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TAX SAVINGS BY CHARITABLE CONTRIBUTIONS

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The federal and state governments have adopted the policy of subsidizing charities to some extent by permitting taxpayers to deduct charitable gifts under the income, gift, estate and inheritance tax laws. The resulting tax savings encourage the taxpayer to make such gifts. One of the basic reasons for this policy is the fact that money given to charity is usually spent for purposes which are quasi-public, and governmental expenditures for the public services performed by charities are thereby reduced.

The taxpayer who plans to save taxes by making charitable gifts is in no sense a "tax dodger"; he is merely doing that which his government is deliberately encouraging. No one should make charitable gifts for the purpose of "beating the government out of taxes". No one can improve his financial situation by such tax saving.¹ However, most men have a strong desire to make charitable gifts, and they can secure the satisfaction of giving to a worthy cause in which they are interested and at the same time offset, to a large extent, the cost of the gift by securing a substantial tax reduction.

Possible tax savings can be very substantial even for the man of moderate means; therefore, they deserve frequent consideration by lawyers. All lawyers have a general familiarity with the statutes permitting tax deductions for charitable gifts. Frequently, however, there are difficulties in determining the various tax effects of a particular transaction, or in drafting a will or deed of trust so as to carry out all of the client's purposes with the maximum tax saving. This paper will attempt to summarize the tax benefits and tax pitfalls pertaining to different types of gifts.²

Charitable gifts, or gifts to charity, as the phrases will be used in this paper, refer to gifts which are deductible for tax purposes. While the different taxing statutes vary slightly in defining such gifts, the deduction applies generally to gifts to religious, charitable, educational, scientific and literary institutions not operated for profit. It is usually fairly easy to determine whether the donee

¹ See note 33, *infra*.

² On this general subject, see: Brandis, *Tax Savings by Means of Charitable Gifts*, 27 N.C.L. Rev. 69 (1948); Clark, *Charitable Deductions*, 6 N.Y.U. Institute on Federal Taxation 1015 (1948); Polisher, *Charitable Gifts*, 7 N.Y.U. Institute on Federal Taxation 717 (1949). For a complete discussion written for laymen, see J. K. Lasser, *How Tax Laws Make Giving to Charity Easy* (1948).

comes within the statutory definition. In case of doubt, a ruling should be requested from the Commissioner of Internal Revenue or state tax administrator. Under state laws, the deduction may not apply to gifts to a charity located outside the state.

TESTAMENTARY GIFTS

Testamentary gifts to charity produce very little tax savings in small estates because the federal estate tax exempts the first sixty thousand dollars in an estate, and the Colorado inheritance tax has a minimum rate of 17.6%. In the case of large estates, the tax saving may be very great because the federal rate goes as high as 77%. A gift to charity will reduce the tax in the taxpayer's highest bracket so that the remaining estate will pay a tax at a lower rate. If the decedent's assets consist of a business, it may be necessary to liquidate the business at a sacrifice to raise money to pay a tax on the whole estate; leaving part of the estate to charity may reduce taxes to an amount which can be paid from other assets. If a testator owns property of uncertain value, troublesome and possibly expensive questions of valuation can be eliminated by leaving such property to a charity.

Section 812(d) of the Internal Revenue Code and Section 15 of the Colorado Inheritance Tax Law permit a deduction in full of all amounts left to charity. The interaction of the federal and Colorado statutes will result in a comparatively small Colorado inheritance tax saving, so this discussion will center on the federal law. The federal deduction is the net amount transferred to the charity after payment of any administrative expense which may be chargeable against the gift.

Outright Gifts by Will

The deduction for a gift of money to a charity is the sum actually received by the charity from the estate.

If there is a gift of specific property, the deduction is the market value of the property at the date of death (or optional valuation date). There will be no capital gains tax either against the estate or against the charity at any time, and no capital loss can be taken.

If the gift is of the residuary estate, any estate or inheritance taxes payable out of the residuary estate in respect to other legacies will diminish the amount received by the charity, and the deduction will be limited to the amount actually received by the charity. In case the federal estate tax is to be paid out of the residuary estate left to charity, the amount of tax to be deducted from the residue and the amount of the charitable deduction allowed in figuring such tax are two mutually dependent variables, so that the use of an algebraic formula is necessary.³ This compli-

³ *Harrison v. Northern Trust Co.*, 317 U. S. 476 (1943).

cation may be avoided by providing that estate taxes shall be paid out of the specific legacies and by making such legacies large enough to meet the testator's wishes as to the net amount the legatees are to receive.

Gifts to Charity of a Remainder Interest

If the testator wishes to provide one or more life estates with a remainder to a charity (whether by trust or not), the deduction will be the value at the date of testator's death of the remainder interest as computed by actuarial tables set out in the Regulations.⁴

No deduction can be taken if the remainder is contingent or if its value is not ascertainable.⁵ In *Ithaca Trust Co. v. U. S.*⁶ the court held that a power in the trustee to invade corpus to maintain the life tenant "in such comfort as she now enjoys" did not defeat the deduction of the charitable remainder since the amount of income would unquestionably be adequate without invasion of corpus. But in *Merchants National Bank v. Commissioner*⁷ the Court disallowed any deduction for a charitable remainder because the trustee had a discretionary power to invade corpus to any extent necessary "for the comfort, support, maintenance and/or happiness" of the life tenant. If the testator desires to give a power to invade corpus, the power should be based on some "readily measurable standard"⁸ or limited as to amount, so that the deduction will not be lost. This is also important from an income tax viewpoint. In the *Merchants Bank* case, *supra*, the trustee sold some capital assets at a profit and sought to escape a capital gains tax because the profit was ultimately to go to charity. The Court held that the gain was taxable because the life tenant might be given the profit under the power to invade corpus.

Instead of providing for a life estate with or without power to invade corpus, the testator may wish to provide for definite, fixed annuity payments to a relative with a remainder to charity. The payments being fixed and certain, the actuarial tables can be used to determine the present value of the remainder interest which will be deductible.⁹ The annuitant will pay income tax on amounts received which are paid from income but not on amounts paid from corpus.¹⁰ If the trustee sells capital assets at a profit, there will be a capital gains tax if there is any substantial possibility that corpus will have to be used to pay the specified annuity.¹¹

Even if a testator has no desire to provide for a charity, every will should contain an ultimate remainder of the residue to insure

⁴ Regulations 105, sec. 81.10; *Simpson v. U. S.*, 252 U. S. 547 (1920); *William Korn*, 35 B.T.A. 1071 (1937).

⁵ Regulations 105, sec. 81.44 and 81.46.

⁶ 279 U. S. 151 (1929).

⁷ 320 U. S. 256 (1943).

⁸ *Henslee v. Union Planters Bank*, 335 U. S. 595 (1949); note, 62 Harv. L. Rev. 1076 (1949).

⁹ *William Nelson Cromwell*, 24 B.T.A. 461 (1931); *Leonard S. Waldman*, 46 B.T.A. 291 (1942).

¹⁰ I.R.C., sec. 22 (b) (3) and 162 (b) and (d).

¹¹ *Commissioner v. F. G. Bonfils Trust*, 115 F. (2d) 788 (C.C.A. 10th 1940).

complete disposition of the estate under all possible contingencies; a charity of a character certain to be in existence is admirably suited for this purpose.

*Charitable Gifts and the Marital Deduction*¹²

A testator may avoid the tax on his estate entirely by leaving his estate to his widow and to a charity in equal shares. This will not have the apparent effect of giving his widow only one half as much property as if he had left her his whole estate, because in the latter case the estate tax would diminish the interest received by her—very substantially in a large estate. A testator may go even further and leave one-half of his estate to his widow and an additional \$60,000 to his widow or children or any other person, and there will be no tax on his estate if the balance of his property is left to a charity.

The general effect of a testator's leaving half of his estate to his wife so that his estate can take the marital deduction is not to avoid estate taxes, but merely to postpone them and transfer their incidence from his estate to his wife's estate (unless she can make gifts free from gift tax and not in contemplation of death). If the family desires to make a gift to charity, the question of when and by whom the gift should be made involves consideration of many factors. Generally, taxes will be saved if the gift is made by the will of whichever spouse has the larger estate, regardless of which spouse dies first. Obviously, tax considerations will be secondary to protection of the family. Nevertheless many situations permit a substantial tax saving without prejudicing family interests.

INTER VIVOS GIFTS

Large savings on federal income tax are possible by making charitable contributions, as the deduction reduces the tax in the taxpayer's highest bracket. This tax saving in effect reduces the net cost to the taxpayer of the charitable gift; the United States is in effect contributing to the charity the amount of the tax reduction. For example, a taxpayer having a taxable income of \$100,000 can make a \$1000 gift to charity at a net cost of only \$234.40; a taxpayer with a \$20,000 income will have a net cost of \$533.60 for a \$1000 gift; a taxpayer with a \$10,000 income can make a \$1000 gift at a net cost of \$700.80. Appendix A shows the net cost to the taxpayer of gifts in other tax brackets.

Gift Tax Deduction

Gifts to charity are exempt from the federal¹³ and Colorado¹⁴ gift tax. Even if made in contemplation of death, such gifts will not be subject to estate or inheritance tax on the donor's death.

¹² I.R.C., sec. 812(e).

¹³ I.R.C., sec. 1004 (a) (2) and (b) (2) (3).

¹⁴ COLO. STAT. ANN., c. 75A, sec. 4 (1947 Cum. Supp.)

If a gift is made for the benefit of both an individual and a charity, only the value of the charity's interest is deductible, e.g., on a gift to A for life with remainder to a charity, the value of the life estate is subject to gift tax, and the present value of the remainder is exempt.¹⁵ The relative values of the life estate and of the remainder are determined by tables set out in the Regulations.¹⁶ If the remainder is contingent so that its value is not ascertainable there can be no deduction.¹⁷

Income Tax Deduction Allowable to Different Classes of Donors

(a) *Gifts by individuals* are deductible up to, but not exceeding, 15% of the adjusted gross income.¹⁸ The individual loses the full benefit of his deduction if he uses the optional tax table or takes the standard deduction. Gifts by a married individual, filing a joint return, are deductible up to 15% of the adjusted gross income of both spouses.¹⁹

(b) *Gifts by corporations* are deductible only up to 5% of the corporation's net income, and only if the gift is to be used in the United States or its possessions.²⁰ There may be a question as to whether a gift by a corporation is *ultra vires*;²¹ however, it is not *ultra vires* for a Colorado corporation to make a charitable gift.²² If the gift is made because of direct business benefits to be received from the charity, it should be deductible as a business expense even if it exceeds 5% of the net income; if the benefits to the corporation are indirect, the deduction must be treated as a charitable contribution subject to the 5% limitation.²³

(c) *Trusts and Estates* are permitted a deduction without limitation for *any part of the gross income* which is *paid or permanently set aside or is to be used exclusively* for charitable purposes.²⁴ To take the deduction, a trustee need not show that sums paid to charity are paid out of income receipts if they do not exceed the gross income for the year.²⁵ However, one case has held that a trustee's gift to charity of stock which was clearly corpus and not income was not deductible, even though the value of the stock was less than the gross income of the trust for the year.²⁶ There is a split of authority as to whether a trustee who has given to charity the full amount of a long term capital gain can deduct

¹⁵ The M. D. Thatcher Estate, 38 B.T.A. 336 (1938).

¹⁶ Regulations 108, sec. 86.13 and 86.19(f).

¹⁷ Simon Guggenheim, 1 T.C. 845 (1943).

¹⁸ I.R.C. sec. 23(o).

¹⁹ Taft v. Helvering, 311 U. S. 195 (1940); Regulations 111, sec. 29.23(o)1.

²⁰ I.R.C., sec. 23 (q).

²¹ Landman, The Low Cost of Charity, 26 Taxes 151 (1948); Cousens, How Far Corporations May Contribute to Charity, 35 Va. Law Rev. 401 (1949).

²² COLO. STAT. ANN. c 41, sec. 26(1) (1947 Cum. Supp.).

²³ I.R.C., sec. 23 (a) (1) (B); Lasser, *Corporate Charitable Payments*, 4 Tax Law Rev. 124 (1948); Landman, *op. cit. supra*, note 21; Clark, *op. cit. supra*, note 2 at 1025.

²⁴ I.R.C., sec. 162 (a).

²⁵ Old Colony Trust Co. v. Commissioner, 301 U. S. 379 (1937).

²⁶ W. K. Frank Trust v. Commissioner, 145 F. (2d) 411 (C.C.A. 3rd 1944).

the entire amount or only the 50% which is treated as gross income for tax purposes.²⁷

A deduction can be taken by a trustee for any money "permanently set aside" for a charity even if not paid out at the time. So there can be a deduction for income accumulated for charity if it is certain that it will ultimately go to charity and cannot be diverted to other purposes. In creating any testamentary or *inter vivos* trust partly for the benefit of individuals and partly for the benefit of charity, it is important to provide that all accumulations of corpus from ordinary income or from capital gains shall be dedicated to the charity and cannot be invaded to pay annuities or to make discretionary payments to individuals.²⁸

In What Year May Income Tax Deduction Be Taken?

A corporation on the accrual basis may deduct the gift in the year it is voted by the directors if paid to the charity within two and one half months after the close of the year.²⁹ An individual donor can take the deduction only in the year in which the gift is actually made, whether he is on the accrual or cash basis. A gift of property is made when title passes. A gift of money is made when actually paid. A pledge is not payment. A check is payment if the check is paid when presented.³⁰

It will obviously be advantageous for an individual donor to equalize his gifts from year to year so that he does not exceed the 15% limitation in one year and fall short of it in other years. In *Andrus v. Burnett*³¹ a donor transferred land to a charity, taking its notes which were payable annually over a period of years. Each year as a note fell due he cancelled it, thus spreading the gift over a period of years and getting a deduction each year. Although the Court upheld these annual deductions, such a device appears vulnerable to attack as a mere subterfuge. In the case of gifts of money or property which is divisible, such as stocks or bonds, there is no difficulty in making a pledge in one year and spreading the actual transfers over a period of years to obtain the maximum deductions.

Gifts of Capital Assets

If a gift of property is made, the deduction is measured by the market value of the property at the time of the gift. Since the capital gain and loss provisions apply only to sales, exchanges and involuntary conversions, there is no capital gain or loss

²⁷ *Commissioner v. Central Hanover Bank and Trust Co.*, 163 F. (2d) 208 (C.C.A. 2nd 1947); *Benedict v. U. S.*, 81 F. Supp. 717 (Ct. Clms. 1949).

²⁸ *Moorman Home for Women v. U. S.* 42 F. (2d) 257 (W. D. Ky. 1930); *Commissioner v. F. G. Bonfils Trust*, 115 F. (2d) 788 (C.C.A. 10th 1940); *Commissioner v. Estate of Upjohn*, 124 F. (2d) 73 (C.C.A. 6th 1941); *Estate of Langenbach v. Commissioner*, 134 F. (2d) 590 (C.C.A. 6th 1943); *William P. Allen*, 6 T.C. 597 (1946).

²⁹ I.R.C., sec. 23 (q), as amended Oct. 25, 1949.

³⁰ *Estate of Modie J. Spiegel*, 12 T.C. 524 (1949); *Acq. I.R.B.*, 1949-20.

³¹ 50 F. (2d) 332 (C.C.A. D.C. 1931).

realized on making a gift.³² A very great tax saving results to a donor who makes a gift of property which would be subject to a capital gains tax if sold. He can deduct the present market value of the property and at the same time avoid any tax on the capital gain. For example, an individual may own stock now worth \$15,000 which cost him \$5000 and which he has held over six months. If he sells the stock he will have to pay a capital gains tax of \$2500. If he gives the stock to charity, he will pay no capital gains tax and can deduct \$15,000 for income tax purposes. If he has ordinary income of \$100,000, he will save \$12,183.75 on his income tax. The net cost of his gift is only \$2,816.25 (\$15,000 less \$12,183.75), and in addition he has freed himself from a present or future capital gains tax of \$2500 on a sale of the stock. The same principle applies to the gift of a building which has a market value in excess of its depreciated value on the taxpayer's books. A gift of property on which there is a very large capital gain made by a taxpayer in a high bracket may actually leave the taxpayer in a better financial condition than he would be in if he sold the property and made no gift.³³

Gifts of Property Representing Unrealized Income

In I.T. 3910,³⁴ a farmer gave to charity wheat which he had raised and which was worth more than 15% of his adjusted gross income. He had taken deductions for all the expenses of raising the wheat. The Bureau ruled that the value of the wheat became realized income when the gift was made and must be reported as income, subject to a charitable deduction of 15% of the farmer's adjusted gross income. This holding is contrary to the general rule that income is not realized when a gift is made, but it has some supporting authority.³⁵ In I.T. 3932³⁶ the Bureau ruled that a farmer who gave cattle to his son realized the value of the cattle as income at the time of the gift. These rulings may or may not be followed by the courts, but they indicate a real danger if a donor attempts to avoid tax by giving away unrealized income. They may cast some doubt on the statement made in the preceding paragraph that there will be no capital gains tax on the gift of a capital asset to charity. There is, however, a real distinction between the two situations, and it would appear that under existing regulations and existing decisions there would be little danger of a capital gains tax on the gift of a capital asset.³⁷

³² L.O. 1118, Dec., 1943 Cum. Bull. 148.

³³ The taxpayer has not actually made money by making a gift. He could have kept the property instead of selling it or giving it away.

³⁴ 1948-1 Cum. Bull. 15.

³⁵ *Helvering v. Horst*, 311 U. S. 112 (1940); *Commissioner v. First State Bank of Stratford*, 168 F. (2d) 1004 (C.C.A. 5th 1948), certorari denied 335 U. S. 867.

³⁶ 1948-2 Cum. Bull. 7.

³⁷ *Miller, Gifts of Income and of Property*, 5 Tax Law Rev. 1 (1949); Note, 62 Harv. Law Rev. 1181 (1949). In *Rudco Oil & Gas Co. v. U. S.*, 82 F. Supp. 746 (Ct. Clms. 1949), the government agreed that there was no realization of a capital gain when a corporation made a distribution to stockholders of appreciated assets.

Gifts of Life Insurance

If a life insurance policy is irrevocably assigned to a charity, the donor may deduct the present value of the policy. If the policy is not fully paid up, the cash surrender value is considered to be its present value; if the policy is paid up or is a single premium policy, present replacement cost is considered to be present value.³⁸ If the donor pays premiums on a policy irrevocably assigned to a charity, each premium paid is a deductible gift.³⁹

INTER VIVOS TRUSTS

A living trust is the most flexible vehicle for a donor to use when he has several purposes to accomplish, especially if he wishes alternative dispositions of his funds on different contingencies. It will be impossible to consider here all of the infinite variations possible in a trust and the intricate tax problems that may be involved. Nevertheless, a discussion of the over-all tax effects of a few simple types of trusts may be helpful to illustrate the possible tax savings. If money or property is put in trust solely for charitable purposes, the tax problems are essentially the same as in the case of an outright gift to charity. We are here concerned with the situation where a trust is created for both charitable and private purposes. Usually it will involve a remainder to a charity, subject to income payments or fixed annuity payments either to the donor or to one or more other individuals, or to both.

Revocable Trusts

In general, under all the tax laws, a donor who has retained a power to revoke, alter, amend or terminate a trust (and in some instances if the power is vested in a third person or in the donor and a third person), is treated as if he were still the owner for tax purposes.⁴⁰ Thus the grantor will be taxed on the income of a revocable trust whether it is paid to him or not. He will be permitted to take a deduction for any income paid to charity. There will be no gift tax on the creation of the trust, but any income paid to a third person will be subject to a gift tax when paid. There will be estate and inheritance taxes on the donor's death in respect to property given to individuals, but not in respect to property given to a charity.

There appears to be no substantial tax advantage in creating a revocable trust; yet many donors may prefer a retention of control over their property to the tax advantages of an irrevocable trust.

The grantor of a trust will be taxed on the income of the trust, if it may be used to pay the grantor's obligations or to support his

³⁸ U. S. v. Ryerson, 312 U. S. 260 (1941); Regulations 108, sec. 86.19 (i).

³⁹ Eppa Hunton, 1 T.C. 821 (1948).

⁴⁰ I.R.C., sec. 166, 167, 811 (d); Estate of Sanford v. Commissioner, 308 U. S. 39 (1939).

dependents or to pay premiums on his insurance policies,⁴¹ or if the trust comes within the *Clifford* doctrine⁴² because it does not run over ten years or because the grantor or some third person may have a sufficient administrative control or power to get direct or indirect benefits from the trust. No trust should ever be drafted in the expectation that the grantor will not be taxed on the income therefrom without a study of the *Clifford* case, the regulations with respect thereto and the court decisions applying the regulations.

It is also important to check the estate tax effects of the trust to see that no gift to an individual has been made in contemplation of death, or subject to a reserved life interest in the grantor, or intended to take effect in possession or enjoyment at or after death. Even if the grantor has no possible interest or reversionary right under the trust, it may now be taxed as part of his estate to the extent that he may have created an interest in an individual who can come into possession or enjoyment only by surviving the grantor.⁴³

Even if a grantor has no desire to make a gift to charity it is still advisable to name an ultimate remainderman; a charity so organized that it will have perpetual existence is ideal for this purpose.

Irrevocable Trusts

If a trust is irrevocable and not taxable to the grantor or his estate under the doctrines discussed above, substantial tax savings may result. There will be no income, gift, estate or inheritance taxes on an interest passing to charity (provided the charity's interest is fixed and certain and not subject to any contingency or to invasion for the benefit of an individual). The present value of the interests given to charity will be deductible by the grantor for income tax purposes (up to 15% of the grantor's adjusted gross income) in the year in which the trust was created. Income payable to individuals will be taxed to the recipient. There will be a gift tax on the grantor to the extent of the value of corpus given to individuals. There will be no estate or inheritance taxes on interests given to individuals. Let us see how this works out in a few typical instances.

Example 1. *An irrevocable trust reserving the income to grantor with remainder to a charity.* The grantor can deduct for income tax purposes the value of the remainder interest,⁴⁴ which will be determined by the tables set out in the regulations.⁴⁵ The income received by the grantor will be taxed to the grantor. There will be no gift tax, and no estate or inheritance taxes, since the entire corpus passes to a charity on the grantor's death.

⁴¹ I.R.C., sec. 167.

⁴² *Helvering v. Clifford*, 309 U. S. 831 (1940); Regulations 111 sec. 29.22 (a) 21-22.

⁴³ I.R.C., sec. 811 (e) (3) as amended Oct. 25, 1949.

⁴⁴ I.T. 3707; 1945 Cum. Bull. 114.

⁴⁵ Regulations 108, sec. 86.19.

If capital assets were put into the trust by the grantor, there should be no capital gain or loss to the grantor even though the present value of the property is deductible for income tax purposes. In an unpublished letter dated Dec. 4, 1946, the Commissioner expressly ruled that there would be no capital gains tax on appreciated assets in this situation. I have been unable to find any published ruling on this point. There is a split of authority as to whether there would be a capital gains tax on the trustee if he later sells such assets for more than the donor's basis.⁴⁶ If, instead of creating a trust, the donor had transferred the assets directly to a charitable corporation (exempt under Sec. 101 (6) of the code) subject to a reserved life estate in the donor, there would be no capital gains tax on a later sale by the charitable corporation as it would be entirely exempt from taxation.

Example 2. *An irrevocable trust to pay the income to a third person with remainder to a charity.* The grantor can deduct the present value of the remainder interest.⁴⁷ The income will be taxed to the third person. There will be no estate or inheritance taxes.

There should be no capital gain or loss to the donor if capital assets were transferred to the trust. As to a possible capital gains tax on a later sale by the trustee, the discussion under example 1, *supra*, applies.

Example 3. *An irrevocable trust reserving fixed annuity payments to the grantor with remainder to a charity.*⁴⁸ The grantor can deduct for income tax purposes the present value of the remainder interest in the year in which the trust is created. The grantor will pay income tax only on amounts paid to him out of income even if his annuity payments exceed income.⁴⁹ If the annuity payments are less than actual income, there will be no tax on the undistributed income if it is ultimately to be paid to the charity. There will be no gift, estate or inheritance taxes. If appreciated property were put into the trust, there should be no capital gains tax on the grantor. On a later sale by the trustee there would be a capital gains tax, at least to the extent that any of the profit might be used to pay the annuity.

Example 4. *An irrevocable trust providing annuity payments to a third person with remainder to a charity.* The tax effects are the same as under example 3 except that the income tax on pay-

⁴⁶ See note 27, *supra*.

⁴⁷ I.T. 1776 Dec., 1923 Cum. Bull. 151; G.C.M. 3016, June, 1928 Cum. Bull. 90.

⁴⁸ This situation must be distinguished from a transfer of money or property to a charity in consideration of the charity's agreement to pay an annuity to the transferor. The law is not well-settled as to such a transaction, but in general treats it as the purchase of an annuity and taxes the annuity payments under I.R.C., sec. 22 (b) (2). If the property transferred to the charity is worth more than the insurance company price for a similar annuity, the excess is deductible as a charitable gift. *Raymond v. Commissioner*, 114 F. (2d) 140 (C.C.A. 7th 1940); *Gillespie v. Commissioner*, 128 F. (2d) 140 (C.C.A. 9th 1942). There will probably be a capital gains tax if appreciated property is transferred for an annuity agreement. *Hill's Estate v. Maloney*, 58 F. Supp. 164 (N. J. 1944). See *Lourie and Cutler, Capital Assets Sold on the Installment Basis*, 26 *Taxes* 707 (1948).

⁴⁹ I.R.C., sec. 22 (b) (3) and 162 (b).

ments from actual income falls on the third person instead of on the grantor, and there will be a gift tax on the present value of the third person's interest.

Example 5. *An irrevocable trust for payment of income to a charity with reversion in the grantor.* If the duration of the trust is under ten years, it will be taxable to the grantor. If the trust is for a period of more than ten years, there will be no income tax on the trust income.⁵⁰ There will be no gift tax. The present value of the charity's interest in the trust is deductible by the grantor for income tax purposes. Such a trust enables a grantor to reduce income taxes for a period of time and still retain the future use of the property. In the event that the grantor later decides that he does not need the property, he can get further income tax deductions by giving to the charity additional gifts of his reversionary interest in the trust. Such gifts will not be subject to gift tax. Estate and inheritance taxes will apply only to the value of whatever reversionary interest remains in the grantor on his death.

TAX SAVING UNDER COLORADO INCOME TAX ACT

So far as income tax is concerned, the above discussion has all been directed to the Federal law. The Colorado Income Tax Act is identical with the federal law as to all questions affecting *inter vivos* gifts, excepting that it contains no provisions similar to those of I.R.C. 22(b) (3) and 162(b) relating to annuity payments to a donee or to the beneficiary of a trust. Under Colorado law probably such payments would be treated as gifts and not taxable to the donee even if actually paid out of trust income.⁵¹ Tax savings under the Colorado law will be comparatively small because the tax is based on net income after a deduction for federal income tax. Since a charitable gift reduces the federal tax, it increases the taxable income under Colorado law by the amount of the federal tax saving. This increase in net income partially offsets the charitable deduction under Colorado law.

CHARITABLE FOUNDATIONS

Much has been written regarding tax savings through the creation of a charitable foundation,⁵² and a large number of foundations have been created in recent years. The word "foundation" is not descriptive of any particular form of organization; it may be a charitable trust,⁵³ though it usually is organized as a corporation not for profit. It may be created *inter vivos* or by will. It is so organized as to be tax exempt under I.R.C. Sec. 101(6). Usually

⁵⁰ U. S. v. Pierce, 137 F. (2d) 428 (C.C.A. 8th 1943); Regulations 111, sec. 29.22(a) 21(c).

⁵¹ See Burnet v. Whitehouse, 283 U. S. 148 (1931) decided before sec. 22 (b) (3) was enacted.

⁵² "How to Have Your Own Foundation," Aug. 1947 Fortune 108; Casey, *The Foundation in Estate Planning*, 6 N.Y.U. Institute on Federal Taxation 98 (1948); Clark, *Charitable Contributions*, 6 N.Y.U. Institute on Federal Taxation, 1015, 1031 (1948); Ross, *A Primer on Charitable Foundations and the Estate Tax*, 27 Taxes 116 (Feb. 1949); note, 34 Va. Law Rev. 182 (1948).

⁵³ Commissioner v. Edward Orton, Jr. Ceramic Foundation, 173 F. (2d) 482 (C.C.A. 6th 1949).

the control is retained in the grantor or his family either as trustees or as a self-perpetuating board of directors. Some foundations engage in a competitive business but escape taxation because the income goes to charity.

The tax advantages from charitable gifts discussed throughout this paper apply to gifts to foundations. It is rather doubtful whether the use of a foundation gives any additional tax advantages over other forms of charitable gifts. It does provide several other advantages in certain instances.

If a man's principal asset is a business, his estate may have to sell the business at a forced sale or give up the controlling interest in order to raise sufficient money to pay estate taxes. Control may be retained through voting and non-voting stock, but this won't pay the taxes. In such a case a foundation may be highly desirable. If a large interest in the business is given to a charitable foundation, it will reduce the estate tax so that it may be possible to pay it out of life insurance proceeds or other funds. Control of the business may be retained either through control of the foundation or by giving the foundation only non-voting stock or both.

The use of a foundation gives a man great flexibility and control over his charitable gifts. If he gives 15% of his adjusted gross income to the foundation each year, he can get the maximum charitable deductions. He can then have the foundation spend the money for charity in such manner and at such times as he sees fit.

Most of the other so-called tax advantages of a foundation are nothing but abuses which either would not be permitted today if discovered or will probably be prohibited by an amendment to the law in the near future. The Bureau of Internal Revenue is concerned over the abuse of foundations, and the C. I. O. and other groups are seeking legislation to stop these abuses.⁵⁴ A foundation may incidentally pay a reasonable salary to a relative⁵⁵ or have its funds charged with an annuity,⁵⁶ but if it is created to aid the grantor, it is not entitled to tax exemption.⁵⁷

It is proper for a donor to control his gifts to charity, but it is not proper for him to use control of a tax exempt foundation for his personal or business purposes, such as padding the payroll with relatives, having the foundation loan him money or finance his business enterprises or make other business deals with him or for his financial benefit. There is considerable agitation at the present time for a law prohibiting tax exempt organizations from engaging in a competitive business.

CONCLUSION

A person who desires to make gifts to charity can do so and at the same time reduce his taxes so that the amount of his gift does

⁵⁴ Fiester, "Taxes, Dynasties and Charity," Apr. 9, 1949, *The Nation* 414.

⁵⁵ *Home Oil Mill v. Willingham*, 68 F. Supp. 525 (Ala. 1946).

⁵⁶ See case cited note 58, *supra*.

⁵⁷ *Scholarship Endowment Foundation v. Nicholas*, 106 F. (2d) 552 (C.C.A. 10th 1939).

not all come out of his own pocket. This is not only legitimate but is encouraged by the federal and state governments. Great care must be exercised to determine the exact tax effect in any unusual or complicated situation; this paper does not purport to cover all of the many angles that might come up in a particular transaction. Any attempt to obtain tax advantages by a transaction which is not bona fide or by concealment of facts is not only illegal, but is extremely dangerous. Finally, before taking any action which will have long range effects, consideration should be given to possible changes in the law through court decisions or through legislation.

APPENDIX A

APPROXIMATE NET COST OF CHARITABLE GIFT
AFTER FEDERAL INCOME TAX SAVING
(Under Revenue Act of 1948)

Txable net income	Rate of tax on Highest income Bracket:	Net cost to donor per \$100 Gift.
Under \$ 2,000	16.6%	\$83.40
\$ 2,000 to 4,000	19.36%	80.64
4,000 to 6,000	22.88%	77.12
6,000 to 8,000	26.40%	73.60
8,000 to 10,000	29.92%	70.08
10,000 to 12,000	33.44%	66.56
12,000 to 14,000	37.84%	62.16
14,000 to 16,000	41.36%	58.64
16,000 to 18,000	44.00%	56.00
18,000 to 20,000	46.64%	53.36
20,000 to 22,000	49.28%	50.72
22,000 to 26,000	51.92%	48.08
26,000 to 32,000	54.56%	45.44
32,000 to 38,000	57.20%	42.80
38,000 to 44,000	60.72%	39.28
44,000 to 50,000	63.36%	36.64
50,000 to 60,000	66.00%	34.00
60,000 to 70,000	68.64%	31.36
70,000 to 80,000	71.28%	28.72
80,000 to 80,000	73.92%	26.08
90,000 to 100,000	76.56%	23.44
100,000 to 136,719.10	78.32%	21.68
136,719.10 to 150,000	80.3225%	19.68
150,000 to 200,000	81.225%	18.78
over 200,000	82,1275%	17.87

The above figures are based on taxable income after all deductions and exemptions except the gift in question. Married taxpayers filing a joint return should consider one half of the joint taxable income as taxable net income for purposes of the above table.

If there are net taxable long term gains taxed at the alternative rate they should not be considered as part of taxable net income in using the above table.