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Tax Aspects of Charitable Contributions and Bequests by Individuals

Cover Page Footnote
Members of the District of Columbia and Maryland Bars.

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PRIVATE giving for the public welfare has long played an important part in our way of life in the United States. While recognizing public responsibility for social welfare, a sense of private duty has expressed itself in support of churches, educational institutions, hospitals, private welfare groups, and a host of similar organizations characterized as charitable.

The birth of the income tax marked the end of the period in which great gifts from very wealthy benefactors could be expected and the beginning of an era in which individual contributions became more and more important to private institutions, whose needs increased at an alarming rate.

The current problem of financing higher education in the coming years exemplifies the ever growing significance of private charitable contributions. The enigmatic question, "When today's children are ready for college, will college be ready for them?," barely suggests the terrible dilemma we face. It is not simply a matter of a number of children who will be ready for college. If the nation is to maintain its present world leadership, a greater percentage of our youth will have to seek the benefits of higher education.¹ Much more important in an economic sense is that we are also in the midst of an explosion of knowledge which has radically increased the expense of higher education itself. In fields such as science and medicine, the simple tools needed for instruction call for incredible expenditures, which increase progressively as the frontiers of knowledge are pushed ever farther. Institutions of higher education, both public and private, desperately seek the support of contributions so essential to their operation. Too often we are unmindful of the fact that even in private institutions of higher learning tuition rates seldom pay more than three-fifths of the cost of the student's education.²

At the outset, Congress recognized the vital need for encouraging pri-

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vate contributions. The Revenue Acts of 1917\(^3\) and 1918\(^4\) first provided an income and estate tax deduction for charitable gifts and bequests. Congress, activated by public policy and a concern for institutions which might become public charges, has through the years abetted charitable contributions by providing additional tax relief to donors.\(^5\)

The primary legislative purpose behind the charitable deduction has, of course, been the desire to promote the support of institutions which in fact perform a public service, either directly or indirectly. If the private college lacks adequate funds to meet its annual deficit, it will soon become a charge upon the state or nation, a fate that more than one important private institution of higher education has already encountered. From an economic point of view it must be recognized, moreover, that a dollar of a private gift given directly to an institution is of considerably greater benefit to the institution than a dollar received by way of taxes and ultimately used for the same purpose. It has been estimated that the federal tax dollar, in its somewhat tortuous course from taxpayer to college, is so worn down that for each dollar received by a college, the taxpayer must provide two or three. The loss occasioned by unavoidable bureaucracy can only be considered waste. This article proposes to examine those sections of the Internal Revenue Code of 1954 dealing with deductions for charitable gifts or bequests by individuals in the hope that both institutions and donors may benefit from an increased awareness of the possibilities present under the law.

I. GENERAL

Donees Available

The Internal Revenue Code describes in sections 170(c)\(^6\) and 2055

5. The Supreme Court in Helvering v. Bliss, 293 U.S. 144, 150-51 (1934), declared: "The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed."
6. Int. Rev. Code of 1954, § 170, provides:
   (c) CHARITABLE CONTRIBUTION DEFINED.—For purposes of this section, the term 'charitable contribution' means a contribution or gift to or for the use of—
   (1) A State, a Territory, a possession of the United States, or any political sub-division of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.
   (2) A corporation, trust, or community chest, fund, or foundation—
      (A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State or Territory, the District of Columbia, or any possession of the United States;
      (B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals;
      (C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and
CHARITABLE DEDUCTIONS

(a) those organizations available as donees or beneficiaries for income and estate tax purposes. Though it is beyond the scope of our discussion to examine what renders an organization charitable, a comparison of these sections reveals but two substantial variations in the spectrum.

(D) no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation.

A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B).

(3) A post or organization of war veterans, or an auxiliary unit or society of, or trust or foundation for, any such post or organization—

(A) organized in the United States or any of its possessions, and

(B) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(4) In the case of a contribution or gift by an individual, a domestic fraternal society, order, or association, operating under the lodge system, but only if such contribution or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

(5) A cemetery company owned and operated exclusively for the benefit of its members, or any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, if such company or corporation is not operated for profit and no part of the net earnings of such company or corporation inures to the benefit of any private shareholder or individual.

7. Int. Rev. Code of 1954, § 2055, provides:

(a) In General.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers (including the interest which falls into any such bequest, legacy, devise, or transfer as a result of an irrevocable disclaimer of a bequest, legacy, devise, transfer, or power, if the disclaimer is made before the date prescribed for the filing of the estate tax return)—

(1) to or for the use of the United States, any State, Territory, any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

(3) to a trustee or trustees, or a fraternal society, order, or association operating under the lodge system, but only if such contributions or gifts are to be used by such trustee or trustees, or by such fraternal society, order, or association, exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, and no substantial part of the activities of such trustee or trustees, or of such fraternal society, order, or association, is carrying on propaganda, or otherwise attempting, to influence legislation; or

(4) to or for the use of any veterans' organization incorporated by Act of Congress, or of its departments or local chapters or posts, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

For purposes of this subsection, the complete termination before the date prescribed for the filing of the estate tax return of a power to consume, invade, or appropriate property for the benefit of an individual before such power has been exercised by reason of the death of such individual or for any other reason shall be considered and deemed to be an irrevocable disclaimer with the same full force and effect as though he had filed such irrevocable disclaimer.

8. It is now elementary that gifts and bequests to individuals are not deductible no matter how deserving they may be. Bowles, 1 B.T.A. 584 (1925) (support payment to taxpayer's dependent mother disallowed); Rev. Rul. 57-183, 1957-1 Cum. Bull. 97 (contribution to fraternal club for sickness and burial expenses of a member disallowed).
of donees listed insofar as citizens or residents are concerned. First, cemetery companies are listed only under the income tax section, which, more significantly, allows a deduction only for contributions to domestic institutions, including those organized in a territorial possession. Thus, no income tax deduction can be taken for a gift, given, let us say, to the University of Mandalay. Still, this does not prevent a deduction for a gift to a domestic organization expending a portion of its funds abroad.

While the theory behind the rule is sound, namely, that citizens of the United States should benefit from any United States revenue lost as a result of a charitable deduction, it does prevent a profitable interchange of gifts with neighboring countries. To date provisions in the income tax conventions with Canada and Honduras are the only exceptions, and these are of little practical moment. Consider, for example, the treaty with Canada. If an American citizen wishes to donate to a Canadian charity, not only must this organization qualify as charitable under the

9. Except where a treaty is applicable, non-resident aliens with no United States business, and having a gross income of not more than $15,400, are taxed at 30% of gross income from United States sources and are not allowed any deductions. Int. Rev. Code of 1954, § 871(a)(2). Non-resident aliens engaged in trade or business here or having a gross income of more than $15,400 from United States sources are allowed a deduction for charitable gifts, subject to the limitations of § 170, whether or not connected with United States income, but only to organizations created in the United States. Int. Rev. Code of 1954, § 873(c).


11. Treas. Reg. § 1.170-2(a)(1) (1958). There are many organizations ruled charitable which transmit all their receipts abroad. It is understood that this regulation is under intensive study by the Treasury. See A.B.A. Section on Taxation Bull., Oct. 1959, p. 33.

12. See Treaty with Canada on Double Taxation, Aug. 8, 1956 [1957] 8 U.S.T. & O.I.A. 1619, T.I.A.S. No. 3916, art. XIII D, wherein it was stated:

1. In the computation of taxable income for any taxable year under the revenue laws of the United States, there shall be allowed as a deduction contributions to any organization created or organized under the laws of Canada (and constituting a charitable organization for the purpose of the income tax laws of Canada) if and to the extent such contributions would have been deductible as a charitable contribution had such organization been created or organized under the laws of the United States. Provided, however, that such deduction shall not exceed an amount determined by applying to the taxpayer's taxable income (in the case of a corporation) or adjusted gross income (in the case of an individual) from sources in Canada the same percentage as is applied by Canada to income in determining the limitation of the deduction for gifts or contributions to charitable organizations of Canada.

2. In the computation of taxable income for any taxation year under the income tax laws of Canada, there shall be allowed as a deduction gifts to any organization created or organized under the laws of the United States (and constituting a charitable contribution for the purposes of the income tax laws of the United States) if and to the extent such gifts would have been allowable had such organization been a Canadian charitable organization. Provided, however, that such deduction shall not exceed an amount determined by applying to the taxpayer's income from sources in the United States upon which he is subject to tax in Canada the same percentage as is applied by Canada to income in determining the limitation of the deduction for such gifts.
laws of both countries, but the deduction cannot exceed the amount which under Canadian law would be allowed on his income from sources within Canada. Thus, the treaty does not permit a deduction for gifts to Canadian institutions unless the American resident has Canadian income. Article XIV(3) of the treaty with Honduras likewise voids the deduction if the taxpayer has no income from Honduran sources.

As suggested, the deduction for charitable bequests of citizens or residents is not restricted to domestic organizations, although total reliance thereon may be unwise. In its audit procedure, the Internal Revenue Service has taken the position that an estate seeking to deduct a bequest to a foreign charity must demonstrate that the charity is the type specified under the Code. On one occasion, an examining agent insisted that as a prerequisite to allowance of the deduction, the charity apply for exemption under this section. The reason given was that foreign charities do not always operate as do their American counterparts. For example, some foreign charities may be part of political subdivisions, and in effect, the bequest will be to a foreign government.

Incidental Income and Gift Tax Problems
Relationship to Sections 501(c)(3) and 2522

To non-profit organizations, two aspects of taxation are paramount: exemption from income tax and deductibility of gifts and bequests. Section 501(c) lists those organizations which are, under section 501(a), exempt from income tax. Gifts and bequests to or for the use of organizations listed in section 501(c)(3), except those organized to test for public safety, generally qualify for deduction. It is of some interest that veterans' organizations incorporated by act of Congress, deductions to which are allowed by both sections 170 and 2055 (but not section 2106, which relates to bequests of non-resident aliens), are not specifically mentioned in section 501(c). Nevertheless, they are generally considered exempt under section 501(c)(4) as organized for the promotion of social welfare.

Taxpayers generally overlook the fact that charitable gifts are subject to the gift tax and that returns must be filed as to those over $3,000.

15. The donee organization need not be of the type described in § 170(c) or § 501(c)(3) as long as the fund is held for such organizations. John Danz, 18 T.C. 454 (1952); I.T. 3707, 1945 Cum. Bull. 114.
16. Apparently, it was a legislative oversight not to include these organizations in §§ 170(c), 2055(a), and 2522(a).
However, section 2522 allows a deduction for such donations and hence no tax is imposed. Except for minor differences in language, the organizations described therein are the same as those in section 2055 and differ from section 170 organizations in permitting gifts to foreign charities but not to cemetery companies. The anomalous result of the omission of cemetery companies is that a gift to one may entitle the donor to an income tax deduction and at the same time subject him to a gift tax. As noted above, a donor to a foreign charity obtains a gift tax but no income tax deduction.

**Limitation on Amount of Contribution**

There has never been a limitation on the amount one can bequeath to charity and still obtain a deduction. However, since the Revenue Act of 1917, there has been an annual limitation on the amount deductible from income. This has varied from fifteen per cent of net income (1917-1943) to fifteen per cent (1944-1951) and twenty per cent (1952 to date) of adjusted gross income.

In 1954, Congress, wishing to benefit certain organizations, provided in section 170(b)(1)(A) for deduction of an additional ten per cent of adjusted gross income for gifts to a church or convention of churches, operating educational organizations, and hospitals or medical research organizations. In computing his maximum charitable deduction, the taxpayer separates gifts to these organizations from all others. The ten per cent limitation is applied to them, and any excess is added to gifts to other organizations, which is then subjected to the twenty per cent limitation. An important limitation is that qualifying gifts must be "to" the charities, not merely "for their use," which has been equated with "in trust for." Accordingly, an outright donation to XYZ University will qualify, but a gift to a trust, or the payment of premiums on a life insurance policy of which the university is the beneficiary, will not.

18. The maximum charitable deduction is subject to recomputation when adjusted gross income changes, for instance, by the spreading back of long-term compensation. I.R. Mm. 43, 1952-2 Cum. Bull. 112. Adjusted gross income should include capital gains even though the alternate method of computing the tax under § 1201 is used. Schultz v. United States, 156 F. Supp. 811 (S.D. Fla. 1957); Springs v. United States, 153 F. Supp. 514 (W.D.S.C. 1957). These cases held that "taxable income" need not be reduced by capital gains when the alternate method is used in computing the dividends received credit but should be analogous.
The one exception to the percentage restriction is the unlimited charitable deduction which has been in the law in some form since 1924. Section 170(b)(1)(C) of the Code provides for an unlimited charitable deduction if in the taxable year, and in eight of the ten preceding taxable years, the charitable contributions and income taxes paid (other than self-employment taxes) during the year in respect of such year or a preceding taxable year exceed ninety per cent of taxable income computed without deduction for charitable contributions, personal exemptions and net operating loss carry backs. As the result of a 1958 amendment, in lieu of the income tax paid during any year, a taxpayer may use the tax paid in respect of such year as long as the same amount is not entered into calculations twice. The change would allow deficiencies and payments of estimated tax to be attributed back to the year to which they relate. A taxpayer thus has some discretion in selecting his taxes for a particular year. It should be kept in mind that a refund or credit will serve to reduce the taxes paid and will be applied against the most recent payments for the year of refund.

The regulations treat at length the matter of joint returns. If a husband and wife make a joint return for the taxable year, and in eight of the ten preceding taxable years (whether or not joint or separate returns are filed), they aggregate meet the requirements of section 170(b)(1)(C), they will not be subject to the percentage limitation. If a separate return is filed by a spouse or by an unremarried widow or widower, an unlimited deduction is available if this person meets the test in the taxable year and if, in the prior years, the joint returns or separate returns fulfilled the conditions. A divorced or remarried taxpayer who filed a joint return for a prior year with a former spouse is not permitted to include the contributions and taxes paid by the former spouse. The separate taxable incomes and taxes of the taxpayer and former spouse are computed as though they had filed separate returns. The taxable income and the taxes attributed to the taxpayer from a joint return is a proportionate allocation of their separate taxable in-


comes and taxes. The taxes paid by a divorced or remarried taxpayer for a taxable year, such as an installment of estimated tax, or for a prior year, such as the payment of a deficiency, must not exceed his allocable portion of the tax with respect to the year.

In computing taxable income, a number of questions may arise. Before the 1954 Code, taxable income was not required to be reduced by personal exemptions or net operating loss carry back. Under the regulations, it seems clear that in computing the taxable income of any year to which the 1939 Code applies, adjustment shall not be made for exemptions and the carry back even though the taxable year is one governed by the 1954 Code. Under a recent case, two further points are also clear. Net income includes only that portion of capital gains actually taxable, not the gross amount. A taxable year meeting the conditions of section 170(b)(1)(C) will not be disqualified by a later tax law retroactively increasing net income. It follows that in totaling charitable deductions and taxable income, the taxpayer is not bound by the amounts shown on the returns filed. The 1954 Code refers to "charitable contributions" and "taxable income." These terms should imply actual, and not merely reported, figures. As a result, it should be within the province of both the taxpayer and the Commissioner to show more or less contributions or taxable income than that actually reported, even though the year is barred by the statute of limitations for refund or for the assessment of a deficiency.

Denial of Deduction

Second only to the donor's joy in giving is his realization that he or his estate will obtain a tax deduction for his munificence. Careful selection of charitable donees is important because spread throughout the Code are various sections denying a deduction for gifts to nonconforming institutions.

The most common denial of deduction will usually arise from a gift to an organization which just does not meet the specifications of sections 170(c), 2055(a), or 2522(a). Perhaps at one time the charity did pass inspection, but not in the year of gift. Probably the donor will have relied upon an old exemption letter which does not describe the institution's present character. Although there is little doubt that the

26. Assume a taxpayer and his former spouse filed a joint return showing taxable income of $24,000 and a tax of $6,800. If they had filed separate returns, the figures would be:
   Taxpayer: taxable income, $14,000; tax $4,260.
   Former spouse: taxable income $10,000; tax $2,640.
   Taxpayer's taxable income and tax for the year in question would be, respectively, $14,000 and $4,198.26 (4,260/6,900 × 6,800).
Commissioner can revoke an exemption retroactively, his announced policy is that a deduction remains allowable until an announcement of revocation is published in the Internal Revenue Bulletin, unless the donor had knowledge of the revocation before it was published. No such policy is followed with respect to the estate and gift tax deduction. The question is whether or not the institution qualifies on the date of the gift or bequest.

Donors must also reckon with section 503(e) which disallows a deduction for gifts and bequests to section 501(c)(3) organizations, with the exceptions noted below, which have had their exemptions denied because they have engaged in a prohibited transaction. The deduction is denied for the same years the exemption is revoked, that is, for taxable years after the year the organization is notified by the Secretary of the prohibited transaction. If, however, the purpose of the transaction is the diversion of a substantial part of the corpus or income...

30. Publication No. 78, Organizations described in Section 170(e) of the Internal Revenue Code of 1954, Cumulative List revised to December 31, 1958.
31. Int. Rev. Code of 1954, § 503, provides:
   (b) ORGANIZATIONS TO WHICH SECTION APPLIES.—This section shall apply to any organization described in section 501(c)(3) or section 401(a) except—
   (1) a religious organization (other than a trust);
   (2) an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on;
   (3) an organization which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from the United States or any State or political subdivision thereof or from direct or indirect contributions from the general public;
   (4) an organization which is operated, supervised, controlled, or principally supported by a religious organization (other than a trust) which is itself not subject to the provisions of this section; and
   (5) an organization the principal purposes or functions of which are the providing of medical or hospital care or medical education or medical research or agricultural research.
32. Int. Rev. Code of 1954, § 503, provides:
   (e) DISALLOWANCE OF CERTAIN CHARITABLE, ETC., DEDUCTIONS.—No gift or bequest for religious, charitable, scientific, literary, or educational purposes (including the encouragement of art and the prevention of cruelty to children or animals), otherwise allowable as a deduction under section 170, 642(e), 545(b)(2), 2055, 2105(a)(2), or 2522, shall be allowable as a deduction if made to an organization described in section 501(e)(3) which, in the taxable year of the organization in which the gift or bequest is made, is not exempt under section 501(a) by reason of this section. With respect to any taxable year of the organization for which the organization is not exempt pursuant to subsection (a) by reason of having engaged in a prohibited transaction with the purpose of diverting the corpus or income of such organization from its exempt purposes and such transaction involved a substantial part of such corpus or income, and which taxable year is the same, or prior to the, taxable year of the organization in which such transaction occurred, such deduction shall be disallowed the donor only if such donor or (if such donor is an individual) any member of his family (as defined in section 267(c)(4)) was a party to such prohibited transaction.
from exempt purposes, no notice is needed to deny exemption, but the deduction will not be disallowed in the year of diversion and prior years unless the donor or a member of his family, as defined in section 267(c)(4), is a party to the transaction. A deduction for contributions in years subsequent to the diversion will be disallowed.

Under section 504, exemption may also be denied section 501(c)(3) organizations, to which section 503 is applicable, for unreasonable accumulations of income. Denial of deduction to organizations unreasonably accumulating income will apply to those years after the exemption is denied.

Section 170(b)(1)(D) disallows an income tax deduction based not upon the character of the donee but upon the manner in which the gift is made. No deduction for a gift in trust will be allowed if the donor has a reversionary interest in the corpus or income of the contributed property which exceeds five per cent of the value of the trust. Reversionary interest means the possibility the income or property may revest in the grantor or his estate or may be subject to a power exercisable by the grantor or a nonadverse party (as defined in section 672(b)) to return it to the grantor or his estate. An interest of the grantor in the property which will terminate before the ripening of the gift is not a reversionary interest.

Also, it should not be forgotten that an income tax deduction will be denied to organizations which are either listed or ordered to register on the lists of communist-action or communist-front organizations maintained by the Attorney General.

Measure of a Gift

Where the subject of the gift or bequest is cash, no problem exists with respect to the valuation of the gift. Even in the case of a bequest of property, there are few problems which can develop with respect to the value of the bequest since whatever is included in the gross estate is also excluded. But, in the case of an inter vivos gift of property, it is important to determine the value of the gift for deduction purposes.

As indicated above, the deduction for charitable contributions first appeared in the Revenue Act of 1917. The regulations promulgated thereunder specified that "the fair market value of the property" constituted the measure of the deduction. Except for a brief period
from 1920 to 1923, when it ruled that the deduction was limited to the cost of the property,\(^41\) the Internal Revenue Bureau has always acknowledged that a deduction may be taken for the “fair market value” of the contributed property.\(^42\) This well-known and long-standing administrative rule can be presumed to have the approval of Congress in view of the frequent re-enactments of the charitable deduction provisions.\(^43\)

In 1938, Congress was specifically importuned to change this rule. As passed by the House, H.R. 9682 included a provision reducing the deduction to the adjusted basis or fair market value, whichever was the lower.\(^44\) In rejecting this proposal, the Senate Finance Committee noted:

Representations were made to the committee by officials of educational and charitable institutions that the effect of such a provision would be to discourage the making of charitable gifts in kind. The committee believes that charitable gifts generally ought to be encouraged and so has eliminated this provision of the House bill.\(^45\)

By re-enactment of section 23(q) of the 1939 Code, Congress clearly approved the rule that fair market value was the measure of the deduction allowable for contributions of property and rejected the contention that such deduction be limited to cost.

Just exactly what is meant by “fair market value”? Although application under certain circumstances is difficult, the general rule is that fair market value is the price at which the property would change hands between a willing seller and a willing buyer, neither being obligated to sell or buy.\(^46\) Since the property is being donated to charity, not sold, it may seem that this rule is not applicable. However, the courts, realizing that the sale to determine fair market value can be only imaginative, have held that sales of similar property are strong evidence of value.\(^47\) Thus, if stock is donated, a taxpayer need only resort to the financial pages of his newspaper to see what other shares of the company

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\(^41\) O.D. 979, 2 Cum. Bull. 148 (1920), and T.D. 2998, 2 Cum. Bull. 151 (1920), limited the charitable deduction to cost since no income was realized upon the gift. Fair market value of property, however, soon became the measure of gift. T.D. 3490, II-1 Cum. Bull. 118 (1923).


\(^47\) See, e.g., Elmhurst Cemetery Co. v. Commissioner, 300 U.S. 37 (1937); West View Cemetery Ass’n v. Commissioner, 95 F.2d 714 (5th Cir. 1938).
sold for on the date of gift.\textsuperscript{49} If the property is of a kind not ordinarily traded, its initial cost or the cost of reproducing it, with adjustments for depreciation, may be determinative.\textsuperscript{49}

The reference to comparable sales as the measure of fair market value has been uniform through the years both in court decisions and the Commissioner's own regulations.\textsuperscript{50} This should be emphasized despite the confusion engendered by the Commissioner's occasional and unsuccessful efforts to tax donors on the difference between the tax basis of property given (particularly inventory) and its fair market value.

\textit{Valuation of Income and Remainder Interests}

Where the gift or bequest consists of an income interest or a remainder interest after an intervening estate, special problems of valuation are presented. The identical tables appearing in the gift and estate tax regulations are employed for the determination of an income or remainder interest where one life is involved.\textsuperscript{51} Where there are complications (for instance, more than one life is involved), the Service offers to provide a factor for valuation based upon the same mortality tables or a taxpayer may do it himself by resort to the tables.\textsuperscript{52} Where there is an annuity purchased from a company regularly engaged in issuing annuities, the Service generally refers to the price currently charged by commercial companies engaged in the sale of similar contracts.\textsuperscript{58}

It should be remembered that evaluating property interests is essentially a matter of fact. Although the Service's method of determining such interests under its tables are generally accepted, it is not necessarily exclusive. One court, in discussing the question of how to value the bequest of a remainder interest under regulations in effect with respect to a prior law declared: "We do not think that [the regulation] directed the use of Table A in all cases, nor do we think that it would have been valid if it had."\textsuperscript{54}

It does seem clear that the value of such a gift is determined as of the date of the gift or the death of the decedent without reference to

\textsuperscript{48} For guides to the valuation of stock in closely held corporations, see Rev. Rul. 59-60, 1959 Int. Rev. Bull. No. 9, at 8.
\textsuperscript{50} Treas. Reg. § 1.170-1(1)(c) (1958).
\textsuperscript{52} See Table 38 of U.S. Life Table & Actuarial Tables 1939-1941, published by the U.S. Dept. of Commerce; Actuarial Values for Estate and Gift Tax, IRS Publication No. 11 (1955).
\textsuperscript{53} See note 118 infra.
\textsuperscript{54} Hanley v. United States, 63 F. Supp. 73, 81 (Ct. Cl. 1945).
circumstances occurring later. As Justice Holmes commented in discussing this issue:

But the value of property at a given time depends upon the relative intensity of the social desire for it at that time, expressed in the money that it would bring in the market . . . . Like all values, as the word is used by the law, it depends largely on more or less certain prophecies of the future; and the value is no less real at that time if later the prophecy turns out false than when it comes out true.55

Ordinarily, where an intervening estate or remainder interest is concerned, references will, of course, have to be made to predictability as set forth in the mortality tables using the assumed rate of interest. The Commissioner's determination on the basis of mortality figures and this assumed rate of interest is certainly entitled to a presumption of correctness. Where, however, the actual interest rate clearly and materially differs from that used by the Commissioner in making his determination, the taxpayer is free to insist on the use of the actual interest rate.56 Likewise, when at the time of the gift or bequest the life tenant's physical condition is such that his life expectancy is considerably less than that predicted by the mortality tables, the value of the remainder interest donated or bequeathed will be determined with reference to his actual condition.57 Thus, in such instances, the factors upon which the Commissioner bases the determination of value is clearly subject to challenge.

A word should be said about the valuation of a remainder interest. The preferred view is that the value of such an interest should be determined by valuing the residue subject to the life estate, rather than valuing the life estate and subtracting that value from the total residuary estate.58

Where the valuation of income interests is concerned, the same rules should prevail. The Commissioner's tables should be presumed correct in the absence of other circumstances. Where the actual facts indicate a mortality different from that shown by the tables, or an interest rate

55. Ithaca Trust Co. v. Commissioner, 279 U.S. 151, 155 (1929). Here a testator left property to charity subject to a life estate in his widow, who died within six months. The court rejected the valuation of the life estate by the use of actual facts and upheld employment of the mortality tables.
56. Hanley v. United States, 63 F. Supp. 73 (Ct. Cl. 1945). In this case, a remainder interest was given a charity following a life estate. Because the corpus was directed to be invested in low income bonds, the court allowed an interest rate of 3½% for life estate, contrary to Table A in art. 10 of Treas. Reg. 81.10 (1942), which uses 4%. The effect was to reduce the value of the life estate and increase that of the remainder.
57. Herron v. Heiner, 24 F.2d 745 (W.D. Pa. 1927); Estate of Nicholas Murray Butler, 18 T.C. 914 (1952); Estate of Nellie H. Hennings, 10 T.C. 323 (1948).
different from that used by the Commissioner, the tables should not measure the value of the gift. 59

II. GIFTS INTER VIVOS

General Requirements

A gift for income tax purposes must have all the characteristics of a valid gift at common law, including effectiveness, 60 donative intent, 61 and no consideration in return. 62 A gift, however, may be part of a larger transaction, featuring quid pro quo, for instance, a bargain sale to a charity where the gift may be the difference between the fair market value of that sold and its sales price. 63 There can be no "Indian-giving." If conditions are attached to a gift, the possibility that the donee will not receive the beneficial enjoyment must be so remote as to be negligible. 64 Although a deduction will not be allowed for a gift to a trust where the creator or anyone else may revoke the trust or deprive the charity of its interest, the creator may retain the right to select the charitable recipients within an acceptable group and the amounts donated. 65 Under the prevailing view, at least some of the trustees may be members of the donor's family. 66

59. Perhaps this is what the Commissioner had in mind when he noted in Treas. Reg. § 1.170-1(e) (1958): "[A]ssume that the assets placed in trust consist of stock in a corporation the fiscal policies of which are controlled by the donor and his family, that the trustees and remaindermen are likewise members of the donor's family, and that the governing instrument contains no adequate guarantee of the requisite income to the charitable organization. Under such circumstances, no deduction will be allowed. Similarly, if the trustees were not members of the donor's family but had no power to sell or otherwise dispose of closely held stock, or otherwise insure the requisite enjoyment of income to the charitable organization no deduction would be allowed." Rather than negate the deduction, such facts should be taken into consideration in determining the value of the gift or bequest for income or estate tax purposes.

60. It was early held that an ineffectual gift of an unassignable World War I adjusted compensation certificate was not deductible. I.T. 2559, X-1 Cum. Bull. 122 (1931).

61. The dedication of land to a county for the widening of a road, necessary to secure a plot plan for the sale of lots, was not a gift. Rev. Rul. 57-488, 1957-2 Cum. Bull. 157.

62. Payments accompanied by benefits, such as the annual dues of an organization which bestows privileges, are not deductible. Rev. Rul. 54-565, 1954-2 Cum. Bull. 95. Not governed by this ruling are pew rents, church dues, and the like, which are not distinguishable from, and confer no other privileges than, other forms of church giving. A.R.M. 2, 1 Cum. Bull. 150 (1919).


68. See Barber v. Edwards, 130 F. Supp. 83 (M.D. Ga. 1955). Although there is a divi
CHARITABLE DEDUCTIONS

In general, a charitable gift is effective if the donee is assured of a benefit. Congress is not inclined to sacrifice revenue where only the taxpayer gains.

Payment Necessary

Whether on the cash or accrual method of accounting, the individual taxpayer can deduct only contributions actually made.69 The signing of a pledge will confer no right to a deduction.70 Payments, other than cash, must be of enough substance to be capable of valuation. For example, permission to use a building is not a payment but merely a privilege.71 But the donation of the use of property in the form of a determinable fee, though of indefinite duration, does constitute a payment.72 The donation of a leasehold interest should qualify as a payment since the donee has something of substance in the form of fixed rights, but the Service would probably not sanction it. The right to occupy real property for a period of time seems to involve as much property right as the right to build additional stories on top of a building, which, as a grant of air space, has been held to qualify for deduction.73

Property Necessary

Since the beginning of the income tax, a deduction has been allowed only for gifts of money or property, which includes all manner of tangible personalty and such intangibles as income74 and remainder75 interests.

No deduction, however, is available for a gift of services,76 such as those of a carpenter who donated his talents to build observations posts for a county civil defense organization.77 It is not always clear what constitutes services. Donations of blood78 and free advertising space by a newspaper79 have been considered gifts of services.
Out-of-pocket expenses, though, incurred by a taxpayer while rendering services to a charity are deductible. Uniforms not of general utility, commuting expenses, and meals and lodging while away from home would be suitable examples. Thus, the expenses of a member of a church or the American Legion to attend a convention as a delegate, transportation costs to and from a local hospital or church, and the expenses of civil defense volunteers in traveling to watch atomic bomb tests and attending meetings are deductible. Nonreimbursable expenses of local governmental officials who serve without compensation are also deductible. The cost of meals during the performance of services for local charities is deemed a purely personal expense satisfying a taxpayer's needs and, unlike commuting expenses which benefit the charity, are not deductible.

Date of Gift

Because of the percentage limitation on gifts and variations in taxpayer's income and tax rates, it is essential to fix accurately the date gifts become effective. As a general proposition, the date property is delivered is the date of gift. When checks are delivered, the gift is effective even though they are cashed in a later year. Where the mails are used, the date of posting constitutes delivery since the mail is agent for both sender and recipient. In the case of stock, delivery of a properly endorsed certificate marks the date of gift. But if the certificate is delivered to some agent of the donor, such as a bank or broker, or to the issuing corporation or its agent, the gift is effective when transferred on the books of the corporation. Objects which render delivery inconvenient may be donated without actual exchange of physical possession. Paintings can be effectively given by delivery of a deed of gift under seal without being removed from storage.

When conditions are attached to a gift, the gift is effective only after the donee has accepted them. Hence, a gift of a check to a hospital accompanied by oral instructions that it be used for specific research

80. This phrase means travel overnight, just as in Int. Rev. Code of 1954, § 162(a)(2).
became effective in a later year when the hospital agreed to comply with them.\footnote{92}

\textit{Gifts of Specific Types of Property}

\textit{Remainder interest (life income plan).} For many years, institutions have noted the reluctance of potential donors to make substantial gifts during their lifetime for fear that they, or close relatives, may need the income to be earned on property which could ordinarily be the subject of a charitable gift. To meet this objection, charities have encouraged donations in the form of remainder interests. The gift may be made by way of contract or trust. The income is payable to the donor or a designated beneficiary for his lifetime, after which the corpus passes outright to the charitable institution. The so-called life income contract was favored in the early days because of a belief, sometimes well-founded, that local laws did not permit the establishment of a trust. As far as the Internal Revenue Service is concerned, in either case, a trust has been established.\footnote{93} Where the trust form is employed, it seems customary to use a charitable institution as the trustee. Nonetheless, the tax results are the same whether or not an independent trustee is appointed.

Whatever the form of the gift may be, the Service has long held that the contribution of a remainder interest is deductible for income tax purposes by the donor in the year of the gift.\footnote{94} The value of the gift is determined by reference to the gift tax regulations.\footnote{95} If the property transferred under the life income contract or to the trust has a fair market value in excess of or less than basis, there will be no taxable gain or deductible loss to the donor.\footnote{96} For a number of years, the Internal Revenue Service has affirmed that no gain is realized to the donor of appreciated property even though it be contemplated at the outset that property contributed will be sold by the donee institution and invested in a particular kind of security. The realization of gain or loss occurs on sale of the property by the trustee or the institution, which is considered to be a trustee for these purposes. Any gain will, therefore, be includable in the gross income of the trust. The trust, however, will be entitled to a deduction under section 642(c) of the Code because the gain is permanently set aside for the use of a charity.\footnote{97}

Where the donor retains a life interest in the income of the trust, he remains the owner of the trust within the meaning of section 677(a) of the Code. Thus, the trust income is included in his return as if it had
been received directly by him. Therefore, if the corpus is invested in tax-exempt securities, the income of the trust will be tax-exempt in the hands of the donor. Should the corpus be invested in a regulated investment company, profit from the sale of investments by the company and distributable under the instrument to the donor by the trust would presumably retain its character as capital gains. Similarly, where the beneficiary of such a trust is not the donor, distributions to him will have the same character in his hands as they had in the hands of the trustee.98

When the gift of the remainder interest to a charitable institution is accompanied by the retention of a life estate in the donor, the corpus will be included in the donor’s estate for federal estate tax purposes. However, the value of any interest therein which passes to the charity at the death of the donor will be deductible from his gross estate.99

Gifts of remainders have proved particularly beneficial to charitable institutions in view of their attractiveness to donors in high tax brackets. By means of a life income plan a donor can obtain a present deduction for the value of the remainder interest and, at the same time, protect himself and his family by the availability of the income. If the donor or the beneficiary is in a high income tax bracket, the assets can be invested in tax-exempt securities, the income being tax-free to the donor or the beneficiary. If the donor is more modestly situated, the assets can be invested in mutual funds or common stock suited to the nature of his means. If taxes are not a major consideration, investment of the corpus in the charitable institution’s permanent endowment fund can guarantee the donor a maximum safe return from stock professionally managed and invested.

In private letter rulings with respect to these plans, the Internal Revenue Service has raised questions which deserve more than passing examination, particularly by the charitable institution which accepts life income contracts or acts as trustee under such instruments. It has suggested that the tax-exempt status of the institution itself may be jeopardized if the operation with respect to such plans is substantial when compared to that comprising the basis for the institution’s exemption. More significant is the Service’s suggestion that activities in connection with the plans, such as the offering of life income contracts on a widely publicized basis, may constitute a trade or business regularly carried on and not substantially related to the exercise of the organization’s charitable functions.100 Finally, the Service has suggested that common investment in a fund of a number of gifts, either in trust or under life

income contracts, may constitute an association taxable as a corpora-
tion.101

Income interest (short-term trusts). Ordinarily a taxpayer cannot
give away anticipated income without being taxed upon it when it is
realized by the donee, charitable or otherwise. A trust, the corpus of
which does not revert until the lapse of ten years, is a well-recognized
exception to this general rule.102 In enacting the 1954 Code, Congress
provided donors tax exemption upon the income from property set aside
in trust for the benefit of certain charitable institutions for a relatively
shorter period of time. Under section 673(b), the grantor of a trust is
not taxable on the income if it is irrevocably payable for a period of at
least two years to an operating church, hospital, or educational institu-
tion. Unless the grantor has a reversionary interest which exceeds five
per cent of the value of the corpus at the time of transfer, he is also
entitled to a deduction for the commuted value of the income set aside.
The reason for encouraging gifts of income to such institutions ap-
parently was the same as that behind the enactment of the extra ten
per cent deduction under section 170(b)(1)(A). The purpose of both
sections was “to aid these institutions in obtaining the additional funds
they need, in view of their rising costs and the relatively low rate of
return they are receiving on endowment funds.”103

In order to understand fully section 673(b), it is necessary to allude
to the situation which existed with respect to trusts prior to the Internal
Revenue Code of 1954. In that period, the Commissioner established
the “Clifford regulations” whereby trust income would be taxed to the
grantor where he could recover the principal or income before ten or, in
certain cases, fifteen years.104 In formalizing a general rule based upon
ten years,105 Congress was persuaded that a much shorter period should
be applicable where the income is set aside for a school, hospital, or
church. Prior to that time, it had been clear that a donor was entitled to
a deduction for a contribution of income, under such circumstances, to
any qualified charitable institution.106 On the other hand, because of the
“Clifford regulations,” it was not clear how long the property had to be
set aside in order that the taxpayer might successfully avoid being taxed
on the income received by the charity. It should be noted that Congress
in enacting section 673(b) has imposed two limitations. First, the prop-
erty has to be set aside at least two years; secondly, the beneficiary of

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101. See Int. Rev. Code of 1954, § 584, especially exempting from taxation common
trust funds of banks.
the trust has to be an operating church, hospital, or educational organization. Under the general rules of section 673, a grantor who wishes to avoid being taxed upon the income set aside for any other charity will have to donate the income for at least ten years.\textsuperscript{107} Whatever the duration of the trust, the donor will be denied a deduction for the charitable contribution if he has a reversionary interest in the corpus which exceeds five per cent of the value of the property transferred.\textsuperscript{108} Thus, to be entitled to the deduction of a gift of income, the grantor must transfer the property effectively from his control forever. Yet, the corpus can revert to the grantor's family or relations, and the grantor will be entitled to the deduction. As a warning, Congress has on several occasions considered denying the deduction where the property reverts to the grantor's family.\textsuperscript{109}

When the grantor has forever disposed of the corpus, there is the added advantage of having the property out of his estate for federal estate tax purposes. Note here that the value of the remainder interest given to others constitutes a gift for gift tax purposes and must be reported as such. Remainder interests, being future interests, are not subject to the annual gift tax exclusion.\textsuperscript{110}

\textit{Limitations on gifts of remainder and income interests.} Special mention should be made of the problem inherent in the limitation under section 170 regarding the amount of deduction. Under the Revenue Act of 1918, individuals were allowed a deduction for contributions "to" charities.\textsuperscript{111} Under the Revenue Act of 1921, the words "or for the use of" were added after the word "to."\textsuperscript{112} Shortly after enactment of the 1921 legislation, the Bureau of Internal Revenue had occasion to interpret the phrase "for the use of" in terms repeated many times since, ruling that such words intended to convey a meaning similar to "in trust for."\textsuperscript{113} After the Revenue Act of 1921, the words "to" and "for the use of" being used in conjunction, it was immaterial whether the gift was to or in trust for a charitable institution. In either case, the deduction was allowed. In enacting section 170(b)(1)(A), permitting the special ten per cent deduction, Congress in 1954 revived the importance of the distinction between "to" and "for the use of." The deduction up to ten per cent of the taxpayer's adjusted gross income made available to individuals

\begin{itemize}
  \item \textsuperscript{107} Int. Rev. Code of 1954, § 673(a).
  \item \textsuperscript{108} Int. Rev. Code of 1954, § 170(b)(1)(D).
  \item \textsuperscript{109} See H.R. 8381, 85th Cong., 2d Sess. § 9 (1958), as passed by the House. This section was deleted by the Senate Finance Committee. See Trammell, supra note 78, at 461.
  \item \textsuperscript{110} Int. Rev. Code of 1954, § 2503(b); Treas. Reg. § 25.2503-3 (1954).
  \item \textsuperscript{111} Revenue Act of 1918, ch. 18, § 214(a)(11), 40 Stat. 1068.
  \item \textsuperscript{112} Revenue Act of 1921, ch. 136, § 214(a)(11), 42 Stat. 241.
  \item \textsuperscript{113} I.T. 1867, II-2 Cum. Bull. 155 (1923).
\end{itemize}
is limited to a contribution to an operating church, educational organization, or hospital.

The Internal Revenue Service has long held that a gift of a remainder interest constitutes a gift to an institution. A remainder interest in bonds after a life estate "was an immediate gift to the church of a definite right which has a present cash value." For a time the Commissioner was reluctant to recognize the application of these holdings to section 170(b)(1)(A).

Early in 1958, the Service began issuing private letter rulings which confirmed that the present value of a remainder interest donated to the specified charitable institutions was a contribution to such an organization within the meaning of section 170(b)(1)(A), indicating that the extra ten per cent deduction is available whether or not the institution itself acts as the trustee of the property being transferred.

It seems equally clear that the gift of income under a short- (or long-) term charitable trust does not qualify for the extra ten per cent deduction. In enacting section 170(b)(1)(A), Congress stated:

It is to be noted that such charitable contribution must be paid to the organization and not for the use of the organization. Accordingly, payments to a trust [where the beneficiary is an organization described in said clauses (i), (ii), or (iii)] are not included under this special rule.

Congress apparently had in mind the provisions of section 673(b) and intended that the deduction available with respect to a gift of income under a short (or long) term trust should not qualify for the extra ten per cent deduction.

**Annuities.** If the cost of the annuity purchased from a charity exceeds its value, a deduction will be allowed for the excess. The value of an annuity is determined under the rules of section 101(b) and the pertinent regulations. If the charity is not regularly engaged in issuing annuities, the value of a contract is based upon estate and gift tax actuarial tables.

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118. Treas. Reg. § 1.101-2(e)(1)(iii)(b) (1957). Value is here based upon whether the issuer is (1) an insurance company or an organization regularly engaged in the business of issuing contracts with the insurance company as coinsurer or reinsurer; (2) an organization not described in (1) but regularly engaged in issuing contracts; or (3) an organization not described in (1) or (2). If the charity issues more than annuity, the Service would consider it in category (2), and the value would be the cost of a comparable contract purchased from an insurance company. The table recommended is the 1937 Standard Annuity Mortality Table.
119. Treas. Reg. § 20.2031-7(f) (1954). For an example using outmoded tables, see
Where the annuity is purchased with cash or unappreciated property, the income taxation of the amounts received by the donor is governed by section 72 of the Code and is relatively simple. The theory of this section is that since part of the payments constitute return of capital, the annuitant is able to exclude from income a portion of the yearly payments representing a proportionate part of the annuity's cost. The amount to be excluded is the yearly payments multiplied by a fraction, the numerator of which is the cost of the annuity and the denominator of which is the return expected by the annuitant considering the years he has to live. The cost of the annuity is its value and excludes any amount deemed to be a charitable gift.\(^{120}\) Take, for instance, a male donor, age fifty-one, who purchases for $100,000 an annuity having a value of about $54,000. Under the contract, payments totaling $3,000 are to be paid to him each year. Considering the years he has to live, the expected return under the contract is $74,100.\(^{121}\) The annuitant would be able to exclude from income $2,186, which is $3,000 multiplied by the fraction, 54,000/74,100. The remainder is ordinary income. He would, of course, have made a charitable contribution of $46,000.

A special problem, however, exists when the annuity is purchased with appreciated property. If the taxpayer uses appreciated property to purchase an annuity from an insurance company, he will be treated as though he had sold the property and used the cash to purchase the annuity.\(^{122}\) On the other hand, if an annuity is purchased from an individual, the prevailing view is that the taxpayer should not be taxed on the gain until he recovers his basis in the property used to purchase the annuity. The rationale is that private annuities have no fair market value because of the doubtful ability of individuals to pay over a period of time.

The Internal Revenue Service is actively examining whether annuities purchased from a charity should be of the private type. For a long time before charitable institutions were deeply involved, their annuities were generally considered private. It is not unlikely that at least some charities will be held to be writing annuities with readily ascertainable market value in view of their financial stability, the commercial manner in which they write annuities, and the tendency on the part of the Service to declare that anything has some fair market value.\(^{123}\)

I.T. 2397, VII-1 Cum. Bull. 90 (1928), in which the value was arrived at by multiplying the yearly payment ($2,500) by the present value ($54,457) of an annuity of $1 for life at 5%, the annuitant being seventy-two years old.

120. Raymond v. Commissioner, 114 F.2d 140 (7th Cir. 1940).

121. See Table I, Treas. Reg. § 1.72-9 (1957). The expected return is produced by multiplying $3,000 by the multiple shown in the table, 24.7.


123. See G.C.M. 1022, VI-1 Cum. Bull. 12 (1927), in which immediate gain or loss inured to a taxpayer who transferred property to a corporation in return for an annuity.
In the example given, assume the donor had transferred to the charity property worth $100,000 which had a basis to him of $25,000. If the annuity bought is deemed to have a fair market value, the donor is taxable immediately in the amount of his gain, $29,000 ($54,000 minus $25,000). However, if the annuity is private, the excludable portion of the annuity payments will be considered as a return of capital until the $25,000 cost is recovered. These payments would then constitute capital gain until the full $29,000 gain has been reported. Thereafter, tax is paid only on the difference between the annuity payment and the excludable portion.\(^2\)

**Life insurance.** A deduction will be allowed for both the assignment of an insurance policy and the payment of premiums on the policy of which a charity is beneficiary.\(^2\) As always, the gift must be complete, and the charity must be the irrevocable assignee or beneficiary.\(^2\) The measure of a gift of the policy is its cash surrender value,\(^2\) but the premiums themselves constitute the gift where a charity is beneficiary. Payment of premiums is not a gift to but for the use of the charity\(^2\) and does not qualify for the extra ten per cent deduction. However, it could be argued that where the policy has been assigned to the charity, the continued payment of premiums does constitute a gift to in the amount that the cash surrender value is increased. Likewise, there should be no reason why a gift of the policy should not be regarded as to the donee.

**Fractional interests.** The size of property sometimes makes imperative its donation in portions. The easiest method is by deed or other instrument to convey to the charity the fractional interest desired, whether it be an oil lease\(^2\) or land.\(^2\) As we shall see, when the right to income is conveyed, care must be taken that the underlying principal be given also. Where the donor wishes the charity to have the use of the entire property from the beginning, as for example, a building, a lease arrangement may be concluded with respect to the fraction not donated. The only published ruling involves a lease of the fraction not donated at fair rental value.\(^2\) It was clear that no grip was released on the undonated portion. There is no reason why a rent-free lease is not possible, provided that the charity's interest in the property not contributed is not the equivalent of ownership.

The donor may wish to contribute the whole property to the charity,

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124. For an excellent discussion of this subject, see Cutler, Various Aspects of Contributions to Charities, N.Y.U. 17th Inst. on Fed. Tax 1117, 1127 (1959).
taking back secured notes which are cancelled from time to time. This plan has been sanctioned for years, even though the charity may have been established by the donor.\textsuperscript{132} Yet, recently, the Tax Court held that a gift of the entire property took place in the initial year where the notes were not meant to be consideration for the transfer and there was no intention from the beginning that they be enforced.\textsuperscript{133} Caution should be exercised where the charity is family-sponsored and lacks funds for the repayment of the indebtedness.

A variation of the plan involving an exchange of property for notes is the transfer of property to a charity secured by an obligation in favor of some third person.\textsuperscript{134} The taxpayer may wish to make contributions to the charity which could be used to retire the mortgage. Much care must be taken to relieve the donor from any liability on the indebtedness after the transfer. Otherwise, any payment in reduction of the donor's indebtedness will be income to him.\textsuperscript{135}

The donor may, of course, retain the use of the property contributed by the retention of a life estate. The amount of the contribution is the value of the remainder interest. One plan which has enjoyed some success is the establishment of a revocable trust for the lifetime of the donor, the remainder interest being in the charity. If the settlor wishes to make a contribution within the limitations imposed by section 170, he can cause a certain fraction of the trust to become irrevocable each year. The amount of the deduction is the value of the remainder interest to which the charity has an undisputed right.

Paintings and other objects of art, the enjoyment of which the donor wishes to retain, have become attractive subjects of charitable giving. Under Revenue Ruling 57-293,\textsuperscript{136} a taxpayer may dispose of an art object, or any fractional interest therein,\textsuperscript{137} but reserve possession of the whole during his lifetime. His deduction is the present value of that fraction of the remainder interest donated. One may also donate a fractional present interest in the art object but retain the remaining portion. In this case, the gift is valid if the charity receives all the rights, such as possession, dominion, and control, consistent with the tenancy in common thus created. If, for instance, a one-third interest is transferred and the donee may possess and enjoy the art object four months of the year, the gift qualifies. But it will fail if the donee's rights are restricted by his retention of full possession for an indefinite period.

\begin{enumerate}
\item Andrews v. Burnet, 50 F.2d 332 (D.C. Cir. 1931).
\item Minnie E. Deal, 29 T.C. 730 (1959).
\item Consideration should be given to the effect of Int. Rev. Code of 1954, § 514 (unrelated business), if the property produces income.
\item Herff v. Rountree, 140 F. Supp. 201 (M.D. Tenn. 1956).
\end{enumerate}
Gifts Involving Taxable Income

The possibility that a contribution may give rise to taxable income in the donor cannot be overlooked. In this area, two general rules deserve consideration.

First, if income itself is the subject of a gift, it will be taxed to the donor upon its receipt by the charity. In an early ruling, the Commissioner held that a taxpayer who contributed bond coupons to a charity was required to include the interest in his taxable income when it was received by the donee. Thus, the donor may be entitled to a deduction, but the tax benefit is neutralized by the treatment of any income contributed as being taxable to him.

On the other hand, despite periodic sniping by the Commissioner, it is clear that the gift of appreciated property does not of itself give rise to taxable income in the donor. This follows from the rather obvious fact that the donor has not realized any gain as where he sells or exchanges property. Thus, it may be advantageous for a taxpayer, with a charitable commitment, to contribute an asset having a value in excess of its tax basis. This is particularly true where the alternative is sale of asset and contribution of the proceeds. It is important to realize that the benefit accruing to the charity which receives the donation is increased by the amount of the tax which would otherwise have been paid by the donor.

Whether or not taxable income results from the contribution of property depends in large measure on which of the above rules is applicable. The dust apparently has settled over the battle which raged with respect to the contribution of inventory items—livestock, grain, and machinery produced. In an early ruling, the Commissioner, perturbed that a taxpayer could obtain one deduction for the cost of growing agricultural products and another for their fair market value upon a gift to a charity, held that at the time of gift, there was a realization of income in the amount of the fair market value of the products contributed. The ruling was directly contrary to two later court decisions which had placed the contribution of inventory items under the second rule above. In *Campbell v. Prothro*, a rancher gave calves to the YMCA. In a lucid opinion, the court, denying the Commissioner's right to tax the rancher on appreciation of the calves, predicated its decision upon the following points: (1) no vested right to income was conveyed away within the principle

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139. See Gelfand, The Individual Income Tax Base and the Charitable Contributions Deduction, 3 Tax Revision Compendium 441.
enunciated in *Helvering v. Horst*;\textsuperscript{142} the animals do not represent income per se; (2) the taxation of unrealized appreciation requires a sale; (3) a gift of appreciated property is a gift of both the principal and the anticipated income which is outside the *Horst* principle.

Subsequently, the Commissioner relented in part and revoked his ruling, recognizing that the fair market value of inventory was not taxable at the time of donation and that the donor was entitled to a contribution deduction for the fair market value of an inventory item.\textsuperscript{143} Still, he attempted to limit fair market value to cost or the amount the donor would have to spend in his most favorable market to replace the donated property immediately. Still wary of double deductions, the Commissioner further stated that the following adjustments would have to be made with respect to the cost of producing the property donated: (1) cost items of producing the property must be removed from inventory; (2) cost items deducted in prior years must reduce the amount of the contribution. The unsoundness of the position thus taken was finally recognized by the Commissioner’s present regulations,\textsuperscript{144} which embody the foregoing principle with two notable exceptions. Foremost is a belated acknowledgment that fair market value is measured by sales price, not replacement cost. In holding that value is determined by the price at which an object could have been sold in the lowest usual market in which the taxpayer customarily sells at the time of contribution, the Commissioner merely confirms long standing case law. The second is that the Commissioner does not require expenses of producing the article deducted in prior years to reduce the amount of the contribution. The regulations state that costs and expenses in the year of contribution are not deductible, as well as those in a prior year, but only if they are reflected in cost of goods sold in the year of contribution, in which case costs of goods must be reduced accordingly.

Quite significantly, the satisfaction of a pledge comes within the second rule above. No gain or loss is realized by the satisfaction of a pledge with appreciated property.\textsuperscript{145} This conclusion follows from a decision not to treat the satisfaction of a pledge in the same manner as the satisfaction of a debt.

Logically, the contribution of section 306 stock to a charity will not result in income to the donor. Section 306 stock is certain preference stock described in that section of the Code, the disposition of which leads to the receipt of ordinary income. The Commissioner holds that no income results to the donor of section 306 stock either upon the con-

\textsuperscript{142} 311 U.S. 112 (1940).
\textsuperscript{144} Treas. Reg. § 1.170-1(c) (1954).
CHARITABLE DEDUCTIONS

tribution or upon the subsequent sale of the stock by the charity. The taxpayer will be entitled to a charitable contribution equal to the fair market value of the stock.

Another kind of gift which does not give rise to taxable income is the sale of appreciated property at its basis to the donor. A deduction is available for the excess of the value over the sales price. The Commissioner in private rulings has held that no taxable gain results from this transaction if the sales price is equal to or below basis. On the other hand, if the taxpayer disposes of real estate to a charity in an installment sale, rather than on a bargain sale basis, and makes a gift of each annual payment as it falls due, he will be taxable as though he had disposed of an installment obligation under section 453 of the Code.

Where property subject to an indebtedness is contributed, there is a danger that the transaction may be considered as one giving rise to taxable income. This is particularly true where the indebtedness exceeds the donor's tax basis. For example, a donor wishes to contribute $10,000 by means of a house worth $40,000 in which he has a tax basis of $20,000. He places a mortgage in the amount of $30,000 and contributes the property subject thereto, taking a deduction for the $10,000, the difference between the fair market value and his equity. Although there are no published rulings or cases on this point, it is the Commissioner's present view that the transaction gives rise to taxable income. However, the transaction may possibly be treated as a sale of the property to the charity for the amount of the liability assumed. The taxation of such transfer does not embody concepts entirely new to our taxing system. In certain tax-free reorganizations, section 357 taxes to the transferor as a gain upon the sale of an asset the excess of the amount of the liability to which the property is subject over its basis. In such a case, the gain may be capital or ordinary income depending on how the property was held by the transferor. On the other hand, the Commissioner may treat the transaction as resulting in income under the general provisions of section 61 of the Code, therefore taxable at ordinary rates.

One type of gift to be wary of pertains to that group of tax devices once promoted by financial counsel in the interest of their clients, but not encouraged by charities. It was observed that if property was transferred to a charity subject to an indebtedness, the interest of which was prepaid by the donor, a deduction might be available not only for the interest but also for a like amount as a charitable contribution of the enhanced value of the gift. Taxpayers in brackets above fifty per cent might actually make money on the gift. A variation in the case of bonds

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subject to an indebtedness was to contribute the bond just before the receipt of an interest payment. The taxpayer here deducted the interest to carry the indebtedness and also the unreceived interest payment which added to the value of the gift. Section 170(b)(4), added in 1958, reduces the charitable contribution by the interest prepaid for any period after the making of the gift and, in the case of bonds, by any interest to carry them before the date of the gift, but only to the extent that income from the bonds is not includable in the donor’s income.

III. CHARITABLE BEQUESTS

General

The nature of a charitable bequest is so similar to a lifetime gift that it might appear that the differences are hardly worth mentioning. However, for tax purposes, there are some distinctions worthy of consideration.

At the outset, it should be noted that insofar as taxes are concerned, the over-all advantage lies with the lifetime gift. Not only is the gift deductible for income tax purposes, but also the property is out of the donor’s estate and hence not subject to the estate tax. When the donor dies after having made a deductible gift to a charity, a double tax benefit is thus enjoyed. The life income plan detailed above is a particularly happy example of “having your cake and eating it too.” The donor, who donates a remainder to a charitable institution after reserving the income to himself for his life, has in effect made a testamentary disposition of the property. He has set aside the remainder irrevocably for the institution concerned. Moreover, in the year of gift, he obtains a deduction for the value of the remainder for income tax purposes. Ordinarily, this deduction is subject to the general twenty per cent limitation of section 170(b)(1)(A). However, if the remainder is payable to an operating educational organization, hospital, or church, the extra ten per cent limitation under section 170(b)(1)(A) is applicable. Even where the income is payable to another beneficiary after the life of the donor, a partial duplication of tax benefits is obtained in that the value of the remainder at the time of gift is deductible for income tax purposes, and the value of the remainder at the time of the donor’s death is excluded from the donor’s gross estate.

The general characteristics of the federal estate tax merit review. First, as previously indicated, there is no limit on the size of the charitable bequest for deduction purposes. However, whereas the income tax benefit of a charitable gift is available to any taxpayer depending upon

his rate, the charitable bequest affords an estate tax benefit primarily in the case of an estate of some substance, because only an estate in excess of the $60,000 exemption is subject to the federal estate tax. Where the decedent is married and leaves half of his estate to his wife, the bequest to the spouse is deductible to the extent of one-half of the adjusted gross estate. In such a case, the estate must thus exceed $120,000 before there is a federal estate tax and a benefit from a charitable bequest. On the other hand, the rate of tax is rapidly progressive once a federal estate tax is assessable. The tax rate increases from zero at $60,000 to thirty per cent at $160,000. Thereafter, the rate increases gradually so that a tax in excess of sixty per cent is not reached until the estate exceeds $4,000,000. The lesson to be learned is that even in a modest estate the deduction for a charitable bequest may prove of substantial value.

Mention should be made of the state tax aspect of charitable bequests, which is sometimes overlooked. Local death tax duties often take the form of an inheritance tax on the beneficiary receiving a bequest. Although the rate does not usually exceed fifteen per cent, it is not unusual for that rate to be imposed upon the whole bequest without reduction by way of exemption. For example, a Maryland bequest to a collateral heir is taxable at the rate of seven and one-half per cent. Thus, even a small estate may reap some state tax benefit from a charitable bequest. It should be kept in mind that some states impose an inheritance tax on a bequest to an out-of-state charity and invalidate charitable bequests made within a certain period before the decedent's death.

Before dealing with the specific problems inherent in charitable bequests, it might be well to mention several situations where the charitable bequest may serve a special purpose. By use of a charitable bequest, a decedent can actually increase the amount of income available to his wife or some other beneficiary. The bequest of a remainder after a life estate is, of course, deductible for federal estate tax purposes. By reducing the federal estate tax on the decedent's estate, such a bequest actually increases the assets remaining after taxes and, therefore, the income which is payable to the surviving beneficiary. This could be of particular benefit in the case of a childless couple who wish protection during their lifetimes. Note also that a charitable bequest may, under some circumstances, provide the means by which a decedent retains control of a family corporation for his heirs. By making a bequest of stock in a family corporation to a family foundation, a decedent may reduce the estate tax on his estate. If the estate is large, the savings may be substantial, and the need to provide funds for the federal estate tax greatly reduced. As a result, other family stock need not be sold and effective control can be retained, at least for a time.
Passage of Property to Charity

Bequests. These dispositions account for most of the charitable deductions from the gross estate. A charitable bequest may take many forms, whether in the foremost part of a decedent's will or in the residuary clause. It may convey to the charity such interests as a right to a sum of money or property, a right to income, or a remainder interest after the payment of an annuity. The donee must be one described in section 2055(a), and the charity must have at the decedent's death some interest of ascertainable value.

Exercise of a power. Section 2055(b)(1) makes the exercise of a power of appointment a useful tool in charitable giving. If the decedent exercises, fails to exercise, releases, or causes to lapse a general power of appointment over property which is includable in his estate under section 2041, and by this action, property passes to a charity, the estate will be allowed a deduction. If, for example, a decedent dies possessed of a general power of appointment granted him in the will or trust indenture of another, the exercise of that general power in favor of a charity qualifies for the estate tax deduction. If the charity is a taker in default of the exercise of the power by the decedent and he fails to exercise the power, a deduction would also be obtained.

Disclaimer. It often results that where the residue of an estate passes to a charity, a refusal by a legatee to accept the bequest due him will increase the amount going to charity. Section 2055 allows the charitable deduction for any amount which accrues to a charitable institution as result of such disclaimer. The disclaimer must be made before the estate tax return is due to be filed (i.e., fifteen months after decedent's death). A power in a person to divert, by invasion, appointment, or otherwise, what passes to a charity often causes a charitable bequest to fail. These powers of diversion may be the subject of disclaimer just as powers of appointment.

Section 2055(a) provides that if this power to consume, invade, or appropriate is terminated by the death of the holder, a deduction from the gross estate may of course result from an inter vivos transfer, for instance, where decedent has transferred property to charity from which he has carved out a life estate. Estate of James M. Schoonmaker, 6 T.C. 404 (1946). Life insurance payable to a charity which is includable in the gross estate is another example.

150. A deduction from the gross estate may of course result from an inter vivos transfer, for instance, where decedent has transferred property to charity from which he has carved out a life estate. Estate of James M. Schoonmaker, 6 T.C. 404 (1946). Life insurance payable to a charity which is includable in the gross estate is another example.


153. The word means a complete and unqualified refusal to receive rights before any acceptance, where there is no consideration for the act. See S. Rep. No. 1631, 77th Cong., 2d Sess. 240 (1942).


or otherwise before the due date of the return and before any exercise, the effect will be that of a formal disclaimer.

**Enforceable pledges.** Under Section 2053(c)(1)(A), payment by decedent's estate of his charitable pledge or subscription which is enforceable\textsuperscript{156} and evidenced by a promissory note or otherwise will be treated as a claim against the estate to the extent the same is allowable under section 2055 if it were a bequest. Before 1942, the Internal Revenue Service insisted that to qualify for a deduction as a claim, a pledge had to be not only enforceable but also contracted bona fide and received by the decedent for an adequate consideration.\textsuperscript{157}

**Eighty-year holder of a power.** A charitable deduction results from a disclaimer only if a charity is the taker in default. In 1956, Congress relaxed this rule in the case of a decedent who leaves property in trust for a surviving spouse of relatively short life expectancy.\textsuperscript{158} If the spouse is entitled to the all of the net income for life, is over eighty years at the decedent's death, and has a power over the corpus adequate to pass property to charities described in section 2055(a)(2), the decedent's estate is entitled to a charitable deduction upon the following conditions: (1) the surviving spouse must receive none of the principal during her life; (2) the surviving spouse must execute within one year after the decedent's death an affidavit specifying the extent to which the power in favor of these organizations is intended to be exercised; and (3) the power must actually be exercised in accordance with the affidavit. The amount of the deduction will be that portion of the trust transferred to charity reduced by the life estate.\textsuperscript{159}

**Disallowance of Deduction**

*Takers by purchase.* With the statutory exceptions already mentioned, it is essential that the charity take as a result of an act of the decedent. No deduction will be allowed for a transfer which, uncertain or defective at the decedent's death, later ripens through negotiations with the heirs. The heirs, not the decedent, will have made the transfer, and the charity will have taken by purchase.\textsuperscript{160} As an illustration,\textsuperscript{161} a will pro-

\textsuperscript{156} Enforceability is a question of local law. Estate of Stanley T. Sochalski, 14 T.C.M. 72 (1955). Allowance of an uncontested charitable claim by a probate court is not proof of enforceability. Ibid.


\textsuperscript{159} Under Int. Rev. Code of 1954, § 6503(e), the statute of limitations for the assessment or collection of the tax on the decedent's estate is suspended until thirty days after the same period with respect to the estate of the surviving spouse.

\textsuperscript{160} Rev. Rul. 55-335, 1955-1 Cum. Bull. 455. If the charity takes under a compromise as a legatee, say, under a prior will, the rule does not apply. Dumont's Estate v. Commissioner, 130 F.2d 691 (3d Cir. 1945).

\textsuperscript{161} Robbins v. Commissioner, 111 F.2d 828 (1st Cir. 1940).
vided for a bequest after a life estate to Amherst College, the monetary amount of which was left to the discretion of the life tenant. This bequest, being indefinite, would have supported no deduction. However, following the decedent's death, the heirs reached an agreement as to the amount passing to Amherst, and the estate was administered accordingly. The court, disallowing the deduction, declared:

Hence, it is clear that whatever rights Amherst College has now come to it through the compromise agreement and not under the will of the testator . . . Obviously, to allow a deduction of the gift . . . to Amherst College . . . is to allow a deduction not under the will of the testator but under the compromise agreement. This would not be a transfer tax on the property of the decedent at the date of his death. It is not a deduction permissible under this statute.162

The same result is reached where bequests to charity are void under state law (for instance, because the will was executed too soon before death) and the takers in default nonetheless agree to honor the decedent's wishes.163 In these cases, the courts generally hold that the transfer arose not from the decedent's will but from the bounty of others.164

*Conditional bequests.* Though it has many applications, the principle is simple that a charitable deduction will not be allowed unless the possibility that the transfer will not become a fact is so remote as to be negligible.165 If at the decedent's death it is uncertain that the charity will benefit, the deduction is lost and cannot be perfected by some later event. The foregoing does not mean that the facts must be known to establish the certainty of a charitable bequest, but only that they exist. In one case,166 a charity was to benefit only if three aliens were not alive at the time of the decedent's death. Though it was not known for years that the aliens had predeceased the decedent, the deduction was upheld since the gift had vested when the testator died.

There are many factors causing uncertainty. Quite frequently, the amount passing to charity is left to the discretion of others. No charitable deduction will result from a provision in a will that a relative of the decedent shall make charitable gifts in such amounts and to such institutions as he shall decide.167 Obviously, such bequests create no interest that a charity can calculate.

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162. Id. at 832.
A bequest often miscarries because conditions are attached to the acceptance of the property. One decedent devised a farm to the city of Milwaukee provided that it be maintained as a public park or, if not, to other political subdivisions in succession. The third devisee, a county, after long deliberation accepted the property. Being influenced by the decline of two charities to accept the property and the hesitance accompanying the county's acceptance, the court held that the possibility was not remote that charity would not accept the farm. Another deduction was disallowed because the consent of the decedent's widow was necessary before the charitable bequests should become effective. A bequest to a university for the construction of a dormitory, provided that within a year funds be raised to make up the difference in construction costs, is not deductible even if the money is procured in time. A charitable bequest need not be unrestricted, but the conditions made cannot be so onerous that there is even a small chance that the charity will refuse the bequest. Each case presents a question of fact. It is probably true that if charity does in fact accept the bequest, the Government will find it difficult to argue about the conditions imposed. It might be prudent to consult the charity at the time the will is drafted if any material conditions are to be placed on a charitable bequest. Where the bequest is dependent upon the happening of some event subsequent to the decedent's death, the deduction will not ordinarily be allowed. In Humes v. United States, the decedent's cash bequests to charity could not mature unless a fifteen-year-old unmarried girl died without issue before attaining the age of forty. The Court declared:

One may guess, or gamble on, or even insure against, any future event. The Solicitor General tells us that Lloyds of London will insure against having twins. But the fundamental question in the case at bar, is not whether this contingent interest can be insured against or its value guessed at, but what construction shall be given to a statute. Did Congress in providing for the determination of the net estate taxable, intend that a deduction shall be made for a contingency, the actual value of which cannot be determined from any known data? Neither taxpayer, nor revenue officer—even if equipped with all the aid which the actuarial art can supply—could do more than guess at the value of this contingency. It is clear that Congress did not intend that a deduction should be made for a contingent gift of that character.

Most courts will not try to guess what chance a charity may have of being actually enriched. If established actuarial tables based upon

168. United States v. Fourth Nat'l Bank., 83 F.2d 85 (10th Cir. 1936) (bequest to church for building if an equal amount is raised).
170. First Trust Co. v. Reynolds, 137 F.2d 518 (8th Cir. 1943).
172. 276 U.S. 487 (1928).
173. Id. at 494.
mortality, such as those showing the present value of a remainder interest after a life estate, cannot be employed, the deduction will often be denied as being impossible of calculation.\textsuperscript{174} The bequest can be deferred but must be assured.\textsuperscript{175} Extraneous facts, however, may show that a charity has a vested interest in property that passes only upon the fulfillment of a contingency, such as the death of a life tenant without issue. Most courts allow a deduction when the life tenant by an operation has been rendered incapable of having children.\textsuperscript{176} There appears to be a conflict when the life tenant is of advanced age.\textsuperscript{177}

A conditional bequest may occur also when a charity's remainder interest is subject to erosion because invasion of corpus for the life tenant is permitted. If the extent of invasion is guided by an ascertainable standard, the likelihood and the quantum thereof can be thus computed and the charitable deduction made certain. If no standard is set, the charity's share may vary from all of the remaining corpus to nothing. Invasion of the corpus to provide funds "that may be necessary to suitably maintain [a life tenant] in as much comfort as she now enjoys" has been held to constitute such a standard.\textsuperscript{178} The following powers did not provide a suitable standard:

\begin{itemize}
\item To expend \ldots either income or principal, for the pleasure, comfort and welfare of my mother. The first object to be accomplished is to take care of and provide for my mother in such manner as she may desire.\ldots.\textsuperscript{179}
\item To invade the corpus 'at such time or times as my said Trustee shall in its sole discretion deem wise and proper for the comfort, support, maintenance, and/or happiness of my said wife, and it is my wish and will that in the exercise of its discretion with reference to such payments from the principal of the trust fund to my said wife, May L. Field, my said Trustee shall exercise its discretion with liberality to my said wife, and consider her welfare, comfort and happiness prior to claims of residuary beneficiaries under this trust.'\textsuperscript{180}
\end{itemize}


\textsuperscript{175} Commissioner v. Sternberger's Estate, 348 U.S. 187 (1955). In United States v. Dean, 224 F.2d 26 (1st Cir. 1955), a charity would take if the testatrix's sister, aged 82, predeceased two people, aged 67 and 68. The chance charity would benefit was not capable (except by suicide) of being influenced by an act under one's control, such as having issue. The court thought mortality tables sufficient to evaluate this chance at 11-to-1 in favor of the charity's receiving property, but disallowed the deduction because the possibility of failure was not so remote as to be negligible.

\textsuperscript{176} United States v. Provident Trust Co., 291 U.S. 272 (1934).

\textsuperscript{177} Deduction disallowed: Farrington v. Commissioner, 30 F.2d 915 (1st Cir. 1929) (life tenant, age 52); deduction allowed: City Bank Farmers' Trust Co. v. United States, 74 F.2d 692 (2d Cir. 1935) (life tenant, 59 years old); Ninth Bank & Trust Co. v. United States, 15 F. Supp. 951 (E.D. Pa. 1936) (life tenants, 67, 63, and 57 years old).

\textsuperscript{178} Ithaca Trust Co. v. United States, 279 U.S. 151 (1929).

\textsuperscript{179} Henslee v. Union Planters Nat'l Bank, 335 U.S. 595, 596 (1949).

\textsuperscript{180} Merchants Nat'l Bank v. Commissioner, 320 U.S. 256, 257-58 (1943).
As far as the Service is concerned, if the power of invasion is governed by such words as "comfort and support," a standard will be supplied which will be the beneficiary's mode of living prior to the decedent's death.\textsuperscript{181} Once the standard is ascertained, the amount of corpus, if any, which will be used to meet the necessity of invasion can be computed. The value of the charity's interest will be reduced, of course, by such amount.

\textit{Mathematical Problems}

It is clear that the tax benefit is obtained only to the extent that charity profits. Section 2055(c)\textsuperscript{182} requires, therefore, that the deduction be offset by any taxes which reduce the charitable bequest.\textsuperscript{183} Calculation of the federal estate tax is complicated enough when only this tax does the reducing. If the charitable bequest is reduced by the estate tax, the deduction is decreased and the tax increased. The final federal estate tax must be calculated by an algebraic formula or by trial and error. But when the deduction must be reduced by state taxes as well, the problem is compounded. The complexity can be illustrated by the example of a charitable bequest by a District of Columbia resident of a remainder interest in the residue following a life estate. The amount passing to charity is not known until the federal estate and District of Columbia inheritance taxes are calculated. These taxes, being paid here from the residue, reduce what the charity receives. The District of Columbia tax cannot be determined until the federal tax, which is a deduction from the former, is known, and the federal tax cannot be computed without ascertaining the charitable deduction, which necessitates knowing both District of Columbia and federal taxes. It is sufficient to say that the mathematical problem is substantial. If the charitable bequest is taxed by the state, the confusion is further increased.

The only way to save an executor the mental torture of such problems is to place the charitable bequest where it will not be reduced by taxes, as in a paragraph preceding the residue with provision that taxes be paid out of the residue.

\textit{Deduction of Local and Foreign Death Taxes on Charitable Bequests}

As was suggested, not all charitable bequests are free of local and foreign death taxes. These usually constitute a credit against the federal estate tax.\textsuperscript{184} But the credit is limited in amount, and no credit obtains

\begin{itemize}
\item \textsuperscript{182} Treas. Reg. § 20.2055-3 (1954).
\item \textsuperscript{183} To what extent the charity will bear the taxes is a matter of apportionment under local law.
\item \textsuperscript{184} Int. Rev. Code of 1954, § 2011.
\end{itemize}
in the case of taxable estates of $40,000 or less. Thus, local and foreign death taxes may not be recouped by deduction from the federal estate tax. It follows that a deduction for these death taxes on charitable bequests would be more beneficial than a credit. Section 2053(d) provides just this opportunity if the executor of the estate elects the deduction before the statute of limitations runs upon the assessment of a deficiency. Conditions to the deduction are either: (1) that the decrease in federal tax resulting must inure to a charity (as where it receives the residue from which federal taxes are paid); or (2) that the federal estate tax is apportioned among all the estate’s distributees (as where under local law each legatee bears his proportionate share of these taxes based upon the net bequest to him).

CONCLUSION

There is much discussion these days about the erosion of our tax base due to the deductions provided, and the privileges given, various taxpayers. The effect, it is alleged, is to distribute the tax burden unequally and to cause unnecessarily high tax rates. The upshot of all the suggestions on this subject to date seems to be something like a gross income tax. There will then indeed be a broad tax base. All taxpayers will compute their taxes based upon percentages of income figured alike, without deductions or any regard for ability to pay.

It has been suggested that the charitable deduction constitutes one of these undermining factors. Yet, any erosion because of the charitable deduction stems not from today’s events but from the very beginning of the tax laws from which it originated.

It is true that the charitable deduction deprives the Government of taxes, and if it were abolished, the Government would of course benefit. Therefore why not eliminate it? The answer is simple. Elimination of the charitable deduction would mean the demise of a large segment of our charitable institutions which depend upon it to stay solvent. If these are not to succumb, funds must come from that source which will benefit at their expense, the Government. Then the result will be government-sponsored schools, hospitals, and churches. The money to support the government in these endeavors will inevitably come from the taxpayer.

It is submitted that the charitable deduction does have a place in our tax laws since it relieves taxpayers generally of obligations they might have to assume were it not for those generous people throughout the country who support charities and incidentally derive tax benefits.