1) limits a trust's charitable deductions to amounts paid pursuant to its governing instrument, and the Trust's governing instrument tracked I.R.C. § 642(c)(1) in providing that the Trust could donate "amounts from gross income" (but not other amounts). (*Id.*, 225-28, 262-64, 311-13.) The Government therefore argued that the Trust could claim a charitable deduction for its adjusted basis in the three donated real properties (which had been included in

its gross income), but not the properties' unrealized appreciation (which had not). (*Id.*, 219-25, 262-64, 305-11.)

The Trust opposed the Government's motion for summary judgment, and it also cross-moved for partial summary judgment regarding its entitlement to a charitable deduction for the fair market value of the donated real properties. The Trust argued that the court should liberally construe I.R.C. § 642(c) in favor of encouraging charitable donations. (*Id.*, 194-96, 298-99.) Applying this liberal construction, the Trust argued that allowing trusts to claim a charitable deduction for the fair market value of donated properties would encourage trusts to donate appreciated properties. (*Id.*, 195-96, 298-99, 320-21.) The Trust also argued that many other sections of the Internal Revenue Code use a fair market value standard. (*Id.*, 191-94, 296-98, 322.) The Trust further argued that – in the context of donations of non-cash property acquired with funds previously reported as gross income – the words "amount of . . . gross income . . . paid" in I.R.C. § 642(c)(1) should be construed as the property's fair market value at the time of donation, whether all or only a portion of that amount had been reported as gross income. (*Id.*, 288-89.)

2. The court's grant of partial summary judgment to the Trust

The District Court issued an opinion denying summary judgment to the Government and granting partial summary judgment to the Trust. (*Id.*, 328-45; A-1 to A-18.) The court held that I.R.C. § 642(c)(1) should be construed liberally to achieve the policy goal of encouraging charitable donations of appreciated property. (Aplt. App. at 337-39; A-10 to A-12.) The District Court noted that the court in *Crestar Bank v. I.R.S.*, 47 F. Supp. 2d 670 (E.D. Va. 1999), had explained that donated property must be sourced from, and traceable to, a trust's gross income in order to qualify for a deduction under I.R.C. § 642(c). (Aplt. App. at 340-41; A-13 to A-14.) Although neither the word "sourced" nor the word "tracing" appears in I.R.C. § 642(c), the District Court here considered their dictionary definitions. (Aplt. App. at 340 n.14-15; A-13.) The court then opined that, to come within the scope of the statute, a donation need not be an "amount of the [trust's] gross income," so long as the donation can be traced to, or derived from, such an amount. (Aplt. App. at 340-41, 343; A-13 to A-14, A-16.) It held that allowing the Trust to claim a deduction for the fair market value of the real properties was consistent with I.R.C. § 170, which sometimes permits

individuals to claim a charitable deduction for the fair market value of donated property, and provisions of the Internal Revenue Code that use a fair market value standard in other contexts. (Aplt. App. at 343-44; A-16 to A-17.) Finally, the court dismissed the language in the trust instrument that provided only for donations of "amounts from gross income." It concluded that a charitable contribution is made "pursuant to the terms of the trust instrument" if the instrument authorizes the trustee to make charitable contributions of any kind. (Aplt. App. at 341-42; A-13 to A-14.)

3. The jury trial, verdict and entry of judgment

In light of the court's grant of partial summary judgment to the Trust on the scope of the charitable deduction available under I.R.C. § 642(c)(1), and the fact that the parties had reached an agreement regarding the fair market values of the Oklahoma property ($355,000, as reported on the Trust's return) and the Texas property ($150,000, rather than the $458,000 reported on the Trust's return) (Aplt. App. at 173-74), the only issue remaining in dispute (relevant to this appeal) was the fair market value of the Virginia property at the time of donation. That issue was tried to a jury. The Government's expert

maintained that the property was worth $16 million when donated (*id.*, 408), while the Trust's expert opined that it was worth $31 million at that time (*id.*, 406). The jury rendered a verdict finding that the fair market value of the Virginia property was $28.5 million at the time of donation. (*Id.*, 387.) The court then entered judgment in accordance with its summary judgment rulings, certain stipulations of the parties and the jury's verdict. (*Id.*, 389-90; A-19 to A-20.)

This appeal followed.

SUMMARY OF ARGUMENT

This case involves the Trust's donation of three parcels of appreciated real property to charity. The plain text of I.R.C. § 642(c)(1) limits a charitable deduction by a trust to the "amount of the gross income" donated to charity. It is fundamental – and undisputed – that gross income does not include unrealized appreciation in property, *i.e.*, the amount by which the property's fair market value exceeds the owner's adjusted basis in the property. Despite the plain language of I.R.C. § 642(c)(1), which limits the amount of a trust's charitable deduction to "gross income" donated, the District Court held that the Trust is entitled to a charitable deduction for the fair market value of

three donated properties, including not only its adjusted basis in the properties (which was paid out of amounts included in its gross income), but also the properties' unrealized appreciation (which was not gross income or reported or taxed as such). The court's ruling in this regard transformed the Trust's $10.7 million investment of gross income into a charitable deduction of $29 million, even though everyone agreed that the $18.3 million in unrealized appreciation was not gross income or taxable as such.

To reach this anomalous result, the District Court held that it was required to construe I.R.C. § 642(c)(1) liberally to achieve the policy goal of encouraging charitable donations; that amounts derived from gross income – such as the unrealized appreciation in issue — should be treated as if they are an "amount of the gross income"; and that a fair market value standard should be imported into I.R.C. § 642(c)(1) from various other provisions of the Internal Revenue Code. The District Court erred in applying this atextual approach to a statute that, by the court's own admission, was clear and unambiguous.

To begin with, there was no basis for departing from the statute's imperative that the contribution be made from gross income, which was

not undercut by any other part of the text of I.R.C. § 642(c)(1) or, for that matter, any other provision in the Code. Nor can the limitation to gross income be stretched to encompass appreciation on that amount. In so concluding, the court misconstrued a gloss providing that the contribution must be sourced from and traceable to gross income in allowing the Trust a deduction for unrealized appreciation. The gloss merely articulates a tracing requirement linking the contribution to an item of gross income. It does not furnish a way to extend the deduction to items not constituting gross income. Besides, compliance with the trust instrument is likewise a condition of the deduction, and the trust instrument here authorized charitable donations only from gross income.

The court's decision is contrary to the weight of authority, which clearly withholds the deduction from amounts not taken into account in computing gross income. The ruling is also unsound as a policy matter, because it allows a duplicative tax benefit, in the form of a deduction for an amount that was never taxed. The fact that the court's interpretation of the statute spawns this unwarranted anomaly confirms the fallacy of its reading.

The judgment of the District Court is erroneous and should be reversed.

ARGUMENT

The District Court erred in holding that the Trust is entitled to a charitable deduction for the unrealized appreciation of donated property notwithstanding that I.R.C. § 642(c) limits the deduction to "the gross income" of the Trust

Standard of review

The District Court's grant of partial summary judgment to the Trust regarding the proper scope of the charitable deduction for trusts under I.R.C. § 642(c) is subject to *de novo* review. *In re Annis*, 232 F.3d 749, 751 (10th Cir. 2000).

A. Introduction: The statutes governing charitable deductions

I.R.C. §§ 170 and 642(c) provide income tax deductions for charitable contributions. In enacting these provisions, Congress wanted to encourage taxpayers to contribute to charity. *E.g.*, *Helvering v. Bliss*, 293 U.S. 144, 147 (1934); *United States v. Benedict*, 338 U.S. 692, 696 (1950). To accomplish this purpose, Congress provided a deduction as an incentive for taxpayers to make contributions to charity, thereby reducing the tax otherwise payable. I.R.C. §§ 170(a), 642(c)(1). At the

same time, however, Congress wanted to prevent charitable deductions from excessively eroding the tax base. As a result, it limited the type and amount of charitable contributions for which taxpayers could claim a deduction. I.R.C. §§ 170(a), (b)(1)-(2), 642(c)(1). As discussed below, the limits vary depending on the type of taxpayer making the contributions, with different rules for individuals, corporations, estates and trusts.

Charitable deductions for individuals and corporations are governed by I.R.C. § 170. I.R.C. § 170(a) encourages such taxpayers to contribute to charity by allowing them to claim a deduction for any payment made to charity:

> There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. . . .[6]

For individuals, I.R.C. § 170(b)(1) generally limits the total amount of charitable deductions to 20, 30 or 50 percent of the individuals' contribution base (*i.e.*, the individuals' adjusted gross income, subject to

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[6] I.R.C. § 170(c) provides that "charitable contributions" are those donations made to domestic governmental entities and certain nonprofit organizations, *i.e.*, public charities organized and operated exclusively for the benefit of the community, veterans organizations and cemetery companies.

certain adjustments), depending on the type of entity to which the donation is made and the type of property being donated. For corporations, I.R.C. § 170(b)(2) generally limits the total amount of charitable deductions to 10 percent of the corporation's taxable income, subject to certain adjustments.

Charitable deductions for estates and trusts are governed by I.R.C. § 642(c), not I.R.C. § 170. *See* I.R.C. § 642(c)(1) (deductions under I.R.C. § 642(c) are "in lieu of" deductions under I.R.C. § 170(a)); I.R.C. § 170(p)(2) (cross-referencing I.R.C. § 642 in the case of charitable contributions of estates and trusts). I.R.C. § 642(c)(1) encourages such taxpayers to contribute to charity by allowing them to claim a deduction for any amount of gross income paid to charity pursuant to the terms of their governing instruments:

> In the case of an estate or trust (other than a trust meeting the specifications of subpart B), *there shall be allowed as a deduction* in computing its taxable income (in lieu of the deduction allowed by section 170(a), relating to deduction for charitable, etc., contributions and gifts) *any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid* for a purpose specified in section 170(c) (determined without regard to section 170(c)(2)(A)). . . .

(Emphasis added.) In contrast to I.R.C. § 170(b)(1) and (2), I.R.C. § 642(c)(1) does not limit the total amount of estates and trusts' charitable deductions to a particular percentage of their income. Instead, I.R.C. § 642(c)(1) limits estates and trusts' charitable deductions to amounts contributed from their gross income, thereby excluding contributions from other sources. In addition, I.R.C. § 642(c)(1) limits the charitable deduction of an estate or trust to contributions made pursuant to its governing instrument, thereby excluding contributions that either are not specifically contemplated or are made *ultra vires*.[7]

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[7] A further limitation on charitable deductions by trusts, but not estates, is found in I.R.C. § 681(a) and the accompanying regulations. When a trust attempts to use charitable deductions to offset unrelated business income (*i.e.*, amounts allocable to a regularly conducted trade or business not in furtherance of an exempt purpose), the trust's deduction is subject to some – but not all – the percentage limits applicable to individuals. I.R.C. § 681(a) (generally precluding a taxpayer from using a deduction under I.R.C. § 642(c) to offset unrelated business income); Treas. Reg. § 1.681(a)-1 (permitting such deductions subject to the percentage limits from I.R.C. § 170(b)(1)(A) and 170(b)(1)(B), but not the percentage limits from I.R.C. § 170(b)(1)(C), (D), and (E)); Treas. Reg. § 1.681(a)-2 (explaining that the percentage limits in Treas. Reg. § 1.681(a)-1 are derived from I.R.C. § 512(b)(11)). For purposes of determining whether income earned by a trust constitutes "unrelated business income," the trust is treated as if it were a tax-exempt organization under I.R.C. § 501(a) and (c)(3).

B. The plain text of I.R.C. § 642(c)(1) allows a trust to claim a charitable deduction only for amounts donated from gross income, and unrealized appreciation is not an amount of gross income

It is fundamental that a deduction is a matter of legislative grace, and the burden of proving a right to a claimed deduction rests with the taxpayer. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934). This case turns on the proper interpretation of I.R.C. § 642(c)(1). In matters of statutory interpretation, the court begins with the text of the statute. *Knight v. Commissioner*, 552 U.S. 181, 187 (2008); *United States v. Burkholder*, 816 F.3d 607, 614 (10th Cir. 2016) (quoting *Salazar v. Butterball, LLC*, 644 F.3d 1130, 1136 (10th Cir. 2011)). The court looks no further than the text of the statute "[i]f the statute has a 'plain and unambiguous meaning with regard to the particular dispute in the case' and the statutory scheme is coherent and consistent." *Butterball,* 644 F.3d at 1137 (quoting *Robinson v. Shell Oil Co.*, 519 U.S. 337, 340 (1997)).

I.R.C. § 681(a). As explained above, p. 7 n.4, *supra*, this limitation will no longer be implicated if the Government prevails in this appeal.

Whether the statutory text is plain or ambiguous "'is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole.'" *Butterball*, 644 F.3d at 1137 (quoting *Robinson*, 519 U.S. at 341). In making this determination, "courts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992). The court's task is to give effect to every word, phrase and clause in a statute, *United States v. Menasche*, 348 U.S. 528, 538 (1955), and not to treat any part of it as inoperative, void or superfluous, *United States v. Corley*, 556 U.S. 303, 314 (2009). As the Supreme Court has cautioned, a court's "task is to apply the text, not to improve upon it." *Pavelic & LeFlore v. Marvel Entm't Group, Div. of Cadence Indus. Corp.*, 493 U.S. 120, 126 (1989).

The relevant statutory text in I.R.C. § 642(c)(1) – requiring that charitable deductions by a trust be paid out of "any amount of the gross income" – has a well defined meaning that excludes unrealized appreciation in property. Because the amounts at issue here are

unrealized appreciation that never entered into the Trust's gross income, no deduction is available under I.R.C. § 642(c)(1).

I.R.C. § 61 defines "gross income" as "all income from whatever source derived." I.R.C. § 61(a). It is fundamental, however, that the unrealized appreciation of an asset is not income. Indeed, since the earliest days of the income tax, it has been clear that "enrichment through increase in value of capital investment is not income in any proper meaning of the word." *Eisner v. Macomber*, 252 U.S. 189, 214-15 (1920), overruled on other grounds, *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955); *Weiss v. Weiner*, 279 U.S. 333, 335 (1929) (observing that the income tax laws do not tax "unrealized appreciation of property"). As a result, while the definition of "gross income" in I.R.C. § 61(a) includes "[g]ains derived from dealings in real property," I.R.C. § 61(a)(3), such gains are only "realized on the sale or exchange of property." Treas. Reg. § 1.61-6(a).

Contributing property to charity is neither a sale nor an exchange. A "sale" occurs when property is transferred "for a price." *Black's Law Dictionary* (10th ed. 2014); *see also* Treas. Reg. § 1.1001-1(a) ("the gain or loss realized from the conversion of property into cash . . . is treated

as income or as loss sustained."). An "exchange" occurs when two materially different properties are exchanged for one another. *Cottage Savings Ass'n v. Commissioner*, 499 U.S. 554, 561 (1991); *see also* Treas. Reg. 1.1001-1(a) ("the gain or loss realized . . . from the exchange of property for other property differing materially in either kind or extent, is treated as income or as loss sustained.").

Consequently, the appreciation in value of property that has not been realized through a sale or exchange is not part of taxpayers' gross income, and it need not be reported on their tax returns. As the Supreme Court explained in *Cottage Savings*, the Internal Revenue Code excludes appreciation from gross income, unless and until the appreciated property is sold or exchanged:

> . . . the Internal Revenue Code defers the tax consequences of a gain or loss in property value until the taxpayer 'realizes' the gain or loss. The realization requirement is implicit in § 1001(a) of the Code . . . which defines the gain or loss from the sale or other disposition of property as the difference between the amount realized from the sale or disposition of the property and its adjusted basis.

499 U.S. at 559 (citation, quotations, and alterations in original omitted). Otherwise, taxpayers and the IRS would be required to "undertake the cumbersome, abrasive, and unpredictable

administrative task of valuing assets on an annual basis" to determine taxpayers' gross income. *Id.* (citations and quotations omitted).

Applying these principles, it is clear that giving away appreciated property does not result in gross income to the donor. "A gift of appreciated property does not result in income to the donor so long as he gives the property away absolutely and parts with title thereto before the property gives rise to income by way of sale." *Carrington v. Commissioner*, 476 F.2d 704, 708 (5th Cir. 1973) (citation and quotation omitted). In other words, the donation of real property "is not an event in which an appreciation of value is recognized" because the property is neither sold nor exchanged. *Id.* Consequently, the difference between a donated property's adjusted basis and its fair market value is not part of a taxpayer's gross income and need not be reported as income on the taxpayer's tax return. *Id.*; *Grove v. Commissioner*, 490 F.2d 241, 246 (2d Cir. 1973); *Parmer v. Commissioner*, 468 F.2d 705, 707 n.1 (10th Cir. 1972) (quoting *Tatum v. Commissioner*, 400 F.2d 242, 246-47 (5th Cir. 1968)). The Trust conceded as much in the proceedings below. (Aplt. App. at 288 ("No one disputes that unrealized appreciation is not part of a taxpayer's 'gross income.'").)

Here, the Trust purchased three properties for a total of approximately $10.6 million and, by the time it donated the properties, it had an adjusted basis in the properties of approximately $10.7 million. (*Id.*, 172-74.) The entire adjusted basis was paid out of the Trust's gross income and reported on the Trust's income tax returns. (*Id.*, 108-10, 172-74.) The parties therefore agree that, under I.R.C. § 642(c)(1), every penny of the approximately $10.7 million constituted an "amount of the [Trust's] gross income . . . which is . . . paid" for a charitable purpose, allowing the Trust to claim a deduction of approximately $10.7 million. *See* I.R.C. § 642(c)(1).

In accordance with the parties' stipulations and the jury's verdict, the three properties had a total fair market value of approximately $29 million when the Trust donated them to charity. (Aplt. App. at 173-74, 387.) Of the $29 million, approximately $18.3 million (*i.e.*, the amount remaining after subtracting the approximately $10.7 million in adjusted basis) constituted unrealized appreciation that was neither included in the Trust's gross income nor reported as income on the Trust's income tax returns. (*See id.*, 214, 276.) The plain language of I.R.C. § 642(c) therefore precluded the Trust from claiming a deduction for the

approximately $18.3 million of unrealized appreciation. *See W.K. Frank Trust of 1931 v. Commissioner*, 145 F.2d 411, 413 (3d Cir. 1944) ("appreciation in value, unrealized by sale o[r] other disposition, was not gross income" and therefore was not deductible under predecessor to I.R.C. § 642(c)).

C. The District Court erred in holding that the Trust could claim a charitable deduction for amounts of unrealized appreciation not included in the Trust's gross income

As discussed above, the plain text of I.R.C. § 642(c)(1) limits a trust's charitable deductions to amounts included in its gross income, and it is well established that gross income does not include unrealized appreciation. The District Court nonetheless held that the Trust was entitled to deduct both its adjusted basis in the donated properties (which the Trust paid out of amounts included in its gross income) and the properties' unrealized appreciation (which the Trust did not include in its gross income). The court justified this holding by finding that: (1) it was required to take a liberal reading of I.R.C. § 642(c)(1); (2) amounts not included in the Trust's gross income were deductible under I.R.C. § 642(c)(1) if they were derived from amounts included in gross income; and (3) I.R.C. § 642(c)(1) should be construed *in pari*

materia with I.R.C. § 170. (Aplt. App. at 336-41, 343-44; A-9 to A-14, A-16 to A-17.) In doing so, the District Court erred.

1. The District Court erred by adopting an unduly broad reading of I.R.C. § 642(c)(1)

The District Court held that it was required to take a broad reading of I.R.C. § 642(c)(1) for two reasons. (Aplt. App. at 337-39; A-10 to A-12.) Neither reason withstands scrutiny or justifies the result that the court reached.

Initially, the court relied on language in I.R.C. § 642(c)(1) providing that trusts are allowed to take a deduction for amounts of gross income donated to charity "without limitation." (Aplt. App. at 338; A-11.) The "without limitation" language, however, has no bearing on the requirement that contributions must be made from gross income to be deductible. In *United States v. Benedict*, the Supreme Court concluded that the only effect of the words "without limitation" in the predecessor statute was to make clear that the percentage limits capping charitable deductions by individuals and corporations are inapplicable to estates and trusts. 338 U.S. at 697 n.8. *Accord, Commissioner v. Central Hanover Bank & Trust Co.*, 163 F.2d 208, 211 (2d Cir. 1947).

Next, the court took the position that *Old Colony Trust Co. v. Commissioner*, 301 U.S. 379 (1937), and *Commissioner v. F.G. Bonfils Trust*, 115 F.2d 788 (10th Cir. 1940), required it to construe any ambiguity in I.R.C. § 642(c)(1) to encourage, rather than hinder, charitable giving. (Aplt. App. at 337 n.11; A-10.) But the court agreed with the parties "that the [statutory] language in question is clear" and unambiguous. (Aplt. App. at 337 n.8; A-10.) As a result, there was no reason to go beyond the plain text in construing I.R.C. § 642(c)(1). Even if it were "entirely certain" that a particular construction "would more effectively achieve the purposes" of the statute being construed, a court should "not feel free to pursue that objective at the expense of a textual interpretation as unnatural as we have described." *See Pavelic & LeFlore*, 493 U.S. at 126.

In any event, in *Old Colony Trust*, the Supreme Court held only that the purpose of I.R.C. § 642(c)(1)'s predecessor was "to encourage donations *out of gross income*," not donations more broadly. 301 U.S. at 384 (emphasis added). This holding does not support the District Court's decision to permit charitable deductions for amounts not included in gross income.

In *Bonfils Trust*, this Court considered whether funds were permanently set aside for charity pursuant to the terms of a trust's governing instrument.[8] 115 F.2d at 790-93. There, "the evidence established beyond a reasonable doubt" that, pursuant to the terms of the governing instrument, the funds at issue would be used for charitable purposes. *Id.* at 793. This Court accordingly held that it would be improper to deny a charitable deduction based on the theoretical, but remote, possibility that the funds might be used for another purpose. *Id.* That situation, however, is readily distinguishable from the case at bar, where the unrealized appreciation did not, as a matter of law, fall within the definition of gross income and was not, as a matter of fact, reported as income.

In assigning a broad construction to I.R.C. § 642(c)(1), the District Court compounded its error by ignoring the longstanding rule that the Internal Revenue Code "should not be interpreted to allow [a taxpayer] the practical equivalent of a double deduction . . . absent a clear

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[8] In addition to amounts of gross income paid to charity, estates and trusts created prior to October 9, 1969, can claim a charitable deduction for amounts of gross income permanently set aside for charity. I.R.C. § 642(c)(2).

declaration of intent by Congress." *United States v. Skelly Oil Co.*, 394 U.S. 678, 684 (1969) (citing *Charles Ilfeld Co. v. Hernandez*, 292 U.S. 62, 68 (1934)) (internal quotations omitted). By virtue of the District Court's opinion, the Trust will not only avoid paying tax on approximately $18.3 million of unrealized gain, but it will also be able to use that same untaxed gain to claim a charitable deduction and shield millions of dollars of additional income from tax. This is precisely the type of double tax advantage that courts should be loath to infer. *Skelly Oil*, 394 U.S. at 684; *see also W.K. Frank Trust of 1931 v. Commissioner*, P-H T.C. Memo. ¶ 43,516, 1943 WL 9336 (Tax Ct. 1943) (recognizing that, for a trust to claim a deduction for amounts of appreciation donated to charity, it needed to sell or exchange the appreciated property, realize the gain as gross income, and report the gain on its return), *aff'd*, 145 F.2d 411 (3d Cir. 1944).[9]

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[9] As evidenced by the discussion in section A, *supra*, individuals – as opposed to estates and trusts – can in fact reap this double tax advantage in certain circumstances. This difference in treatment, however, stems directly from the different statutory language applicable to charitable deductions by individuals (governed by I.R.C. § 170), as opposed to trusts and estates (governed by I.R.C. § 642(c)).

2. The District Court erred in misapplying a gloss as a substitute for applying the words of the statute

The District Court cited *Crestar Bank* for the well settled requirement that donated property must be sourced from, and traceable to, a trust's gross income to qualify for a deduction under I.R.C. § 642(c)(1). (Aplt. App. at 340; A-13.) The court concluded that because the Trust used gross income to purchase the three real properties at issue, the unrealized appreciation in the properties was, broadly speaking, sourced from and traceable to the Trust's gross income. (Aplt. App. at 340-41, 343; A-13 to A-14, A-16) ("each of the Donated Properties *derives from* the Trust's gross income") (emphasis added). Finally, it held that the Trust was allowed to claim a deduction for the unrealized appreciation even though such appreciation was not an amount included in the Trust's gross income. (Aplt. App. at 343-44; A-16 to A-17.)

The court's analysis was flawed. Neither *Crestar Bank*, nor any other decision addressing the sourced-from-and-traceable-to requirement, overrode – or could override – the clear statutory proscription against trusts and estates claiming charitable deductions

over and above amounts included in gross income. To the contrary, those decisions have been used to enforce that proscription by requiring that each dollar of a charitable deduction correspond to a dollar of gross income.

In *Crestar Bank*, an estate donated to charity approximately $1 million of stock that was part of the estate's corpus, not its gross income. 47 F. Supp. 2d at 671. Citing *Old Colony Trust*, the estate nonetheless argued that it could claim a deduction for the donation because it had earned and reported gross income in excess of $1 million. *Id.* at 671-72. In other words, the estate argued that its gross income and corpus assets were fungible, and that there was no need for it to trace the donation to gross income, so long as it had earned sufficient gross income that it could have made the donation out of its gross income. *Id.* The court in *Crestar Bank* rejected this argument and held that I.R.C. § 642(c) requires charitable contributions to be sourced from and traceable to an estate or trust's gross income. *Id.* at 677 ("The Estate's reading of *Old Colony Trust Co*. . . . in effect, would destroy the tracing requirement of Section 642(c).").

The decision in *Crestar Bank* is consistent with a uniform line of authority providing that, to claim a deduction under I.R.C. § 642(c), estates and trusts must trace their charitable contributions to amounts of gross income:

> As Section 642(c) provides, a charitable deduction is available only if the source of the distribution is gross income. Tracing of charitable distributions is still required under Section 642(c), and to the extent that a charitable distribution is not paid out of gross income in accordance with the requirements of Section 642(c), then we think that Congress intended that no deduction is allowable.

Mott v. United States, 462 F.2d 512, 518-19 (Ct. Cl. 1972). *Accord, Van Buren v. Commissioner*, 89 T.C. 1101, 1109 (1987) (citing *Riggs Nat'l Bank v. United States*, 352 F.2d 812, 814 (Ct. Cl. 1965)) ("Tracing is required since [§ 642] specifically requires that the source of the contribution be gross income."); *see also* 9 Mertens, *The Law of Federal Income Taxation* § 36.84; Rev. Rul. 2003-123, 2003-2 C.B. 1200, 1200-01 ("Because § 642(c) specifically requires that a charitable deduction is available only if the source of the contribution is gross income, tracing of the contribution is required in determining its source.").[10] The

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[10] It is not necessary, however, for a trust to prove the contributions of cash to charity arise from gross income that was

preceding authority shows that the sourced-from-and-traceable-to requirement is intended to prevent taxpayers from claiming a deduction for any portion of a donation not reported as gross income. *See, e.g.*, *Crestar Bank*, 47 F. Supp. 2d at 677 (denying deduction for donation traceable to corpus rather than gross income); *Mott*, 462 F.2d at 518 (same).

Decisions of the Supreme Court and other Circuits similarly confirm that the touchstone for deductibility under I.R.C. § 642(c)(1) is inclusion in gross income, and that the requirement that the donation be sourced from, and traceable to, gross income enforces, rather than supplants, that test. In *W.K. Frank Trust,* a trust donated appreciated shares of stock that were part of its corpus. 145 F.2d at 412. The Third Circuit held that no deduction was allowable for the donation: the original value of the shares was part of the trust corpus, not gross

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realized during the same year in which it was contributed to charity. *Old Colony Trust*, 301 U.S. at 384; Treas. Reg. § 1.642(c)-1(a)(1). Instead, a payment of cash is still considered to have its source in the gross income of a trust even if the gross income was earned in prior taxable years.

income, and the shares' unrealized appreciation in value was likewise not gross income.[11] *Id.* at 413.

In *United States v. Benedict,* the trust realized approximately $60,000 of capital gain, but under the law in effect at the time, 50 percent of that gain was excluded from its gross income. 338 U.S. at 694. The trust donated approximately $30,000 of the $60,000 to charity and sought to deduct that entire amount, reasoning that the entire approximately $60,000 was includable in gross income. *Id.* at 694-95. The Supreme Court held that only approximately $15,000 was deductible. *Id.* at 697-99. Citing *Frank Trust*, the Supreme Court explained 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." *Id.* at 698-99

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[11] The Trust argued below that the unrealized appreciation in the shares of stocks donated by the Frank Trust was not deductible because the appreciation was traceable to corpus, not because the trust was not required to (and did not) report the unrealized appreciation as income. (Aplt. App. at 289, 325.) But in a Tax Court case underlying the Third Circuit's decision, the Tax Court recognized that it was "entirely clear" that the Frank Trust would have been entitled to a charitable deduction for the amount of appreciation had it sold the shares, realized the gain as income, reported the income on its return, and donated to charity the portion of the sale proceeds attributable to appreciation. *Frank Trust*, 1943 WL 9336.

n.10-11. The Supreme Court also cited favorably the Second Circuit's decision in *Central Hanover Bank*, 163 F.2d at 210, which had adopted the same approach. *Id.* at 695, 698-99 n.11.

Indeed, the District Court's interpretation of I.R.C. § 642(c)(1) largely writes the limiting language – "amount of the gross income" – out of the statute. In ordinary usage, the most natural meaning of "amount of the gross income" is the amount of gross income earned and reported by the taxpayer, not something that can merely be traced back to that amount. *See Commissioner v. Soliman*, 506 U.S. 168, 174 (1993) (words used in taxing statutes should be considered according to their "ordinary, everyday senses") (citations and internal quotations omitted).

While the Government continues to maintain that this Court should not look beyond the plain and unambiguous text of I.R.C. § 642(c)(1), doing so actually would provide further support for its position. Throughout the Internal Revenue Code, the language "amount of gross income" consistently refers to the amount of gross income earned and reported. *E.g.*, I.R.C. §§ 1244(c) (rendering inapplicable certain limitations on small business stock losses where the amount of deductions exceeds the "amount of gross income"),

5000A(c)(2)(B), (e)(2) (explaining that individuals whose "amount of gross income" falls below a certain level are not subject to a penalty for failing to maintain health insurance coverage), 6248(c)(2) (extending the statute of limitations for the IRS to assess additional taxes when a taxpayer files a return that understates the "amount of gross income" by more than 25 percent), 6501(e)(1)(A)(i) (referring to the "amount of gross income" stated on a return). It logically follows that, under I.R.C. § 642(c)(1), the amount of a taxpayer's charitable deduction is limited to the "amount of the gross income" that the taxpayer received, reported and donated.

The legislative history and regulations accompanying I.R.C. § 642(c)(1) reinforce this interpretation. The predecessor to I.R.C. § 642(c)(1) allowed estates and trusts to claim a deduction for "any part of the gross income" donated to charity. *See Leon A. Beeghly Fund v. Commissioner*, 35 T.C. 490, 524 (1960) (quoting the prior statute). In 1954, Congress changed that language to "any amount of the gross income," and that language still exists today. *See* S. Rep. 83-1622, at 4982 (June 18, 1954), *reprinted in* 1954 U.S.C.C.A.N. 4621, 4982 (1954). In both the House and Senate Reports to the 1954 amendment,

Congress explained that, if a trust or estate made a charitable donation that included both amounts of gross income and other amounts, then the trust or estate's charitable deduction would be limited to the amounts that had actually entered into its gross income:

> If the estate or trust pays, permanently sets aside, or uses any amount of its income for the purposes specified in this subsection and such amount includes any items of trust income not entering into the gross income of the estate or trust, the deduction under this subsection is limited to the gross income so paid, permanently set aside or used.

Id. at 4982-83; H. Rep. 83-1337, at 4333 (Mar. 9, 1954), *reprinted in* 1954 U.S.C.C.A.N. 4025, 4333 (1954) (same). The Treasury Department has since promulgated essentially the same guidance as a regulation:

> If an estate, pooled income fund, or other trust pays, permanently sets aside, or uses any amount of its income for a purpose specified in section 642(c)(1), (2), or (3) and that amount includes any items of estate or trust income not entering into the gross income of the estate or trust, the deduction allowable under § 1.642(c)-1 or § 1.642(c)-2 is limited to the gross income so paid, permanently set aside, or used.

Treas. Reg. § 1.642(c)-3(b)(1).

The guidance from Congress and Treasury closely tracks the situation here, where the Trust donated real properties worth approximately $29 million, but reported only approximately $10.7 million of that amount as gross income. The Trust is therefore entitled

to deduct only the amount so reported, *i.e.*, the "amount of the gross income" paid to charity. *See* I.R.C. § 642(c)(1).

3. The District Court erred by importing into I.R.C. § 642(c) provisions of I.R.C. § 170 that Congress omitted

The District Court observed that I.R.C. § 642(c) incorporates certain provisions of I.R.C. § 170 by reference and that the two statutes serve a similar purpose. (Aplt. App. at 336-38; A-9 to A-11.) The court then found that it was required to construe the two statutes *in pari materia* unless expressly contradictory. (Aplt. App. at 337-38 n.12; A-10 to A-11.) Because I.R.C. § 170 sometimes allows individuals to claim a deduction for the fair market value of donated property, and "the fair market value standard is as close to a generalized valuation standard as there is in the tax code," the court held that the Trust was entitled to deduct the fair market value of the donated properties, including both the properties' adjusted basis (which was included in the Trust's gross income) and their unrealized appreciation (which was not). (Aplt. App. at 343-44; A-16 to A-17.) This analysis misses the mark.

Initially, it bears repeating that the statutory language at issue is clear and unambiguous. It was therefore an error to resort to I.R.C.

§ 170. *See United States v. Fisher,* 456 F.2d 1143, 1145 (10th Cir. 1972) (citing *Greenport Basin & Construction Co. v. United States*, 260 U.S. 512 (1923)) (district court erred in using *in pari materia* to construe clear and unambiguous language); 2B Sutherland Statutory Construction, § 51:1 (7th ed. Nov. 2016 Update). Moreover, I.R.C. § 642(c)(1) provides that estates and trusts are entitled to a charitable deduction thereunder "*in lieu of* the deduction allowed by section 170(a)." (Emphasis added); *W.K. Frank Trust*, 145 F.2d at 413. The District Court's opinion disregards this clear directive to apply I.R.C. § 642(c) to the exclusion of I.R.C. § 170, unless otherwise provided.

In addition, the text of I.R.C. § 642 reflects a series of deliberate decisions about which provisions of I.R.C. § 170 to incorporate. Following the initial reference to I.R.C. § 170(a) discussed above, I.R.C. § 642(c)(1) provides that a donation does not qualify for a charitable deduction unless it is "paid for a purpose specified in section 170(c) (determined without regard to section 170(c)(2)(A))." Other provisions of I.R.C. § 642 likewise incorporate specific sections of 170. *See* I.R.C. § 642(c)(2)(A)(i) (incorporating I.R.C. § 170(c)), (c)(2)(B)(iii) (hanging paragraph) (same), (c)(3) (same), (c)(5)(A) (incorporating I.R.C.

§ 170(b)(1)(A)). But nowhere does I.R.C. § 642 incorporate I.R.C. § 170's provisions regarding valuation, which sometimes allow individuals and corporations to take a deduction for the fair market value of donated property. *See* I.R.C. § 170(e)(1), (3); Treas. Reg. § 1.170A-1(c)(1). Because Congress expressly incorporated several provisions of I.R.C. § 170 into I.R.C. § 642(c), but omitted the provisions regarding valuation, it should be inferred that the omission was intentional. *See Elwell v. Okla. ex rel. Bd. of Regents of Univ. of Okla.*, 693 F.3d 1303, 1312 (10th Cir. 2012) (explaining the doctrine of *expressio unius est exclusio alterius*).

Further, after electing not to incorporate I.R.C. § 170's valuation provisions by reference, Congress chose to draft I.R.C. § 642(c) in terms that diverge sharply from I.R.C. § 170. *Compare* I.R.C. § 170(a), (b)(1)-(2) (allowing deductions for "any charitable contribution" paid, limited to a certain percentage of the taxpayer's income) *with* I.R.C. 642(c)(1) (allowing deductions for "any amount of the gross income, without limitation," paid to charity). Neither the court below nor the Trust has explained why Congress used such different language if it meant to accomplish the same result.

Finally, the court's observations that I.R.C. § 642(c) does not provide a valuation standard, and that the Internal Revenue Code frequently uses a fair market value standard in other contexts, are irrelevant. (*See* Aplt. App. at 343-44; A-16 to A-17.) In I.R.C. § 642(c)(1), Congress obviated any need to resort to valuation methodologies by fixing the amount of the deduction at the amount of gross income donated.

4. The trust instrument demonstrates that the District Court erred

The fallacy in the District Court's reasoning is further illustrated by the terms of the trust instrument, which track I.R.C. § 642(c)(1) in authorizing deductions only from gross income. As explained below, a limitation contained in the instrument itself presents an independent basis for denying the Trust a deduction for unrealized appreciation.

To qualify as charitable deductions, donations by estates or trusts must be authorized by their respective instruments. I.R.C. § 642(c)(1) (allowing deductions for amounts of gross income paid "pursuant to the terms of the governing instrument"). Absent such authorization, no deduction is allowed. *See Rebecca K. Crown Income Charitable Fund v. Commissioner*, 98 T.C. 327, 337 (1992), *aff'd*, 8 F.3d 571, 576-77 (7th

Cir. 1993); *John Allan Love Charitable Found. v. United States*, 710 F.2d 1316, 1320 (8th Cir. 1983); *Ernest and Mary Hayward Weir Found. v. United States*, 508 F.2d 894, 895 (2d Cir. 1974).

Here, the trust instrument authorized the Trustee to "distribute to charity such amounts from gross income of the Trust as the Trustee determines appropriate . . ."[12] (Aplt. App. at 20.) The Trust contained no provision directing the Trustee to distribute amounts other than gross income. Because unrealized appreciation is not gross income, *see* section B, *supra*, the Trust's donation of unrealized appreciation could not have been made "pursuant to the terms of the governing instrument." *See* I.R.C. § 642(c)(1). Consequently, no deduction is allowable therefor.

The District Court nevertheless held that the Trust's donation of unrealized appreciation to charity was made "pursuant to the terms of the governing instrument" because the trust instrument authorized the

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[12] The Trust has conceded that the trust instrument used the term "gross income" according to its well established meaning in the federal tax context. (Aplt. App. at 283-86.) In any event, state law parallels federal law in holding that "an increase in the value of a trust asset which has not been realized by a sale at a profit does not constitute income of the trust." George Gleason Bogert, *The Law of Trusts and Trustees*, § 822 at 440-41 & n.49 (Rev. 2d ed. 1981).

trustee to make some charitable contributions, albeit of a different kind. (Aplt. App. at 341-42; A-14 to A-15.) This holding cannot be reconciled with either the text of section 642(c)(1) or case law interpreting it. The Supreme Court has held that "pursuant to," as used in the predecessor to I.R.C. § 642(c)(1), should be construed according to its usual sense, meaning "acting or done in consequence or in prosecution (of anything); hence, agreeable; conformable; following; according." *Old Colony Trust,* 301 U.S. at 381, 383 n.3 (internal quotations omitted). In ordinary usage, the most natural meaning of distributing an amount to charity "pursuant to the terms of the governing instrument" is making the kind of charitable donation contemplated by the instrument, not some other kind. *See also U.S. Trust Co. v. I.R.S.,* 803 F.2d 1363, 1367 (5th Cir. 1986); *Crestar Bank*, 47 F. Supp. 2d at 675-76 (where the governing instrument provided for donations to be made from corpus, the estate could not claim a charitable deduction for donations made from another source).[13]

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[13] The Eighth Circuit's decision in *John Allan Love*, 710 F.2d at 1320-21, is not inapposite. There, the court held that charitable contributions could not have been made "pursuant to the terms of the governing instrument" when that instrument did not authorize the

D. The Trust's reliance on a subsequently enacted, since-repealed statutory provision is misplaced

The Government anticipates that the Trust will defend this appeal by repeating an argument it made below, but that the District Court did not address: that Congress's intent in enacting I.R.C. § 642(c)(1) should be construed in light of the text of I.R.C. § 57(a)(6) as in effect from 1988 until it was repealed in 1993. (Aplt. App. at 291-96, 322-24.) This argument lacks merit.

By way of background, I.R.C. §§ 55 to 59 address the alternative minimum tax, which prevents some high-income taxpayers from using deductions, credits and exclusions in a way that would result in their paying little or no tax. *Merlo v. Commissioner*, 492 F.3d 618, 620 (5th Cir. 2007). In a nutshell, if a high-income taxpayer reports a ratio of tax to income that is too low, then the taxpayer may be required to calculate its tax liability without taking into account certain deductions, credits, and exclusions. *Snap-Drape, Inc. v. Commissioner*, 98 F.3d 194,

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trustee to make any charitable contributions. *Id.* It did not hold that any and all charitable contributions must be considered made "pursuant to the terms of the governing instrument" just because the instrument authorizes one kind of charitable contributions. *Id.*

199 (5th Cir. 1996). The deductions, credits, and exclusions not taken into account are called "tax preferences." *See* I.R.C. § 57.

I.R.C. § 57 sets forth various tax preferences. From 1988 until 1993, I.R.C. § 57(a)(6) provided that one such tax preference was "[t]he amount by which the deduction allowable under section 170 or 642(c) would be reduced if all capital gain property were taken into account at its adjusted basis," *i.e.*, if no charitable deduction were allowed for the property's appreciation in value. The Trust argued below that I.R.C. § 642(c) must permit trusts to claim a deduction for the fair market value of appreciated property, because the tax preference temporarily provided in I.R.C. § 57(a)(6) would otherwise have been rendered "a nullity." (Aplt. App. at 294.)

The Trust is wrong. As a threshold matter, the Government reiterates that the statutory language at issue in I.R.C. § 642(c)(1) is clear and unambiguous, rendering resort to other statutes unnecessary and inappropriate. *See Greenport Basin*, 260 U.S. at 516.

But even assuming, *arguendo*, that resort to other statutes were appropriate, it is dubious to suggest that section 642(c)(1) – which has been on the books in one form or another since 1918, and stands word-

for-word unchanged since 1976 – should be construed in light of a provision that was not enacted until 1988. The Supreme Court has cautioned that "'the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one.'" *South Dakota v. Yankton Sioux Tribe*, 522 U.S. 329, 355 (1998) (quoting *United States v. Philadelphia Nat. Bank,* 374 U.S. 321, 348-49 (1963)). Resorting to this version of I.R.C. § 57(a)(6) becomes all the more inappropriate considering that it was repealed in 1993, a mere six years after it was enacted and more than a decade before the tax year at issue. *See First Am. Bank v. Resolution Tr. Corp.*, 30 F.3d 644, 648 (5th Cir. 1994) (declining to resort to the legislative history of a repealed statute to interpret a statute that was still in effect).

Finally, the Trust is simply incorrect in contending that the Government's interpretation of I.R.C. § 642(c)(1) would have rendered the now-defunct tax preference a nullity. For example, if trusts and estates contribute appreciated property to charity, and the contribution satisfies an obligation to make a donation in a specific dollar amount, then they (unlike the trust here) are required to recognize the appreciation as gain and report the gain as income on their returns.

See Rev. Rul. 83-75 (1983) (citing Treas. Reg. § 1.661(a)-2(f)(1)).[14] From 1988 to 1993, the tax preference in I.R.C. § 57(a)(6) required trusts and estates that made such contributions, and were subject to the alternative minimum tax, to calculate their charitable deductions based solely on the donated property's adjusted basis without regard to amounts of realized appreciation. Absent this tax preference, these trusts and estates would have been entitled to an additional deduction equal to the amounts of realized appreciation. *See* I.R.C. § 57(a)(6) (1988-1993).

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[14] To be sure, a report accompanying the enactment of the 1988 amendment suggests that the tax preference was not intended to apply in the situation described in Revenue Ruling 83-75. *See* S. Rep. 100-445, at 96 (Aug. 3, 1988), *reprinted in* 1988 U.S.C.C.A.N. 4515, 4614 (1988). But legislative history cannot override the plain text of the statute itself, which leaves no doubt that the tax preference would have applied in precisely that situation.

CONCLUSION

The judgment of the District Court should be reversed, and the case remanded with instructions for judgment to be entered in favor of the United States.

STATEMENT REGARDING ORAL ARGUMENT

Counsel for the United States respectfully inform the Court that this case involves important issues of tax administration and statutory interpretation that oral argument would help to resolve.

Respectfully submitted,

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STATUTORY ADDENDUM

26 U.S.C. § 642(c):

(c) DEDUCTION FOR AMOUNTS PAID OR PERMANENTLY SET ASIDE FOR A CHARITABLE PURPOSE

(1) GENERAL RULE

In the case of an estate or trust (other than a trust meeting the specifications of subpart B), there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by section 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in section 170(c) (determined without regard to section 170(c)(2)(A)). If a charitable contribution is paid after the close of such taxable year and on or before the last day of the year following the close of such taxable year, then the trustee or administrator may elect to treat such contribution as paid during such taxable year. The election shall be made at such time and in such manner as the Secretary prescribes by regulations.

(2) AMOUNTS PERMANENTLY SET ASIDE

In the case of an estate, and in the case of a trust (other than a trust meeting the specifications of subpart B) required by the terms of its governing instrument to set aside amounts which was—

(A) created on or before October 9, 1969, if—

(i) an irrevocable remainder interest is transferred to or for the use of an organization described in section 170(c), or

(ii) the grantor is at all times after October 9, 1969, under a mental disability to change the terms of the trust; or

(B) established by a will executed on or before October 9, 1969, if—

(i) the testator dies before October 9, 1972, without having republished the will after October 9, 1969, by codicil or otherwise,

(ii) the testator at no time after October 9, 1969, had the right to change the portions of the will which pertain to the trust, or

(iii) the will is not republished by codicil or otherwise before October 9, 1972, and the testator is on such date and at all times thereafter under a mental disability to republish the will by codicil or otherwise,

there shall also be allowed as a deduction in computing its taxable income any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, permanently set aside for a purpose specified in section 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or operation of a public cemetery not operated for profit. In the case of a trust, the preceding sentence shall apply only to gross income earned with respect to amounts transferred to the trust before October 9, 1969, or transferred under a will to which subparagraph (B) applies.

ATTACHMENTS

Order (Nov. 4, 2015); Doc. No. 48 ....A-1

Judgment (Nov. 4, 2016); Doc. No. 97 ....A-19

**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA**

MART D. GREEN, Trustee of the David and Barbara Green 1993 Dynasty Trust,	)	
Plaintiff,	)	
vs.	)	Case No. CIV-13-1237-D
UNITED STATES OF AMERICA,	)	
Defendant.	)	

O R D E R

This is a tax refund action arising from the internal revenue laws of the United States. Before the Court are the parties' cross-motions for summary judgment [Doc. Nos. 37, Plaintiff, and 38, Defendant]. Defendant has responded to Plaintiff's motion [Doc. No. 42], and Plaintiff has responded to Defendant's motion [Doc. No. 43]; Plaintiff has filed a Reply in support of his motion [Doc. No. 47]. The motions are fully briefed and ready for determination. This Order primarily addresses Plaintiff's Motion for Partial Summary Judgment.[1]

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[1] The issues in the motions substantially overlap. However, in addition to the issues addressed in this Order, Defendant's Motion requests summary judgment regarding $4.7 million in cash contributions made by Hobby Lobby Stores, Inc., as well as Plaintiff's overall entitlement or lack thereof to a tax refund exceeding the $20 million it has already received. These issues will be addressed in a subsequent order.

Statement of Undisputed Facts

The Trust and GDT

On December 7, 1993, David M. Green, Barbara A. Green, and Mart D. Green signed a Trust Agreement creating The David and Barbara Green 1993 Dynasty Trust (the "Trust"). *See* Complaint [Doc. No. 1-1]. David and Barbara Green are the settlors of the Trust, and Mart D. Green is the trustee ("Plaintiff"). The Trust expressly authorizes Plaintiff to "distribute to charity such amounts from the gross income of the Trust as the [Plaintiff] determines appropriate" [Doc. No. 1-1, § 2.2]. The Trust also provides that "[a] distribution may be made from the Trust to charity only when both the purpose of the distribution and the charity are as described in Section 170(c) of the Code" [Doc. No. 1-1, § 1.6].[2]

The Trust wholly owns GDT CG1, LLC ("GDT"), a single-member limited liability company. GDT is disregarded as an entity separate from the Trust for federal income tax purposes.[3]

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[2] "Charitable contribution," as defined by 26 U.S.C. § 170(c), includes "a contribution or gift to or for the use of ... [a] corporation, trust, or community chest, fund, or foundation ... organized and operated exclusively for religious [or] charitable ... purposes." *Id.* at § 170(c)(2)(B).

[3] Absent a taxpayer election to the contrary, a single-member limited liability company is not regarded as separate from its owner for income tax purposes. *See* 26 C.F.R. § 301.7701-3. As such, the income, deductions, and credits of the disregarded entity are reported and reflected on its owner's income tax return. *Id.*

Hob-Lob Limited Partnership

Between 2002 and 2004, Hob-Lob Limited Partnership ("Hob-Lob") owned or operated many, but not all, Hobby Lobby stores.[4] During this same period, the Trust was a 99% limited partner in Hob-Lob. Consequently, Hob-Lob filed its yearly income tax return (Form 1065, U.S. Return of Partnership Income) with the Internal Revenue Service ("IRS") and, in conjunction with that filing, issued a yearly form known as a Schedule K-1 to all of its partners, including the Trust.[5]

On line 22 of the 2002 Schedule K-1 issued to the Trust, Hob-Lob reported that the Trust received distributions of $38,722,126 during the year ending December 31, 2002. On line 1 of the same document, Hob-Lob reported that the Trust's distributive share[6] of ordinary business income totaled $72,465,646 for that same year. The Trust reported such amount on its 2002 income tax return.

On line 22 of the 2003 Schedule K-1 issued to the Trust, Hob-Lob reported that the Trust received distributions of $41,076,436 during the year ending December 31, 2003. On line 1 of the same document, Hob-Lob reported that the Trust's distributive share of ordinary

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[4] Hobby Lobby stores sell craft supplies throughout the United States.

[5] Among other things, a Schedule K-1 identifies each partner's share of income, deductions, and credits that flow through the partnership to the partner, as well as any distributions from the partnership to the partner for the particular year.

[6] "Distributive share" refers to the allocation of income, gain, loss, deduction, and credit from a partnership business to a partner. *See* 26 U.S.C. § 702.

business income totaled $68,303,318 for that same year. The Trust reported such amount on its 2003 income tax return.

On line 19 of the 2004 Schedule K-1 issued to the Trust, Hob-Lob reported that the Trust received distributions of $29,480,397 during the year ending December 31, 2004. On line 1 of the same document, Hob-Lob reported that the Trust's distributive share of ordinary business income totaled $60,543,215 for that same year. The Trust reported such amount on its 2004 income tax return.

Virginia Property

On February 19, 2003, GDT purchased approximately 109 acres of land and two industrial buildings in Lynchburg, Virginia from Ericsson, Inc. for $10.3 million. GDT obtained the money to purchase the property through a distribution from Hob-Lob to the Trust. For purposes of the summary judgment motions only, the parties stipulate that this distribution was part of the distributive share of ordinary business income from Hob-Lob to the Trust in 2003.

On March 19, 2004, GDT donated a significant portion of the property to the National Christian Foundation Real Property, Inc. ("NCF"). The donation consisted of the two industrial buildings and approximately 73 acres of land (the "Virginia Property"). At that time, NCF was an organization described in 26 U.S.C. § 170(b)(1)(A). The Trust reported on Form 8283, Noncash Charitable Contributions, attached to its 2004 income tax return, that as of March 19, 2004, its adjusted basis in the Virginia Property was $10,368,113.

Although a factual dispute exists between the parties regarding the fair market value of the Virginia Property on the date of donation, for purposes of the summary judgment motions only, both parties stipulate that the Virginia Property had a fair market value in excess of $10,368,113 on March 19, 2004.

Oklahoma Property

In August 2002, GDT purchased a church building and several outbuildings in Ardmore, Oklahoma (the "Oklahoma Property") from Trinity Baptist Church for $150,000. GDT obtained the $150,000 necessary for the purchase through a distribution from Hob-Lob to the Trust. For purposes of the summary judgment motions only, the parties stipulate that this distribution was part of the distributive share of ordinary business income from Hob-Lob to the Trust in 2002.

On October 5, 2004, GDT donated the Oklahoma Property to the Southwest Oklahoma District Church of the Nazarene ("SWODCN"). At that time, SWODCN was an organization described in 26 U.S.C. § 170(b)(1)(A). The Trust reported on Form 8283, Noncash Charitable Contributions, attached to its 2004 income tax return, that as of October 5, 2004, its adjusted basis in the Oklahoma Property was $160,477. The fair market value of the Oklahoma Property was $355,000 on said date.

Texas Property

In June 2003, GDT purchased approximately 3.8 acres of land in Dickinson, Texas (the "Texas Property") from Marina Bay Development Corp., Inc./Travis Moss for $145,000.

GDT obtained the $145,000 necessary for the purchase through a distribution from Hob-Lob to the Trust. For purposes of the summary judgment motions only, the parties stipulate that this distribution was part of the distributive share of ordinary business income from Hob-Lob to the Trust in 2003.

On October 5, 2004, GDT donated the Texas Property to the Lighthouse Baptist Church ("LBC"). At that time, LBC was an organization described in 26 U.S.C. § 170(b)(1)(A). The Trust reported on Form 8283, Noncash Charitable Contributions, attached to its 2004 income tax return, that as of October 5, 2004, its adjusted basis in the Texas Property was $145,180. The fair market value of the Texas Property was $150,000 on said date.

Amended Return

On or about October 15, 2005, Plaintiff timely filed the Trust's Form 1041 income tax return for tax year 2004 with the IRS, claiming a charitable deduction totaling $20,526,383. On October 15, 2008, Plaintiff timely filed an amended Form 1041 (the "Amended Return") on behalf of the Trust, increasing the Trust's reported charitable deduction to $29,654,233 and claiming a tax refund of $3,194,748. On December 8, 2011, the IRS sent Plaintiff a Notice of Disallowance of the refund claim stating "[t]he charitable contribution deduction for the real property donated in 2004 is limited to the basis of the real property contributed" [Doc. No. 1-3].

Standard of Decision

Summary judgment is appropriate "if the movant shows that there is no genuine dispute as to any material fact and that the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). A material fact is one that "might affect the outcome of the suit under the governing law." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). A dispute is genuine if the evidence is such that a reasonable jury could return a verdict for either party. *Id.* at 255. If a party who would bear the burden of proof at trial lacks sufficient evidence on an essential element of a claim, all other factual issues concerning the claim become immaterial. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986).

The movant bears the burden of demonstrating the absence of a dispute of material fact warranting summary judgment. *Celotex*, 477 U.S. at 322-23. If the movant carries this burden, the nonmovant must then go beyond the pleadings and "set forth specific facts" that would be admissible in evidence and that show a genuine issue for trial. *See Anderson*, 477 U.S. at 248; *Celotex*, 477 U.S. at 324; *Adler v. Wal-Mart Stores, Inc.*, 144 F.3d 664, 671 (10th Cir. 1998). "To accomplish this, the facts must be identified by reference to affidavits, deposition transcripts, or specific exhibits incorporated therein." *Adler*, 144 F.3d at 671; *see also* Fed. R. Civ. P. 56(c)(1)(A). "The court need consider only the cited materials, but may consider other materials in the record." Fed. R. Civ. P. 56(c)(3). The Court's inquiry is whether the facts and evidence identified by the parties present "a sufficient disagreement

to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Anderson*, 477 U.S. at 251-52.

Matters of statutory interpretation present questions of law "appropriate for resolution on summary judgment." *Thomas v. Metro. Life Ins. Co.*, 631 F.3d 1153, 1160 (10th Cir. 2011) (citation omitted). When interpreting statutory language, the Court's duty is to determine congressional intent by beginning with the "plain language of the law." *St. Charles Inv. Co. v. Comm'r*, 232 F.3d 773, 776 (10th Cir. 2000). Traditional canons of statutory interpretation guide "judges [in] determin[ing] the Legislature's intent as embodied in particular statutory language." *Chickasaw Nation v. United States*, 534 U.S. 84, 94 (2001). However, such guides "need not be conclusive and are often countered ... by some maxim pointing in a different direction." *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 115 (2001). Therefore, the Court must analyze the statute as a whole and look to the "disputed language in context, not in isolation," when ascertaining congressional intent from statutory text. *True Oil Co. v. Comm'r*, 170 F.3d 1294, 1299 (10th Cir. 1999) (internal quotations omitted).

Analysis

Plaintiff's Motion presents the following issue: "whether a charitable deduction under 26 U.S.C. § 642(c)(1) for donated real property purchased out of gross income should be

calculated based on the property's fair market value or the [T]rust's adjusted basis[7] in the property." *See* Plaintiff's Motion [Doc. No. 37] at 1. Plaintiff contends the fair market value standard should apply to the charitable deduction because Congress did not specify a different valuation standard in 26 U.S.C. § 642(c)(1). Defendant argues (1) that 26 U.S.C. § 642(c)(1) limits a trust's deduction to the amount of gross income it contributed to charity; (2) gross income does not include unrealized appreciation; and (3) a liberal construction of the statute allowing fair market valuation would negate the gross income derivative requirement.

Construction of § 642(c)(1)

The Court begins its analysis with the language of 26 U.S.C. § 642(c)(1), which, in pertinent part, provides:

> [T]here shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by section 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in section 170(c) (determined without regard to section 170(c)(2)(A)). If a charitable contribution is paid after the close of such taxable year and on or before the last day of the year following the close of such taxable year, then the trustee or administrator may elect to treat such contribution as paid during such taxable year. The election shall be made at such time and in such manner as the Secretary prescribes by regulation.

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[7] Adjusted basis is "cost, less certain property-related expenditures, depreciation, and other statutory decreases." *See* Defendant's Motion for Summary Judgment [Doc. No. 38] at 4, n.1 (citing 26 U.S.C. §§ 1011, 1012(a), and 1016).

Id.[8] As indicated in the statute, to properly understand the meaning of § 642(c)(1) requires one to look to 26 U.S.C. § 170, which pertains to charitable deductions by individuals and corporations. Among other things, § 170 defines and categorizes qualifying charities and, based upon the particular charity, limits the amount of a taxpayer's adjusted gross income which can be deducted in a single year.[9] *See* 26 U.S.C. § 170(b). It also distinguishes between charitable contributions of cash and property other than money, and values the latter at the fair market value at the time of contribution. *See* 26 U.S.C. § 170(f)(8)(B)(1); *see also* 26 C.F.R. § 1.170A-1(c)(1).[10] The policy behind § 170 is to "encourag[e] charitable activities." Michael P. Rose and John C. Chommie, *Federal Income Taxation* § 11.18, at 664 (3d ed. 1988). The statute at issue, 26 U.S.C. § 642(c)(1), has a similar purpose,[11] and must

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[8] Neither party contends that the language of § 642(c)(1) is ambiguous, but each advances different applications on the instant facts. The Court agrees that the language in question is clear and capable of interpretation without resort to extraneous sources.

[9] Any excess deduction not allowed under the limitation can be carried forward for five years. *See* 26 U.S.C. § 170(b)(1)(B)(ii).

[10] "If a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in section 170(e)(1) and paragraph (a) of § 1.170A – 4, or section 170(e)(3) and paragraph (c) of § 1.170 – 4A." 26 C.F.R. § 1.170A – 1.

[11] In *Old Colony Tr. Co. v. Comm'r*, 301 U.S. 379 (1937), the Court stressed the importance of construing § 162(a) of the 1928 Revenue Act – 26 U.S.C. § 642(c)'s precursor – congruent with Congress's intent to "encourage[] ... donations by trust estates." *Id.* at 384. The Tenth Circuit echoed such sentiment in *Comm'r v. F.G. Bonfils Tr.*, 115 F.2d 788 (10th Cir. 1940), holding "[t]he purpose of Congress in enacting [this section] was to encourage charitable gifts ... [and similar] provisions have been judicially construed so as to further and not hinder their beneficent purpose." *Id.* at 791 (citations omitted).

be read in light of the basic definitions and principles set forth in § 170, except where expressly contradictory. *See Erlenbaugh v. United States*, 409 U.S. 239, 243 (1972) (discussing the rule of *in pari materia*).[12]

A notable distinction between § 642 and § 170 is the absence of limiting language in § 642, which is present in § 170. Rather than place limiting language in § 642, Congress specified a deduction "without limitation." *See* 26 U.S.C. § 642(c)(1); *see also* Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-in Gains*, 56 TAX L. REV. 1, 24 (2002) (briefly discussing the distinction and acknowledging the unlimited charitable deduction that trusts and estates enjoy with regard to donations made from gross income). Defendant's interpretation, though, seeks to impose limitations where Congress clearly declined to do so. "[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992).

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[12] "The rule of in pari materia – like any canon of statutory construction – is a reflection of practical experience in the interpretation of statutes[; it] ... is but a logical extension of the principle that individual sections of a single statute should be construed together, for it necessarily assumes that whenever Congress passes a new statute, it acts aware of all previous statutes on the same subject." *Erlenbaugh* 409 U.S. at 239 (citing *Allen v. Grand Cent. Aircraft Co.*, 347 U.S. 535, 541 (1954)) (further citations omitted). Thus, 26 U.S.C. §170, and its underlying policy, forms part of the context the Court must consider when determining the intent of Congress as reflected in the plain language of the statutory text at issue here. *See, e.g.*, *True Oil Co.*, 170 F.3d at 1299 (disputed language of a statute must be examined in context, not in isolation; the court looks to the language and design of a statute as a whole).

Despite the absence of any limiting language in § 642(c)(1), Defendant argues for a strained construction, and holds tight to the "familiar rule that an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer." *INDOPCO Inc. v. Comm'r*, 503 U.S. 79, 84 (1992) (quoting *Interstate Transit Lines v. Comm'r*, 319 U.S. 590, 593 (1943) (internal quotations omitted)).

The Sixth Circuit addressed this distinction in *Weingarden v. Comm'r*, 825 F.2d 1027 (6th Cir. 1987), acknowledging that generally statutes imposing a tax are construed liberally, in favor of the taxpayer, while statutes allowing deductions and exemptions are strictly interpreted, being "matters of legislative grace." *Id.* at 1029 (citing *Porter v. Comm'r*, 288 U.S. 436, 442 (1933) and I. R. Mertens, *Law of Federal Income Taxation* §§ 3.05, 3.07 (1986) (internal quotations omitted)). However, and of particular importance here, *Weingarden* went further to distinguish statutes regarding charitable deductions, stating they are not matters of legislative grace, but rather "expression[s] of public policy." *Weingarden*, 825 F.2d at 1029 (citing *Helvering v. Bliss*, 293 U.S. 144, 150-51 (1934) (further citations omitted, internal quotations omitted)). As such,"[p]rovisions regarding charitable deductions should ... be liberally construed in favor of the taxpayer." *Id.* (citing *Hartwick Coll. v. United States*, 801 F.2d 608, 615 (2d Cir. 1986)). Thus, even if the language of the statute were unclear, a liberal construction in favor of the taxpayer would be appropriate.

Gross Income

Other language at issue in 26 U.S.C. § 642(c)(1) is the term "gross income," and whether that term includes properties purchased by the Trust in one year and donated to charities in another ("Donated Properties").[13] The Supreme Court, considering 26 U.S.C. § 642(c)(1)'s predecessor, noted "[t]here are no words limiting [donations] to something actually paid from *the year's* [gross] income. And so to interpret the Act could seriously interfere with [its] beneficent purpose." *Old Colony*, 301 U.S. at 348 (emphasis added). Therefore, the fact that the Donated Properties were given to charities in a year subsequent to their purchase does not disqualify them from being considered as charitable donations derived from gross income.

However, Defendant also contends that for the Donated Properties to qualify as charitable deductions under§ 642(c)(1), they must be "*sourced from*[14] *and traceable to*[15] a trust's gross income." *See* Defendant's Motion [Doc. No. 38] at 13 (citing 26 U.S.C. § 642(c)(1) and *Crestar Bank v. I.R.S.*, 47 F. Supp. 2d 670 (E.D. Va. 1999) (emphasis added)).

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[13] Gross income includes "all income from whatever source derived, including ... gains from dealings in property." 26 U.S.C. § 61(a)(3).

[14] "Sourced" is defined as "a point of origin or procurement." *See* Plaintiff's Response to Defendant's Motion for Summary Judgment [Doc. No. 43] at 1 (citing MERRIAM WEBSTER'S COLLEGIATE DICTIONARY 1123 (10th ed. 1993) (internal quotations omitted)).

[15] "Tracing" is defined as "[t]he process of tracking property's ownership or characteristics from the time of its origin to the present." *See* Plaintiff's Response to Defendant's Motion for Summary Judgment [Doc. No. 43] at 1 (citing BLACK'S LAW DICTIONARY 1629 (9th ed. 2009) (internal quotations omitted)).

The parties agree that the requirements necessary to qualify as a deduction under § 642(c)(1) include that the donation be traceable to gross income. *See infra* note 16. The Court concurs, and finds there is no real question here regarding the type of income used to purchase the Donated Properties. The properties were all purchased with distributions from Hob-Lob to the Trust. Each distribution was part of GDT's gross income for the year in which it was distributed. Therefore, the Donated Properties were purchased with an amount of the Trust's gross income.

Defendant also asserts that Plaintiff is not entitled to the § 642(c)(1) deduction because, when the donations were made, the Donated Properties had become part of the principal of the Trust, and that Plaintiff was not authorized to make charitable donations from principal (i.e., the donations were not "pursuant to the terms of the governing instrument"). Plaintiff counters that Defendant conflates the federal tax concept of "gross income," with state law fiduciary accounting concepts of "income" and "principal." The Court agrees with Plaintiff.

First, it should be noted that Defendant's argument that the donations are not in conformity with the Trust instrument is belied by Defendant's apparent concession that Plaintiff is entitled to a § 642(c)(1) deduction *in some amount* – at most, limited by the adjusted basis in the Donated Properties. *See, e.g.*, Defendant's Opposition to Plaintiff's Motion [Doc. No. 42] at 13 ("It is the United States' position that, at most, the Trust's charitable deduction relating to the Donated ... Properties would be the adjusted basis ....").

Indeed, Defendant devotes the vast majority of its argument not to the notion that the Donated Properties were purchased from a source other than gross income, but to the proposition that the amount of the § 642(c)(1) deduction should be limited to the adjusted basis in the Donated Properties. Nevertheless, the more appropriate focus when considering whether the first requirement[16] of the § 642(c)(1) deduction is met – that the contribution was pursuant to the terms of the trust instrument – is whether the trust instrument authorizes the trustee to make charitable contributions, and here it clearly does. *See* Trust, § 2.2 [Doc. No. 1-1, p. 7 of 55 (ECF numbering)]; *see also John Allan Love Charitable Found. v. United States*, 710 F.2d 1316, 1319 (8th Cir. 1983) ("The statutorily mandated test is whether the charitable contributions were made 'pursuant to the terms of the governing instrument.' We believe an essential element of this test is that the trust instrument authorize the trustee to make charitable contributions."). Defendant's conflating of fiduciary accounting principles with the federal tax concept of gross income unnecessarily muddies the water – here, there can be no serious question that the donations were made "pursuant to the terms of the governing instrument."[17]

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[16] The parties agree that to qualify for a § 642(c)(1) deduction a contribution must be: (1) authorized by and made pursuant to the trust instrument; sourced from and traceable to gross income; and (3) for a purpose specified in 26 U.S.C. § 170(c). *See* Plaintiff's Motion [Doc. No. 37] at 10; Defendant's Motion [Doc. No. 38] at 12-13.

[17] This distinction is, for instance, demonstrated in 26 U.S.C. § 643(b), which provides in pertinent part:

Valuation

The remaining question is the proper valuation of the Donated Properties – whether adjusted basis or fair market valuation is appropriate under the statute. Plaintiff contends fair market value is applicable, while Defendant argues for adjusted basis.

Defendant contends that any capital appreciation must not be considered in the Donated Properties' valuation because such constitutes unrealized gains. *See* Defendant's Motion [Doc. No. 38] at 16-19 (citing *W.K. Frank Tr. of 1931 v. Comm'r*, 145 F.2d 411 (1944), *U.S. v. Benedict*, 338 U.S. 692 (1950), and *Comm'r v. Cent. Hanover Bank & Tr. Co.*, 163 F.2d 208 (2d Cir. 1947)). In support of this position, Defendant likens the Donated Properties either to (1) cash gifts not fully derived from gross income, or (2) donations made out of a trust's corpus. However, those analogies are inapposite because, as the Court has found, each of the Donated Properties derives from the Trust's gross income.

Under the facts of this case, using adjusted basis as the valuation standard would allow no consideration for the appreciation of real property donated in kind, regardless of whether such property was donated in the year of acquisition or in subsequent tax years. Defendant asks the Court to read a limitation into the statute where none expressly exists.

> [T]he term 'income', when not preceded by the words 'taxable', 'distributable net', 'undistributed net', or 'gross', means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law.

See also Estate of Clymer v. Comm'r, 221 F.2d 680, 683 (3d. Cir. 1955); *Casco Bank & Tr. Co. v. United States*, 406 F. Supp. 247, 254 (D. Me. 1975).

Conversely, "the fair market value standard is as close to a generalized valuation standard as there is in the tax code." *Schwab v. Comm'r*, 715 F.3d 1169 (9th Cir. 2013).[18] Notably, Congress did not specify a different standard of valuation in § 642. Further, considering the context of the statutory language in question and in light of § 170 's general rule of fair market valuation regarding donations of property other than cash,a fair market valuation standard is consistent with the observation of the court in *Schwab*, and does not do violence to the plain language of § 642(c)(1).

Conclusion

The plain language of 26 U.S.C. § 642 supports a construction in favor of Plaintiff. The Court finds that Congress sought in § 642(c)(1) to authorize a deduction "without limitation," and fair market value is the appropriate valuation standard regarding the Donated Properties. Therefore, the Oklahoma Property is to be valued at $355,000 as of the date of donation, and the Texas Property is to be valued at $150,000 as of the date of donation. The Virginia Property's fair market value remains to be determined.

IT IS THEREFORE ORDERED that Plaintiff Mart D. Green's Motion for Partial Summary Judgment [Doc. No. 37] is **GRANTED,** and the portions of Defendant United

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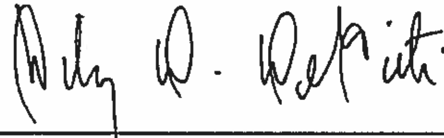
[18] The Ninth Circuit furthered its explanation by quoting an earlier decision by the Tax Court – "the concept of fair market value has always been part of the warp and woof of our income, estate, and gift tax laws, and ... [thus] the necessity of determining ... fair market values ... for ... numerous purposes has always been a vital and unavoidable function of the tax administrative and judicial process." *Id.* (quoting *Nestle Holdings, Inc. v. Comm'r*, 94 T.C. 803, 815 (1990) (internal quotations omitted)).

States of America's Motion for Summary Judgment [Doc. No. 38] addressed in this Order are **DENIED**.

IT IS SO ORDERED this 4th day of November, 2015.



TIMOTHY D. DEGIUSTI
UNITED STATES DISTRICT JUDGE

**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA**

MART D. GREEN, Trustee of the David and Barbara Green 1993 Dynasty Trust,

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

Case No. CIV-13-1237-D

JUDGMENT

1. On November 4, 2015, this Court entered an Order granting Plaintiff's motion for partial summary judgment and denying, in part, Defendant's motion for summary judgment [Doc. No. 48].

2. On February 10, 2016, this Court entered an Order denying the remainder of Defendant's motion for summary judgment [Doc. No. 49].

3. The parties filed various stipulations in this case [Doc. Nos. 36, and 84].

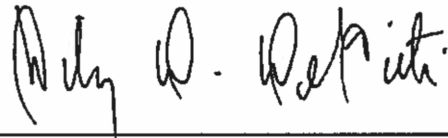
4. On October 20, 2016, a jury issued a verdict in this case [Doc. No. 95].

5. After the trial, this Court instructed the parties to submit a separate form of judgment in accordance with the Court's decisions, the jury's verdict, and the parties' stipulations. Such a submission is without prejudice to either party's right to appeal.

6. The parties have conferred and reached an agreement concerning the form of judgment to be entered in light of the Court's decisions, the jury's verdict, and the parties' stipulations.

THEREFORE, judgment is entered in favor of Plaintiff and against Defendant in the amount of $2,754,514, plus statutory interest as provided by law. Entry of this Judgment disposes of all claims and is a final order within the meaning of Rule 54(a) of the Federal Rules of Civil Procedure.

ENTERED this **4th** day of November, 2016.



TIMOTHY D. DEGIUSTI
UNITED STATES DISTRICT JUDGE

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1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because:

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Date: March 31, 2017

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CERTIFICATE OF SERVICE AND DIGITAL SUBMISSION

I hereby certify that on March 31, 2017, I electronically filed the foregoing using the court's CM/ECF system which will send notification of such filing to the following:

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I hereby certify that with respect to the foregoing:

(1) all required privacy redactions have been made per 10th Cir. R. 25.5;

(2) if required to file additional hard copies, that the ECF submission is an exact copy of those documents;

(3) the digital submissions have been scanned for viruses with the most recent version of a commercial virus scanning program, System Center Endpoint Protection 2012 (updated daily), and according to the program are free of viruses.

Date: March 31, 2017

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