Bullard v. Commissioner, 82 T. C. 270 (1984)

The charitable contribution deduction for a bargain sale of appreciated property must be calculated based on the appreciation inherent in the contributed portion only, not the entire property.

Summary

In Bullard v. Commissioner, the taxpayers sold their interest in Weimar Medical Center to Hewitt Research Center at a bargain price, claiming a charitable contribution deduction under section 170. The issue was whether the deduction should be reduced by the unrealized gain on the entire property or just the contributed portion. The Tax Court invalidated the Treasury regulations that required the reduction based on the entire property's unrealized gain, ruling that such a reduction was inconsistent with the statutory language and purpose of sections 170(e)(1) and 1011(b). The court held that the deduction should only account for the gain in the contributed portion, aligning with the intent to tax the sale element separately from the charitable contribution.

Facts

Victor M. and Pauline E. Bullard sold their interest in Weimar Medical Center to Hewitt Research Center, a nonprofit affiliated with the Seventh-Day Adventist Church, on May 24, 1977. The sale involved both capital gain and ordinary income property. The Bullards reported a charitable contribution deduction on their 1977 tax return, calculated as the difference between the fair market value and the sales price of the Weimar property. The IRS challenged the deduction, arguing that it should be reduced by the unrealized gain on the entire property under section 170(e)(1).

Procedural History

The Bullards filed a petition in the U. S. Tax Court challenging the IRS's disallowance of their charitable contribution deduction. The case was submitted fully stipulated. The Tax Court reviewed the applicable Treasury regulations and statutory provisions before issuing its opinion, which was reviewed by the full court.

Issue(s)

1. Whether the charitable contribution deduction for a bargain sale of appreciated property should be reduced by the unrealized gain on the entire property or only the contributed portion under section 170(e)(1).

Holding

1. No, because the reduction should only account for the unrealized gain in the contributed portion, as the regulations requiring reduction based on the entire

property’s gain were invalidated for being inconsistent with the statutory language and purpose of sections 170(e)(1) and 1011(b).

Court’s Reasoning

The court’s decision hinged on the interpretation of sections 170(e)(1) and 1011(b). The court noted that section 170(e)(1) was designed to prevent tax windfalls from donating appreciated property without recognizing gain, acting as a “deemed sale substitute. ” However, section 1011(b) was intended to recognize the actual sale element in a bargain sale transaction, ensuring that gain from the sale portion is taxed. The court found that the Treasury regulations, which required reducing the deduction by the entire property’s unrealized gain, improperly extended the “deemed sale substitute” and conflicted with the purpose of section 1011(b). The court emphasized that the regulations led to arbitrary tax results based on minor differences in the sales price. The court concluded that the only rational interpretation was to apply section 170(e)(1) to the contributed portion alone, invalidating the regulations to the extent they were inconsistent with this interpretation.

Practical Implications

This decision clarifies the calculation of charitable contribution deductions in bargain sales of appreciated property. Taxpayers and practitioners should calculate deductions based on the unrealized gain in the contributed portion only, ensuring that the sale element is taxed separately as intended by section 1011(b). This ruling may encourage more bargain sales to charities, as taxpayers can now realize the full tax benefit of their charitable intent without the arbitrary reduction imposed by the invalidated regulations. The decision also underscores the importance of reviewing and challenging regulations that may exceed statutory authority, particularly in complex areas like tax law. Future cases involving bargain sales will need to apply this ruling, and any subsequent regulations or guidance will need to align with the court’s interpretation.