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CHARITABLE REMAINDERS AND THE INCOME TAX

JOSEPH D. GARLAND*

A SIMPLE BUT FREQUENTLY overlooked procedure for painless charitable giving, advantageous to both the donor and the recipient exempt organization, is the contribution of a vested remainder interest. The procedure is painless because it need not result in the surrender of possession or enjoyment of property during the donor's lifetime. It is advantageous to the donor because, subject to the percentage limitations, he secures one of the most sought after items in modern society, a present income tax deduction. Finally, the exempt organization donee is an enthusiastic and appreciative recipient, for despite the postponement of possession or enjoyment, once the arrangement has been executed it is certain eventually to receive the property and is no longer subject to the continued good will of a prospective testator-donor.

For example, Mr. Discriminating Giver, a bachelor, is fifty years old and is in the thirty-eight percent federal income tax bracket, enjoying a taxable income of ten to twelve thousand dollars a year.[1] He owns one hundred shares of common stock of the National Dog Biscuit Company which have a market value of $100 a share. By transferring some or all of these shares to a simple irrevocable trust, income payable to Giver for his life and remainder to the Propagation of the Faith, he will obtain a present income tax deduction[2] equal to the value of the remainder interest contributed to the charity, as determined by actuarial tables.[3] Since the present value of the right to receive $1 after the death of a

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[1] For simplicity, an unmarried taxpayer who is not the head of a household has been chosen as the contributor. Married couples filing joint returns, surviving spouses and heads of households have also been known to make charitable gifts and, of course, the same principles are applicable to them.

[2] Subject, of course, to the percentage limitations of §170 (b) of the INT. REV. CODE OF 1954, discussed *infra*.

[3] U. S. Treas. Reg. 108, §86.19 (f); IRS ACTUARIAL VALUES FOR ESTATE AND GIFT TAX, PUBLICATION NO. 11 (1955) (Reprinted, 2 CCH ESTATE AND GIFT TAX REPORTER #8003); see also, U. S. Treas. Reg. 105, §81.10 (i).

man presently fifty years old is actuarially computed to be $0.4803, a deduction of $48.03 will accrue to Giver for every $100 worth of property conveyed to the trust. If Giver would like a deduction of approximately $1000, which in his bracket would save him $380 in taxes, he should transfer $2100[4] or 21 shares to the trust. Moreover, once the trust is established, before the end of each successive tax year Mr. Giver can determine the amount of money or property he should transfer to the trust in order to obtain the maximum charitable contribution deduction or whatever lesser deduction he may desire.[5] In addition to the present tax saving, which increases spendable income, Mr. Giver will continue to receive income for the rest of his life from the property constituting the trust corpus.

Moreover, all the rules relating to the contribution of property which has appreciated in value are applicable. At least in the case of property which is not inventory nor held for sale to customers in the ordinary course of business,[6] a contribution of property does not constitute the realization of taxable income. At the same time, the amount of the charitable deduction is determined by the value of the property transferred at the time of the gift without regard to its tax cost or basis.[7] If, in our hypothetical, Mr. Giver had paid $50 a share for the stock, he would still obtain a deduction of $48.03 for each share, a remainder interest in which he contributed to charity.

The tax advantage of this form of gift over charitable bequests or devises is obvious since the estate tax consequences are similar. The donor has traded his freedom to revoke a testamentary provision for a substantial income tax saving.

Variations

While the illustration involves a trust and income producing property, neither is necessary to secure a deduction for the value of a remainder contributed.

A remainder after a legal life estate would qualify.[8] Thus a home owner could convey his home to himself for life, remainder to a charity and obtain the deduction while continuing to live on the property.[9] Of course, the law of waste as well as the other rules regarding the relationship of life tenant and remainderman would apply.[10]

A deduction could also be obtained for the gift of a remainder interest following more than one life,[11] for example, a gift

[4] The exact figure is $2082.03.

[5] As Mr. Giver gets older, the percentage value of the remainder interest will increase.

[6] The same rule may apply to these types of property: Rev. Rul. 138, 1955-1 CUM. BULL. 223, revoked I.T. 3910, 1948-1 CUM. BULL. 15; Rev. Rul. 531, 1955 INT. REV. BULL. No. 34, at 17, revoked I.T. 3932, 1948-2 CUM. BULL. 7; Campbell v. Prothro, 209 F.2d 331 (5th Cir. 1954).

[7] Rev. Rul. 275, 1955-1 CUM. BULL. 295.

[8] With a legal life estate followed by a remainder to a church, school or hospital, there should be no question of the applicability of the special additional 10% limitation discussed *infra*.

[9] The home could also be conveyed by a husband to himself and wife for life, remainder to charity.

[10] For example, consider the problem of special assessments, for a portion of which the charitable remainderman might be liable. If the life tenant paid the entire amount, he would presumably be entitled to a charitable deduction for the amount owed by the remainderman.

[11] G. C. M. 3016, VII – 1 CUM. BULL. 90; Rev. Rul. 275, 1955-1 CUM. BULL. 295; IRS ACTUARIAL VALUES FOR ESTATE AND GIFT TAX, PUBLICATION No. 11 (1955). There was no proof in the record as to the value of the remainder and consequently a deduction was denied in Illinois Merchants Trust Co., 14 B.T.A. 890 (1928).

in trust for the donor for life, the donor's wife for life,[12] with the remainder to charity.[13]

In addition, a life estate-remainder trust could be created with the donor serving as trustee and the corpus consisting of an art collection, rare books, valuable stamps, or any other subject of a hobby or avocation.[14] For the sake of prudence and proof, if such a course is followed, a clearly written trust instrument should be prepared, the charitable recipient notified of the transfer in trust and the gift of the remainder interest should be accepted.

Percentage Limitation Applicable to the Deduction

The gift of a remainder interest to a qualified exempt organization would clearly entitle the donor to a deduction which, together with his other charitable contributions for the year, does not exceed 20% of his adjusted gross income.[15] This limitation is applicable to gifts "to or for the use of" qualified organizations.[16] The special additional 10% deduction for contributions "to" churches, educational organizations and hospitals[17] should also be applicable if the remainderman is such an organization, but this is not certain. The Congressional Committee Reports dealing with the 1954 Internal Revenue Code state that the difference in language is significant.

> It is to be noted that such charitable contributions 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 . . .) are not included under this special rule.[18]

The word "beneficiary" appears to be used in a non-technical sense and to be indicative of a gift of an income interest in trust for the use of the qualified organization.[19] While a remainderman may be technically a "beneficiary" of a trust,[20] it is unusual so to describe him and a remainderman should not be included within the scope of the term unless the clear import of the language used requires it. Clearly the remainder interest which is vested immediately in a church, school or hospital is a gift *to* it and the property itself is not being held *for its use* by anyone. In this connection, the language of I.T. 1776, which is self-explanatory, is significant.

> The taxpayer by a written instrument dated in 1922 conveyed to a trustee and a donee certain bonds. The trustee, under the instrument, was to pay the income from the bonds to the beneficiary of the trust during his lifetime, and upon his death to deliver the bonds to donee, an incorporated church.

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12 Such an arrangement would give rise to a taxable gift of the value of the succeeding life estate given to the wife. Since it is a future interest the annual exclusion [INT. REV. CODE OF 1954, §2503 (b)], would not apply, but the lifetime specific exemption, (INT. REV. CODE OF 1954, §2521), would.

13 Of course, the value of the charitable remainder might be considerably reduced.

14 Life insurance policies can also form the corpus of the trust: Eppa Hunton, IV, 1 T.C. 821 (1943); Ernst R. Behrend, 23 B.T.A. 1037 (1931). However, a simple assignment to the named charitable beneficiary of all incidents of ownership would accomplish the same objective (O.D. 299, 1 CUM. BULL. 151).

15 INT. REV. CODE OF 1954, §170 (b) 1 (B).

16 INT. REV. CODE OF 1954, §170 (c).

17 INT. REV. CODE OF 1954 §170 (b) 1 (A).

18 H. R. REP. No. 1337, 83d Cong., 2d Sess. A 53 (1954); S. REP. No. 1622, 83d Cong., 2d Sess. 207 (1954).

19 *E.g.*, Rev. Rul. 1954, 1953-2 CUM. BULL. 128. See also INT. REV. CODE OF 1954, §673 (b).

20 1 RESTATEMENT, TRUSTS §127, comment *b* (1935) (synonymous with beneficial interest).

The trust terminates on the death of the beneficiary and the gift of the remainder to the church is absolute. The donor has parted with all her interest in and control over the bonds.

The taxpayer states that the remainder interest acquired by the church has a present cash value and claims that he is entitled to deduct the cash value of his gift to the church under section 214 (a) 11 of the Revenue Act of 1921. It is contended that, inasmuch as the gift was not made direct to the church, it may not be deducted under section 214 (a) 11, above referred to.

The donor by the instrument gave, first, a life estate in the bonds to the beneficiary, and, second, the remainder interest to the church. The church has a vested remainder interest in the bonds. There was an immediate gift to the church of a definite right which has a present cash value. It is held that the gift to the church is within the provisions of section 214 (a) 11 of the Revenue Act of 1921 and that the donor may deduct the cash value (computed as of the date of the gift) in accordance with the provisions of said section. (This section contained the clause "to or for the use of").[21]

Form of the Remainder

A remainder interest that is irrevocably vested in an exempt organization gives rise to the deduction. But the donor may wish to "hedge" his gift.[22] For example, he may wish to provide for the possibility of a later invasion of corpus for the benefit of the life tenant. Or, he may desire to make the remainder contingent or vested subject to being divested on the happening of a future event. In either case, he jeopardizes the deduction and, at least, invites litigation.

An analogy can be found in the federal estate tax deductions for charitable remainders following intervening life estates. It has been held that, if a sufficiently definite and fixed standard governs the exercise of the power to invade corpus so as to permit the ascertainment, with reasonable certainty, of the value of the remainder interest to charity, an estate tax deduction for this value is allowable.[23]

Presumably this value itself, as well as the possibility of determining it, would be dependent upon the probability of invasion which would in turn be dependent upon the condition of the life tenant at the time the trust was created. On the other hand, if the remainder to charity is conditional and there is a possibility that the charity will not receive the remainder, no estate tax deduction has been allowed even though the possibility of taking can be actuarially determined.[24]

While there are no clear precedents applicable to the income tax deduction, it can be assumed that the courts will feel, at the very least, no greater compunction to grant an income tax deduction than an estate tax one for these types of remainder gifts. The only safe course to insure the

21 I.T. 1776, II-2 CUM. BULL. 151.

22 INT. REV. CODE OF 1954, §170 (b) 1 (D) denies the deduction for the value of an interest transferred in trust if the settlor retains a reversionary interest which has a value in excess of 5% of the property transferred. The deduction has been disallowed if the trust is revokable, Thomas L. Awrey, 25 T.C. 643 (1955), and if the remainder passes to the charity only in default of the exercise of a power of appointment, I.T. 2403, VII-1 CUM. BULL. 92.

23 Lincoln Rochester Trust Co. v. McGowan, 217 F. 2d 287 (2d Cir. 1954) ("unusual demands, emergencies, requirements or expenses for her personal needs").

24 Commissioner v. Estate of Sternberger, 348 U. S. 187 (1955); *cf.* United States v. Dean, 224 F. 2d 26 (1st Cir. 1955) (disallowed the deduction but indicated that some conditional gifts to charity would qualify).

deduction would appear to be the avoidance of "hedges" of either type by the creation of an irrevocably vested remainder without a power to invade the corpus under any circumstance.

Conclusion

The possibility of desirable arrangements for the disposition of property to exempt organizations by means of remainder gifts are virtually limitless. Since income tax deductions may be available, these arrangements are advantageous to everyone, not only to those wealthy taxpayers who may be concerned with the estate tax. For this reason they should be utilized more frequently than appears to be the case.

CYAMOPSIS TETRAGONOLOBA

Even the occasional scholar and botanist that recognizes *cyamopsis tetragonoloba* as ordinary guar seed may fail to appreciate its significance to the lawyer who is charged with the duty of advising a religious corporation on import duties. Reference to Public Law 1001 of the 84th Congress, Chapter 989, Second Session, H. R. 9396 entitled "An Act to Amend the Tariff Act of 1930 to Place Guar Seed on the Free List," approved August 6, 1956, will show that paragraph 1774 was also amended to include mosaics on the free list which heretofore included altars, pulpits, statuary and similar articles imported for the use of religious corporations or associations.