

Home Run Kings, Unabombers, and the Taxation of Generosity

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Two recent headlines have given the IRS a headache. In the first, some bright tax experts noted that the record-breaking home run balls of Mark McGwire were worth quite a fortune. Each ball, therefore, represented a taxable gift from the fan or groundskeeper who happened to retrieve it and gave the ball back to McGwire. Catching the ball probably also represented taxable income to the temporary owner of the ball.

In the second, the family of the Unabomber received a reward for providing information leading to his arrest. The experts again noted that this income could not escape tax simply because the family wanted to give the money back to the Unabomber's victims. Moreover, the gift itself did not qualify for a charitable deduction.

Members of Congress have been quick to indicate compassion for those involved, although no provisions were actually passed. IRS Commissioner Charles O. Rossotti recanted an earlier statement by another IRS official and also indicated that anyone who immediately returns a home run ball to McGwire would not be assessed a tax on the gift. He made an analogy with the nontaxability of a prize or gift that is immediately rejected and to the return of unsolicited merchandise. (See a viewpoint by Kip Dellinger in *Tax Notes*, Sept. 14, 1998, p. 1250.) Some, however, argue that this outcome is not consistent with other applications, and that the IRS could be "making up the law as it goes along." (See *Tax Notes*, Sept. 14, 1998, p. 1364.) Thus, the question remains of how to treat similar situations where individuals pass on income and property in such a generous manner.

Several issues of tax law are involved here. Most important for our purposes here is the murky field of how to tax the transferor of income or wealth to others. In truth, there is no consensus among experts as to the proper treatment of these activities, and the law itself is inconsistent—in this case because there are competing principles. Among the issues at hand are whether income should be taxed to the transferor or transferee or both. Take, for example, a taxpayer who has \$100 in income, but then transfers that \$100 to someone else. Who should be taxed? Only \$100 in actual product is involved—that is, the \$100 at most finances \$100 in consumption. Do we want to tax the original recipient of the income or the person who is more likely to consume out of that income? Or do we want to tax both of them since at some point they both had command over the resources?

The income tax usually taxes earners on their wages and salaries. But then, if married, the earners effectively get to have some of the income taxed to transferees if they are spouses, but not children. The transferor of income through charitable contributions can avoid tax on that income, at least up to a limit, but here the transferee or donee is usually not taxed either. Gifts and inheritances are not taxed for most people, but the wealthy may pay tax on income when earned and then pay another (estate or gift) tax when it is transferred. One might think of this latter tax as close to an inheritance tax, which means that both transferor and transferee are effectively taxed. While this results in double taxation of income that has been realized as earned, a further complication is added because the wealthy often pay no individual income tax on income if it is in the form of accrued capital gains. But they do pay corporate income tax indirectly. To some the estate tax is simply a substitute for a tax the transferor never paid; to others it is still a double tax or even a triple tax. Take your pick: where income is earned and transferred, the law sometimes taxes transferees, sometimes transferors, sometimes both, and sometimes it taxes one or both of them more than once on the same income.

The purpose of this short litany is not to determine some broader reform of the nation's tax system, whatever the merit. Instead, it is to suggest that one can make a reasonable case for not taxing lump sum windfalls such as received by home-run ball retrievers and recipients of awards if they immediately designate that income to other parties. The logic is close to the commissioner's argument about prizes or returned merchandise, but, in truth, he stretched that analogy a bit. The better step would be to add some further

clarification in the law or regulations.

A problem similar to the McGwire and Unabomber cases comes up when someone wins a lottery or other game of chance, then decides to share or turn over that income to a charity. The law technically sets limits on the amount of income against which charitable deductions can be taken—hence denying the generous giver the ability to make a transfer of all or most of the winnings. But much of this is sheer legalism. If givers really thought they might win when there are extraordinary odds, and if they walked around with tax attorneys drafting papers for them, they would know how to get around this rule. For instance, take a \$1 lottery ticket that produces \$1 million in winnings. The winner could have signed a legal document making the gift of the \$1 chance before he won, and then the gift would be valued at only \$1, not \$1 million, and the income effectively would all be the charity's, not the giver's. But, alas, lottery ticket salespeople do not sell legal advice and documents along with every ticket sale. For some reason, people generally do not consider it rational to do that much extra paperwork!

I have suggested before that the law or regulations simply be changed to allow winners of lotteries to designate charities as partial or full beneficiaries, and that the IRS extend to them the same treatment that the commissioner is willing to extend to those who return baseballs to Mark McGwire. Indeed, I would argue that the case for the gift to charity is even greater than the case for a gift to McGwire, at least when we take into account the situation of both the transferor and the transferee. In the case of the charitable gift, the donee is much more likely to be in a lower-income bracket than Mr. McGwire. Of course, if you want to consider more complicated matters, he, too, might turn the balls over to museums. In this case, we have another recognition of income that could run up against a charitable contribution limit assuming that the income from the ball is also recognized by McGwire.

Another reason for clarifying the law here is equality of enforcement. In one case of which I have only anecdotal information, the winner of a lottery ticket simply mailed it off to a charity in an envelope with no return address or identification. I suppose technically the IRS could have gone after the charity to claim that it had some prior right to a portion of the gift, but, again, it is doubtful that the IRS would so offend public sentiment. But why should the IRS treat the nonreporter of the income or his charity better than someone who reports the income honestly and then has less to give to charity? Sure, all laws require some line drawing that is arbitrary, but this is a line that should not be drawn where it is now. More open and honest giving is no less deserving of IRS leniency.

My argument for extending this treatment to the generous giver goes beyond the simple issue of tax law enforcement. I believe that if the tax law were clarified to make it easier to pass on winnings or awards or sudden windfalls that more people would do it. Financial advisors, mutual funds, charity officials, and others would find it much easier to encourage such giving if they didn't have to add a caution to contact one's tax adviser for how to handle what for most people would be unintended and unexpected tax consequences. Governments offering lotteries might even find it easier to help individuals designate portions of winnings to local charities or community chests.

So come on you members of Congress who offered bills on behalf of the Unabomber's family or protested any IRS action against those who gave back Mark McGwire's home run balls. Take the next logical step. The IRS commissioner and Treasury also should exercise some leadership here. Each of you has already opened the box on this issue. Admittedly, there's no pure solution that's going to deal with all situations, but there are better solutions than what we have now. The result of a little effort now would be to make it a lot easier for people to be generous with their windfalls.

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