THE TIMES THEY ARE NOT A-CHANGIN': REFORMING THE CHARITABLE SPLIT-INTEREST RULES (AGAIN)

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> The exemption from taxation of money or property devoted to charitable or other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from the financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare.[1]

At the end of the 1960's there was a fever for tax reform in the area of charitable giving. The treasury laid out specific areas of abuse where taxpayers were benefiting to an extent unnecessary to encourage charitable donations.[2] Convinced that most of those changes were desirable, Congress enacted legislation[3] to produce more tax equity.[4] During this process, voices were raised to moderate those measures to achieve more flexibility.[5]

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1. H. R. REP. 1860, 75th Cong., 3d Sess., on The Revenue Act of 1938, Pub. L. No. 75-55452 Stat. 447, *cited in* J.S. Seidman, SEIDMAN'S LEGISLATIVE HISTORY OF THE FEDERAL INCOME TAX LAWS: 1938–1861 17, col. 1. *See also* Thomas B. Petska, *Charitable Trusts: An IRS Examination of Nonexempt Philanthropic Organizations* 254 (1983), *available at* http://www.amstat.org/sections/srms/Proceedings/papers/1983_047.pdf.

2. *See* U.S. DEP'T OF THE TREASURY, TAX REFORM STUDIES AND PROPOSALS: JOINT PUBLICATION COMMITTEE ON WAYS AND MEANS OF THE U.S. HOUSE OF REPRESENTATIVES AND COMMITTEE ON FINANCE OF THE U.S. SENATE, *as reprinted in* 2 TAX MANAGEMENT—PRIMARY SOURCES (BNA) I, at § 170.31 (1976) [hereinafter cited as 1969 TREASURY STUDIES AND PROPOSALS]; STAFF OF THE S. COMM. ON FIN., SUMMARY OF TREASURY DEPARTMENT TAX REFORM STUDIES AND PROPOSALS 6–7 (1969), *available at* http://bulk.resource.org/gao.gov/91-172/000062E2.pdf [hereinafter cited as SENATE SUMMARY OF TREASURY PROPOSALS].

3. Tax Reform Act of 1969, Pub. L. No. 91-172, § 201, 83 Stat. 487, 526, 549 (1969).

4. S. REP. NO. 91-552, at 92 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2027, 2122 ("The committee agrees with the House that this double benefit is *an unwarranted tax advantage which is not a necessary inducement to charitable giving*." (emphasis added)).

5. Press Releases, Actions in Executive Sessions, S. Finance Comm. Decisions—Compilation, 14, *as reprinted in* 2 TAX MANAGEMENT—PRIMARY SOURCES (BNA) I, at § 170.63 [hereinafter cited as Finance Comm. Press Release] stating:

> The [Senate] Committee, in general, accepted this provision of the House bill but adopted a series of modifications of the provision to provide persons with greater flexibility in making this type of gift and to reduce the potential adverse effect of the provision on established forms of giving, while at the same time protecting against the abuses to which the provision is directed.

Also, there were those who believed that the stringencies of this legislation would inhibit charitable giving[6] so that charities would become dependent upon the goodwill of the government for their continued existence.[7] Some considered the reforms unnecessary.[8] Many of the arguments made in 1969 continue to be made today.[9]

Id. House Action Summary, 37, *as reprinted in* 2 TAX MANAGEMENT—PRIMARY SOURCES (BNA) I, at § 170.58 [hereinafter cited as 1969 House Action] ("*Arguments Against.*— . . . (2) The limitations restrict the flexibility presently available to persons who wish to make gifts to charity in the form of a remainder interest in trust. This smaller degree of flexibility might lead to an undue curtailment of this type of charitable gift."); STAFF OF JOINT COMM. ON INTERNAL REVENUE TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM OF 1969 84 (Comm. Print 1970):

> *Explanation of provision*.—For the reasons discussed above, the Act provides limitations (for income tax, gift tax, and estate tax purposes) on the allowance of a charitable contributions deduction for a charitable gift of a remainder interest. In general, a deduction is allowed for a charitable gift of a remainder interest in trust, where there is a non-charitable income beneficiary, if the trust is either a charitable remainder annuity trust or a charitable remainder unitrust. These general limitations are provided so the amount received by the charity will be consistent with the charitable deduction allowed to the donor on creation of the trust. This result occurs under these two limitations because they remove the flexibility of the prior provisions whereby it was possible to favor the income beneficiary over the remainder beneficiary by means of manipulating the trust's investments. Under the new requirements, the amount received each year by the income beneficiary, generally, will have to be either a stated dollar amount or a fixed percentage of the value of the trust property.

Id.

6. It is unclear how much taxes influence charitable donations. In 1969, Treasury acknowledged:

> In addition to the economic motivations for charitable giving, the American Association of Fund-Raising Counsel recognizes many non-economic incentives for giving. These include responses to social awareness, generosity, social pressure, pity, and habit. To the extent that the noneconomic factors influence charitable giving patterns, changes in the tax treatment of charitable donations have little repercussion on the level of contributions.
>
> Since these noneconomic motivations are largely nonquantifiable, the importance of the economic incentive is difficult to distinguish from that of the noneconomic incentive. There is reason to believe, however, that noneconomic motivations have considerable influence on the level of giving. This is substantiated by the fact that studies relating variations in charitable contributions to changes in both the tax treatment and the incomes of contributors have been successful in explaining scarcely half of the observed variation in contributions.

1969 TREASURY STUDIES AND PROPOSALS, *supra* note 2, at 198, *as reprinted* at § 170.39.

7. H. R. REP. NO. 91-413, pt. 1, at 218 (1969) *as reprinted in* 2 TAX MANAGEMENT—PRIMARY SOURCES (BNA) I, at § 170.51(Separate Views of Hon. James B. Utt on H.R. 13270) *reprinted in* 1969 U.S.C.C.A.N. 1645, 1873 ("The committee's action in connection with charitable gifts may have an adverse impact on private philanthropy. . . . The committee's bill may result in many activities that are now reserved to our private sector becoming the responsibility of Government and may also increase the dependence of our universities on the Federal Government. These results would not be healthy for our free-enterprise system."); *id.* at 225, *as reprinted* at § 170.52, *reprinted in* 1969 U.S.C.C.A.N. at 1880 (Supplementary Views of Hon. George Bush and Hon. Rogers C.B. Morton) ("We are unquestionably eliminating some tax inequities. But in doing so, we are forcing private charities and all educational institutions to turn more to the Federal Government."); House Action Summary, at 37, 39, *as reprinted in* 2 TAX MANAGEMENT—PRIMARY SOURCES (BNA) I, at §§ 170.58–59 ("*Arguments Against* . . . (2)The limitations restrict the flexibility presently available to persons who wish to make gifts to charity in the form of a remainder interest in trust. This smaller degree of flexibility might lead to an undue curtailment of this type of charitable gift.").

8. 2 TAX MANAGEMENT—PRIMARY SOURCES (BNA) I at §§ 170.58–59("*Arguments Against* . . . (1) This provision is not necessary because local laws which impose heavy responsibilities upon trustees and fiduciaries serve as sufficient assurance that trusts will be handled properly.").

9. *See, e.g.*, Martin Feldstein, *A Deduction From Charity*, WASH. POST A15 (Mar. 25, 2009):

As the legislation proceeded through its customary course towards passage, those reforms naturally underwent certain modifications. One change, however, that did not seem deliberate is the definition of charitable split-interest[10] that appears in the statute. That definition is broader than the definition originally appearing in the Treasury proposals, House and Senate Reports, and in the stated rationale for the charitable split-interest trust reforms.[11] The 1969 legislation was aimed at correcting abuses inherent in using the actuarial tables to value present and future interests in the same property;[12] however, during the reform process the original language and definition of a charitable split-interest in trust expanded to apply to property interests that do not involve the potential for valuation manipulation that was characteristic of actuarial valuation because they do not require the use of the actuarial tables to determine their value. While generally corrective of problems inherent in actuarially determined valuation, the plain language of the statute as enacted denies a charitable deduction to the taxpayer in circumstances that do not have any abuse potential.[13] Indeed, some charitable split-interest trusts do not qualify for any deduction despite the fact that the donor's tax benefit, if allowed, would equal the benefit to the

> President Obama's proposal to limit the tax deductibility of charitable contributions would effectively transfer more than $7 billion a year from the nation's charitable institutions to the federal government. But the high-income taxpayers affected by the rule change are likely to cut their charitable giving by as much as the increase in their tax bills, which would, ironically, leave their remaining income and personal consumption unchanged.

Id.; Robert Frank, *Why the Obama Tax Hikes Won't Kill Charity*, WALL ST. J. Blogs (Mar. 4, 2009), *available at* http://blogs.wsj.com/wealth/2009/03/04/why-the-obama-tax-hikes-wont-kill-charity/, stating:

> As I wrote last week, charities are up in arms over President Obama's proposal to trim the deductions that the rich take on charitable donations. Some alarmists say charity as we know it will be dead. The reality may be less alarming. A philanthropy study out today from Bank of America shows that the majority of today's wealthy and affluent donors wouldn't stop their giving even if deductions were wiped out entirely. (BofA and the Center on Philanthropy at Indiana University polled 700 households with net worths of at least $1 million and incomes of $200,000, which now counts as 'Obama rich.') . . . So only 10% of the rich would cut off their contributions–and that is only if deductions went to zero. President Obama is proposing to reduce the deduction for top-income households to 28% from 35%.

Included among the 1969 reforms proposed by Treasury, but not adopted by Congress, was a three percent floor on charitable deductions. *See* SENATE SUMMARY OF TREASURY PROPOSALS, *supra* note 2, at 6 ("The report believes that this would reduce significantly the number of returns requiring audit but would maintain tax incentive for more than routine gifts to charity.").

10. This article will focus on charitable split-interests in trust. The Tax Code also provides a charitable deduction for a remainder interest in a personal residence or a farm, *see* Treas, Reg. §20.2055-2(e)(2)(ii) (as amended in 2003), and a charitable deduction or exclusion for qualified conservation easements. *See* I.R.C. §§ 170(h), 2031(c), 2055(f), 2522(d) (2006); Treas. Reg. § 1.170A-14 (as amended in 1999).

11. *See supra* notes 2, 4–7.

12. 1969 TREASURY STUDIES AND PROPOSALS, *supra* note 2, at 38, *as reprinted* at § 170.32.

13. *See* Tax Reform Act of 1969, Pub. L. No. 91-172, § 201, 83 Stat. 487, 526, 549 (1969).

charity.[14] The plain language of the statutory definition of a charitable split-interest trust has consequently engendered its own inequities.[15]

Moreover, when Congress focused on curtailing the abuses related to charitable split-interest trusts in its 1969 tax reforms, it did not anticipate that it was creating new tax loopholes. By permitting a net income charitable remainder unitrust ("NICRUT") or a net income charitable remainder unitrust with a makeup provision ("NIMCRUT"), Congress has allowed donors to defer the taxation of income with a much greater flexibility than the Tax Code currently provides.[16] Likewise, by creating the charitable lead trust ("CLT"), Congress fashioned a device—currently popular with the very wealthy—that invites abuses of the very same nature that Congress had sought to correct in its 1969 tax reforms.[17] As promoted by charities and estate planners, a donor can establish a CLT and thereby transfer much of his wealth to his family for comparatively little cost in terms of estate or gift taxes. Therefore, the charitable split-interest rules need to be re-infused with the spirit of 1969 and further revised to serve tax equity.

This article will review the history of the tax treatment of charitable split-interest gifts, emphasizing the policy rationale behind the seminal 1969 legislation, identify the inequities that Congress generated by the 1969 legislation, and propose further reforms to protect the charity, the donor, and the United States Treasury.

I. THE 1969 TAX REFORM ACT

The 1969 Tax Reform Act made major changes to the area of charitable donation deductions. These reforms affected the income, gift, and estate tax consequences for making certain types of charitable gifts. The modifications included the maximum income tax deduction value for a gift of appreciated property to a charity,[18] new maximum percentage limitations for a current year income tax charitable deduction,[19] the bargain sale to

14. *See id.* at § 201, 83 Stat. at 553–54.

15. *See infra* Part II.C.

16. *See* Ron Shoemaker & David Jones, *K. Charitable Remainder Trusts: The Income Deferral Abuse and Other Issues*, at 140 (1997), *available at* http://www.irs.gov/pub/irs-utl/topic-k.pdf.

17. *See infra* Part III.C.

18. Tax Reform Act of 1969, Pub. L. No. 91-172, § 201(e)(1)(B), 83 Stat. 487, 555–556 (1969) (reducing the fair market value of the donation by any amount of gain that would not have resulting in longer term capital gain in a sale and, reducing by fifty percent of the long term capital gain (62.5 percent for a corporation) (1) the fair market value of a donation of tangible personal property if its use is not related to the charity's exempt purpose or (2) in the instance of a donation for a private foundation.) *See* I.R.C. § 170(e)(1) (2006).

19. Tax Reform Act of 1969, 83 Stat. at 550–553 (codified as I.R.C. § 170(b)) (including an overall limitation for an individual's aggregate charitable deduction to no more than fifty percent of his

charity required basis adjustments,[20] and the availability of an income tax deduction for a contribution to a charitable remainder trust (CRT).[21] More pertinent here, however, the amendments produced required forms for deductible split-interest gifts to charities.[22] The 1969 changes to the charitable split-interest rules were primarily motivated by the then-current abuses where the taxpayer's donation financially benefited the taxpayer more than the charity.[23]

A. *The 1969 Charitable Split-Interest Rules*

Beginning in 1970, if a donor makes a split interest gift in trust to a charity, she is entitled to a charitable deduction only if she makes that gift in a specific statutory form: a CRT, a CLT, or a pooled income fund.[24] A CRT must be created either as a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT).[25] A CLT must be in the form of either a charitable lead annuity trust (CLAT) or a charitable lead unitrust (CLUT).[26] While the income interest of either a CRUT or a CRAT may be subject to a qualified contingency, the value of that interest will be com-

or her contribution base, which is defined as a taxpayer's adjusted gross income without regard to any section 172 net operating loss carryback.) *See also* I.R.C. §§ 170(b)(1)(A) & 170(b)(1)(F). The reforms also included the repeal, with a five year phase-out, of a 100 percent charitable deduction allowed in some instances. Tax Reform Act of 1969, *supra* note 3, at § 201(a) and (h) (enacting I.R.C. §§ 170(b)(1)(C), (f)(6) & (g)). *See* 115 CONG. REC. 22,805 (Aug. 7, 1969) (statement of Rep. Randall):

> The original unlimited charitable contribution deduction [for income taxes] goes back to the case of the Philadelphia nun who, as one of the Drexel heirs in 1927, was sworn to poverty. Her case was responsible for legislation which was the beginning of rule allowing unlimited charitable deductions. . . . We do not impugn the good intentions of contributors but at the same time this worst of all loopholes should be eliminated because of the privilege to give away at the appreciated value rather than its original or low cost basis and then utilize this as an unlimited deduction against other income, all under the shelter of giving to charitable causes.

Id.

20. Tax Reform Act of 1969, *supra* note 3, at § 201(a) (codified as I.R.C. §§ 170 (e) & 1011(b)).

21. *Id.* (disallowing a deduction, other than for a remainder interest, for property in trust unless the trust is an annuity or unitrust and unless the grantor is taxed as the owner under the grantor trust rules). *See also* I.R.C. § 170(f)(2).

22. Tax Reform Act of 1969, *supra* note 3, at §§ 201(a)(1)(B), (b), (d)(1), & (e)(1), 83 Stat. 556–557, 559–564 (amending I.R.C. §§ 170(f), 642(c), 664, 2055(e), & 2522(c)).

23. *See supra* Part I.B.

24. I.R.C. §§ 170(f)(2)(A), 170(f)(2)(B), 170(f)(3), 2055(e)(2), 2522(c)(2). This article focuses on issues regarding CRTs and CLTs. A pooled income fund is defined in I.R.C. § 642(c)(5). Additionally, there are statutory exceptions, including an exemption in section 170 for "a contribution of an undivided portion of the taxpayer's entire interest in property . . ." I.R.C. § 170(f)(3)(B)(ii).

25. *See* I.R.C. § 170(f)(2)(A).

26. *See* I.R.C. § 170(f)(2)(B).

puted without reference to that contingency;[27] thus the non-charitable interest will not be discounted to increase the charitable deduction.

A CRAT is a trust in which not less than 5 percent and not more than 50 percent of the initial contribution value of the trust must be paid annually, for no more than a twenty year fixed term or for life, to at least one individual who is not a charity;[28] however, a CRAT must not pay any other amounts to anyone other than to a qualified charity[29] and a CRAT may not receive additional contributions from anyone.[30] Moreover, there are certain ordering rules for determining the character of CRT distributions made to the non-charitable beneficiaries that begin as the least tax favored.[31] At the end of the specified term of the annuity, the remainder, valued at a minimum of 10 percent of the value of the initial contribution to the trust,[32] must pass to a qualified charity.[33]

By contrast, a CRUT is a trust that must pay at least annually a fixed percentage, rather than a fixed amount like the CRAT, of not less than 5 percent and not more than 50 percent of the trust's asset value, determined yearly, for not more than twenty years or for life, to at least one individual[34] and must not pay anyone else, except a charity.[35] Unlike with a CRAT, however, the CRUT instrument may allow for income payments in any year to be the lower of the trust's income or the above computed in-

27. I.R.C. § 664(f)(1)–(2). A "qualified contingency" is "any provision of a trust which provides that, upon the happening of a contingency, the payments described in paragraph (1)(A) or (2)(A) of subsection (d) (as the case may be) will terminate not later than such payments would otherwise terminate under the trust." I.R.C. § 664(f)(3).

28. I.R.C. § 664(d)(1)(A). *See* H. R. REP. NO. 91-413, pt. 2, 38–39 (1969).

29. I.R.C. § 664(d)(1)(B).

30. Treas. Reg. § 1.664-2(b) (as amended in 2001):

> A trust is not a charitable remainder annuity trust unless its governing instrument provides that no additional contributions may be made to the charitable remainder annuity trust after the initial contribution. For purposes of this section, all property passing to a charitable remainder annuity trust by reason of death of the grantor shall be considered one contribution.

This subsection of the regulation was adopted on August 23, 1972. T.D. 7202 (1972).

31. CRT distributions are first treated as taxable ordinary income to the extent of trust income and income undistributed in earlier years, second as capital gain likewise to the extent of trust capital gain and capital gain undistributed in earlier years, then as other income, and ultimately as the nontaxable return of capital. I.R.C. § 664(b)(1)–(4). The trust itself is not taxed on income, except for an excise tax applicable to unrelated business taxable income. I.R.C. § 664(c)(2).

32. I.R.C. § 664(d)(1)(D). The value of the remainder must be determined by the actuarial tables. *See* I.R.C. §7520.

33. I.R.C. § 664(d)(1)(C). However, the remainder may also:

> be retained by the trust for such a [charitable] use or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined by subsection (g)) . . .

Id.; *see* I.R.C. § 664(g).

34. I.R.C. § 664(d)(2)(A).

35. I.R.C. § 664(d)(2)(B).

come amount (a NICRUT)[36] and may allow for the total of any excess fixed percentage amounts to be paid to the non-charitable beneficiary in later years (a NIMCRUT).[37] The remainder requirements for a CRUT are the same as those for a CRAT[38] and the value of the charitable contribution to either type of CRT is determined at the time of the creation of the trust by considering the yearly required distributions of 5 percent, or greater amount as required by the trust, of the value of the trust's assets.[39]

B. The Policy Behind the 1969 Rules

When the Treasury made recommendations for changes to be made to the split-interest charitable contribution provisions, it focused on ensuring that the charity's benefit matched the amount of the donor's charitable deduction:

> When property is transferred to a trust in which a charity has either an income or remainder interest, the contributor often receives a deduction for an amount considerably in excess of the amount that the charity ultimately realizes. This occurs because the method for valuing the charitable interest may have little relation to investment policy as regards income versus capital growth.
>
> *The Treasury recommends* that for gifts in this form the charitable deduction be allowed only under arrangements which guarantee that the charity will actually receive an amount equivalent to the amount for which the deduction is allowed.[40]

Thus, the Treasury proposed that the income interest in the trust, whether it is a CRT or CLT, be either an annuity or a unitrust. The Treasury liked the annuity form because at that time the Treasury believed that "the trustee would have no incentive to manipulate trust investments or misallocate deductions or receipts."[41] Because with an annuity the trust would pay a fixed amount, comprised of income and, if insufficient, of principal, the Treasury thought that the trustee would inevitably apply "sound business judgment" to make the entire trust profitable "since neither interest could benefit from a different investment policy."[42] Moreover, the Treasury explained that the unitrust form—a more flexible option that

36. I.R.C. § 664(d)(3)(A). A NICRUT, or a NIOCRUT, is an acronym for a net income (only) charitable remainder unitrust.

37. I.R.C. § 664(d)(3)(B). A NIMCRUT is an acronym for a net income with a makeup provision charitable remainder unitrust.

38. I.R.C. § 664(d)(2)(C)–(D).

39. I.R.C. § 664(e).

40. 1969 TREASURY STUDIES AND PROPOSALS, *supra* note 2, at 21, *as reprinted* at § 170.31.

41. *Id.* at 183, *as reprinted at* § 170.34.

42. *Id.* Clearly, in retrospect, these judgments were naïve. *See infra* Part III.C.

would likewise insure that the charity profit equally with the non-charitable interest—would allow the annuitant to increase the amount of the income she received, but that both parties would be entitled to the same increases due to "inflation or investment success."[43]

The House reiterated the essential policy rationale that a change was necessary because the current law did not require a match between the amounts of the charity's benefit and the charitable deduction. "This is because the trust assets may be invested in a manner so as to maximize the income interest with the result that there is little relation between the interest assumptions used in calculating present values and the amount received by the charity."[44] This policy underlined the motivation behind other split-interest measures in the House bill, such as denying a charitable deduction for a gift of a contingent charitable remainder[45] or of a charitable interest in a trust that allows invasion of that interest for the benefit of the non-charitable beneficiary.[46]

43. 1969 TREASURY STUDIES AND PROPOSALS, *supra* note 2, at 184, *as reprinted* at § 170.35:

> In this situation all incentive for the trustee to invest the property for the benefit of either the income or the remaindermen to the detriment of whichever was the noncharitable interest would be removed. Such a trust would make it possible for the trustee to pursue either a growth-oriented investment policy or an income-oriented investment policy or some combination of both with the assurance that neither investment policy would benefit one party to the detriment of the other.

Id.

44. H. R. REP. NO. 91-413, *supra* note 7, at 58.

> For example, the trust corpus can be invested in high-income, high-risk assets. This enhances the value of the income interest but decreases the value of the charity's remainder interest.
>
> Your committee does not believe that a taxpayer should be allowed to obtain a charitable contribution deduction for a gift of a remainder interest in trust to a charity which is substantially in excess of the amount the charity may ultimately receive.

Id.

45. *See, e.g.*, Gillespie v. Comm'r, 75 T.C. 374, 375–376 (1980), wherein, under the Tax Reform Act of 1969, the court denied a charitable deduction for decedent's testamentary trust whereby the church would only receive the remainder interest in a trust if decedent's son died before he received all of the payments at age 26 without leaving any children who survived to age 21. The court rejected the estate's arguments that the 1969 statute was unconstitutional as a "senseless restriction on testamentary giving," and that the decedent's son, an often institutionalized schizophrenic, was unlikely to have any children so that the church would probably get at least a part of the trust corpus.

46. 1969 House Action, *supra* note 7, *as reprinted* at §§ 170.58–59. *See, e.g.*, Hartford Nat'l Bank & Trust Co. v. United States, 467 F. 2d 782, 786 (2d Cir. 1972), wherein the decedent created a testamentary trust for her daughter and her children, or the survivor, for life, remainder to two hospitals and a church and the trustee had the power to invade the principal of the trust for the "physical welfare" of the life beneficiaries. Under pre-1969 law, the court upheld a charitable deduction for the split-interest trust because, under former Treas. Reg. § 25.2522-2(a) (1958), *inapplicable to decedents dying after 1969*, the power was "sufficiently objective under current doctrine to permit the charitable remainder interest to be presently ascertained." *Hartford*, 467 F.2d at 786. In addition, where an asset, such as a closely held interest or real estate, is difficult to value, qualification for the charitable deduction requires an independent trustee's sole valuation of the interest. H. R. REP. NO. 91-413, *supra* note 7, at 60; *see* I.R.C. §§ 664(d)(1)(A) & (2)(A).

Regarding CLTs in the income tax context, the House decried the double tax benefit wherein a taxpayer not only received a deduction for his income interest, but also was untaxed on CLT income. "In fact, this double benefit allows a taxpayer to increase his aftertax cash position by postponing a planned noncharitable gift."[47] The House described this benefit of a CLT as "an unwarranted tax advantage which it is not necessary to provide as an inducement to charitable giving."[48] Finally, in order to erase even a partial undeserved earlier double income tax benefit, the House bill provided for the recapture of income tax deductions where a taxpayer, once taxable on trust income, was no longer subject to that liability.[49] Likewise, besides proposing the recapture of any income tax charitable deduction in those circumstances, the House called for an equal recapture of the donor's *gift* tax charitable deduction.[50]

The Senate gave the same reasons for reforming CRTs and CLTs, however, because it considered restricting all charitable split-interest gifts to those forms as "unduly restrictive," as potentially having "a significant adverse effect on established forms of charitable giving," and as not adaptable to those two trust formats, the Senate recommended amending the House bill to continue to allow a deduction for certain types of split-interest gifts, like pooled income funds[51] and a remainder interest in one's home.[52] In order to maintain the overall goal of the 1969 legislation that the donor's deduction equals the charity's benefit, the Senate amendment included a

47. H. R. REP. NO. 91-413, *supra* note 7, at 61:

> For example, assume a taxpayer in the 70-percent bracket transferred property worth \$100,000 currently earning interest at the rate of 5 percent to a trust for 2 years specifying that \$5,000 be paid to charity each year, remainder to A. If the taxpayer had retained the property for 2 years he would have received \$10,000 in interest taxable at 70 percent for an aftertax return of \$3,000. On the other hand, by transferring the property to a trust he received a charitable deduction of \$9,498.50 (the present value of the charitable interest). The \$10,000 received by the charity is not included in income and the deduction claimed reduces his tax on other income \$6,648.95.

Id.

48. *Id.*

49. *Id.* at 61–62.

> This [recapture feature] is accomplished by treating the donor at the time he ceases to be taxable on the trust income as having received income to the extent the deduction he previously was allowed exceeds the value of the income previously earned by the trust and taxable to him. For this purpose, these amounts of income are to be discounted to their value at the time of the contribution to the trust.

Id. at 62; 1969 House Action, *supra* note 7, at 39, *as reprinted* at § 170.59.

50. H. R. REP. NO. 91-413, *supra* note 7, at 62.

51. S. REP. NO. 91-552, *supra* note 4, at 87. The Senate, however, would impose on these conventional split gifts "appropriate limitations, however, to prevent the overstating of the charitable contribution deduction." *Id.*

52. *Id.* at 88–89.

method for valuing the charitable donations of property to a pooled income fund[53] and of a non-trust gift of a remainder interest in real property.[54]

In order to give the donor "greater flexibility,"[55] the Senate added the allowance of a payout of the lower of (1) the CRAT or CRUT net income or (2) 5 percent of the value of the trust assets. The Senate also proposed the allowance of a makeup provision in a year where the net income of a CRT later exceeds the percentage of asset value.[56] The Senate believed the availability of these formats would thwart the destruction of the charity's remainder interest by eliminating the need for a trust to invade principal in a year with an unanticipated income shortage.[57] In addition, the Senate not only imposed a minimum annual required payout of the lower of trust income or 5 percent of the net fair market value of trust assets, but also required the contribution's value to be based on the non-charitable income beneficiary annually receiving *the higher* of 5 percent of the net fair market value of the trust assets or the payout required by the trust instrument, consequently reducing the value of the donor's charitable deduction in those instances.[58] The Senate intended that the combination of the two requirements would eliminate the advantage that the CRT otherwise would have over private foundations that have current income distribution mandates. That is, without a payout requirement of current income, accumulated income in the CRT would grow tax-free in the trust, a tax exempt entity.[59] Likewise, the Senate underlined that no other payments, besides the annu-

53. *Id.* at 88. The Senate version provided that the charitable deduction would:

> be determined by valuing the income interest on the basis of the highest rate of return earned by the particular pooled income fund in any of the three taxable years preceding the taxable year of the fund in which the transfer occurs. Where a fund has not been in existence for this period of time, the rate of return is to be assumed to be 6 percent, unless a different rate is prescribed by the Secretary of the Treasury or his delegate.

Id.

54. *Id.* at 88–89. The Senate required that valuation of the real property would reflect appropriate straight-line depreciation and cost depletion and that the Treasury would apply a reasonable rate of return to value this split-interest "in view of the interest rates and investment returns prevailing at the time of the gift." *Id.*

55. *Id.* at 90; Finance Comm. Press Release, *supra* note 5, *as reprinted* at § 170.63; *See infra*, note 157.

56. S. REP. NO. 91-552, *supra* note 4, at 89 ("For purposes of this provision, the determination of what constitutes trust income is to be made under the applicable local law and, thus, is not to include items such as capital gains which must be allocated to the trust principal.").

57. *Id.*

58. *Id.* at 89–90.

59. *Id.* at 90. However, the Senate clarified that a CRT would lose its tax exempt status:

> for any year in which the trust has income which would be unrelated business taxable income if the trust were an exempt organization subject to the unrelated business income tax. The committee does not believe that it is appropriate to allow the unrelated business income tax to be avoided by the use of a charitable remainder trust rather than a tax-exempt organization.

Id.

ity or fixed percentage amount, could be made to a non-charitable recipient from a CRAT or a CRUT[60] and clarified a few other requirements of the charitable split-interest trusts.[61]

The Senate agreed with the House that the double income tax benefit accorded CLTs was unjustified.[62] However, the Senate considered that loophole confined to income taxes only and, therefore, modified the House bill so that the income tax deduction rule would *not* apply to either gift or estate taxes.[63] Moreover, the Senate modified the House bill—and then-current law—to allow a donor with a substantial reversionary interest in a CLT to obtain a charitable deduction where the income is taxed to him.[64] Further, while the House bill required all of the private foundation restrictions to apply to nonexempt charitable split-interest trusts in order to prevent their use merely to avoid those rules,[65] the Senate amended the blanket application of private foundation limitations to exempt CRTs and other split-interest trusts with small amounts of income benefiting a charity from the stock ownership and speculative investment requirements in certain instances.[66] The Senate explained that the reason for applying those rules to private foundations, specifically "the problems of conflict of interest and

60. *Id.*

61. For example, the Senate explained that:

> an annuity trust or a unitrust may have more than one noncharitable income beneficiary, if the interest of each such beneficiary either is for a term of years which does not exceed 20 years or is for the life of the beneficiary. An individual who is not living at the time of creation of the trust, however, may not be an income beneficiary of a charitable remainder trust.

Id.

62. *Id.* at 92.

63. *Id.*

64. *Id.*

65. *Id.* at 94. A nonexempt charitable trust is a trust that does not qualify for tax exempt status and therefore must pay tax on its taxable income. *See* I.R.C. § 4947(a)(1) (2006).

66. S. REP. NO. 91-552, *supra* note 4, at 94:

> The committee amendments further provide, however, that the stock ownership and speculative investment requirements imposed on private foundations are not to apply to split-interest trusts (A) in cases where charity is only an income beneficiary and the beneficial interest of charity in the trust is less than 60 percent of the value of the trust property and also (B) in cases where the only interest of charity in the trust is as a remainderman. In the latter case, the stock ownership and speculative investment requirements are to become applicable at the time the remainder interest of charity comes into possession.
>
> The bill also provides that a charitable contribution deduction (for income, gift, and estate tax purposes) is not to be allowed for a charitable interest in a nonexempt trust unless the trust instrument expressly prohibits the trust from violating the restrictions and requirements to which it is subject (such as, self-dealing, business holdings, etc.).

Id.

diversion of attention from the interests of charity" would not arise in the context of nonexempt charitable split-interest trusts.[67]

Resolving the differences on charitable split-interests in the two houses, the Conference Report[68] explained that while the Senate amendments had been generally accepted, there were a few modifications: (1) a donation of a non-trust remainder interest in real property was to be valued at contemporaneous "money rates and investment returns";[69] (2) the payout requirements that allow for distributions of the lesser of income or 5 percent of the fair market value of the assets were to be restricted to CRUTs and inapplicable to CRATs,[70] with payment options not discretionary with the trustee;[71] and (3) some different effective dates for the legislation.[72]

II. DEFINITION OF CHARITABLE SPLIT-INTEREST TRUST

A. First Definitions

The Treasury Department's Studies and Proposals—which formed the impetus and substance for much of the 1969 legislation—incorporated temporal interests, such as a life estate and a remainder interest, in its definition of a charitable split-interest trust; thus, the Treasury described a split-interest trust as a trust containing either a charitable income interest and non-charitable remainder interest or a trust with a non-charitable income interest and a charitable remainder interest.[73] The root of the abuse in such a trust was the "the investment policy as regards income versus capital growth," which emphasis would vary depending upon which interest had the non-charitable beneficiary. [74] This definition of a split-interest trust is

67. "In these cases, the interest of charity in the trust property is not substantial enough in relation to the interests of the noncharitable beneficiaries to warrant the imposition of restrictions on the trust's investments." *Id.*

68. H.R. REP. NO. 91-782 (1969) (Conf. Rep.) *reprinted in* 1969 U.S.C.C.A.N. 2391.

69. *Id.* at 296.

70. *See supra* notes 36–37 and accompanying text.

71. H.R. REP. NO. 91-782, *supra* note 68, at 296.

72. *Id.* at 296–297 ("The new rules are made applicable for income and gift tax purposes in the case of transfers in trusts and gifts after July 31, 1969.").

73. 1969 TREASURY STUDIES AND PROPOSALS, *supra* note 2, at 21, *as reprinted* at § 170.31.

74. *Id.* The Treasury had listed among its main concerns involving charitable deduction abuses:

> *When property is transferred to a trust in which a charity has either an income or remainder interest* (emphasis added), the contributor often receives a deduction for an amount considerably in excess of the amount that the charity ultimately realizes. This occurs because the method for valuing the charitable interest may have little relation to investment policy as regards income versus capital growth. *The Treasury recommends* (emphasis in the original) that for gifts in this form the charitable deduction be allowed only under arrangements which guarantee that the charity will actually receive an amount equivalent to the amount for which the deduction is allowed.

Id.

repeatedly used in that report and the exploitation is identified as stemming from the split-interests being valued by using actuarial tables where the actual investment facts belie the assumptions of that valuation method.[75]

Despite the language of the bill using the definition of the enacted statute, the House Report conformed to the Treasury Department's definition of a charitable split-interest trust as a trust with an income and a remainder interest where the beneficiary of one of those interests was a charity and of the other was an individual:

> (7) Split-Interest Trusts—The Committee tentatively decided in the case of *split-interest trusts (a trust under which the income is paid to provide persons and the remainder to charity, or vice versa)* to adopt a provision under which the charitable contribution deduction would be recaptured in whole or in part where the investment policies of the trust—as between the income and the remainder beneficiaries—are not consistent with the assumptions on which the deduction was originally computed, and also to adopt a provision disallowing a charitable contribution deduction for a gift to charity in the form of an income interest in trust where the remainder is to go to a noncharitable beneficiary.[76]

Likewise, in the Senate Report, charitable split-interest trusts are defined: "[i]n the case of nonexempt charitable trusts which are *split-interest trusts (i.e., trusts which have a noncharitable income beneficiary and a*

75. *See, e.g.*, *id.* at 38, *as reprinted* at § 170.32:

> The charitable contribution deduction for a trust interest given to a charity is based on an assumed actuarial calculation made at the time the trust is created. Management of the trust property, however, can be conducted with a view to favoring the interests of the noncharitable beneficiaries and giving charity less than was assumed in calculating the deduction. The proposal would restrict the deduction to the amount that the charity actually receives.

Id.; *Id.* at 182–183, *as reprinted* at § 170.34–35:

> *When property is transferred to a trust in which the charity has either an income or remainder interest*, the contributor often claims current income tax deductions whose magnitude has little relation to the value of the benefit which the charity ultimately realizes. The problem arises because of the need to value the charity's interest at the time the trust is created. The interest is valued for these purposes by determining present values using actuarial life expectancy tables and an assumed interest rate. The amount so determined is currently deductible even though the charity may not receive the property until a later date and the amount it could ultimately receive may be subject to various contingencies including the possibility of manipulation by the donor or others to enhance the noncharitable interest.

Id. (emphasis added).

76. H. R. Committee Decisions (Tentative)—Press Releases, 7-8, *as reprinted in* 2 TAX MANAGEMENT—PRIMARY SOURCES (BNA) I, at § 170.48 (1970) (emphasis added). *See* H. R. REP. NO. 91-413, *supra* note 7, at 58 (wherein the House clearly focused on a trust with a remainder interest: "*General reasons for change.*—The rules of present law for determining the amount of a charitable contribution deduction in the case of gifts of remainder interest in trust do not necessarily have any relation to the value of the benefit which the charity receives"). Likewise, in its explanation, the House report began:

> For the reasons discussed above, your committee's bill provides that a charitable contribution deduction (for income tax, gift tax, or estate tax purposes) is not to be allowed for a charitable gift of a remainder interest in trust where there is a non-charitable income beneficiary, unless the trust is either a charitable remainder annuity trust or a charitable remainder trust.

Id. at 59.

charitable remainder beneficiary or vice versa)."[77] Finally, in the summary of H.R. 13270, as prepared by the Joint Committee and the Finance Committee staffs, describing the then-current problems with charitable remainder trusts, that trust is defined as "a trust which provides that the income is to be paid to a noncharitable beneficiary for a period of time and the remainder interest is to go to charity [and that] the House bill provides that if specified requirements are met, the trust is to be tax exempt."[78]

B. Plain Language of the Statute

While the definition described in the last section of this article might well describe the legislative intent of the definition of charitable split-interest, the enacted House bill included the following broader language—which has virtually remained unchanged[79]—that defines a charitable split-interest for estate tax purposes as:

> an interest in property (other than a remainder interest in a personal residence or farm or an undivided portion of the decedent's entire interest in property) [that] passes or has passed from the decedent to a person, or for a use, described in subsection (a) [i.e., a charitable use], and an interest (other than an interest which is extinguished upon the decedent's death) in the same property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to a person, or for a use, not described in subsection (a) . . . .[80]

In 1969 the language identifying a charitable split interest for gift tax purposes was,[81] and remains,[82] similarly framed as a trust with any charita-

77. S. REP. NO. 91-552, *supra* note 4, at 94 (emphasis added).

78. STAFFS OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION AND THE COMMITTEE ON FINANCE, SUMMARY OF H.R. 13270, THE TAX REFORM ACT OF 1969 (AS PASSED BY THE HOUSE OF REPRESENTATIVES), 91ST CONG. 1ST SESS. 36 (Comm. Print 1969).

79. I.R.C. § 2055(e)(2) (2006) currently reads:

> Where an interest in property (*other than an interest described in section 170(f)(3)(B))* passes or has passed from the decedent to a person, or for a use, described in subsection (a), and an interest (other than an interest which is extinguished upon the decedent's death) in the same property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to a person, or for a use, not described in subsection (a), no deduction shall be allowed under this section for the interest which passes or has passed to the person, or for the use, described in subsection (a) unless [the interest is in the form of a charitable remainder annuity trust, a charitable remainder unitrust, a pooled income fund, a charitable lead annuity trust, or a charitable lead unitrust.]

(emphasis added to indicate the only language changed from the 1969 legislation).

I.R.C. § 170(f)(3)(B) provides that:

> Subparagraph (A) shall not apply to—
>
> (i) a contribution of a remainder interest in a personal residence or farm,
>
> (ii) a contribution of an undivided portion of the taxpayer's entire interest in property, and
>
> (iii) a qualified conservation contribution.

80. Tax Reform Act of 1969, *supra* note 3, § 201(d)(1), 83 Stat. at 560 (codified at I.R.C. § 2055(e)(2)).

81. The 1969 provision read:

ble interest and any non-charitable interest. The income tax charitable deduction statute encompassed, then and now, virtually any property interest transferred to a trust, wherein the grantor is taxed on the income under the grantor trust rules.[83] Gone from the language of any of the charitable split-interest statutes is any clear reference to those disparate interests being successive temporal interests like a life estate and a remainder interest, which must be valued actuarially. In their place, the enacted statute encompasses many more trusts, some of which do not provide opportunities for abuse.

C. Regulations

For decedents after 1969, the estate tax regulation basically restates the definition of a charitable split-interest in the same language as the statute.[84] There are, however, two additions. First, in describing the non-charitable part of the split-interest that the decedent created, the regulation adds the following parenthetical: "an interest (*other than an interest which is extinguished upon the decedent's death*) in the same property passes or has passed from the decedent for private purposes . . . ."[85] Since an interest that terminates on a decedent's death is not taxed to his estate, this addition is not very significant. Second, in determining the phrase "passes or has passed from the decedent," the regulation provides that, at decedent's death, if the non-charitable interest depends on "the performance of some

> Where a donor transfers an interest in property (other than a remainder interest in a personal residence or farm or an undivided portion of the decedent's entire interest in property) to a person, or for a use, described in subsection (a) or (b) [i.e., a charitable use] and an interest in the same property is retained by the donor, or is transferred or has been transferred (for less than an adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in subsection (a) or (b) . . . .

Id. at § 201(d)(3), 83 Stat. at 561 (codified at I.R.C. § 2522(c)(2)).

82. The current code section provides:

> Where a donor transfers an interest in property (other than an interest described in section 170(f)(3)(B)) to a person, or for a use, described in subsection (a) or (b) and an interest in the same property is retained by the donor, or is transferred or has been transferred (for less than an adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in subsection (a) or (b) . . . .

I.R.C. § 2522(c)(2) (2006). *See supra* note 81.

83. The code provides that:

> No deduction shall be allowed under this section for the value of any interest in property (other than a remainder interest) transferred in trust unless the interest is in the form of a guaranteed annuity or the trust instrument specifies that the interest is a fixed percentage distributed yearly of the fair market value of the trust property (to be determined yearly) and the grantor is treated as the owner of such interest for purposes of applying section 671.

I.R.C. § 170(f)(2)(B). The current provision is exactly the same as the one enacted in 1969. *See* Tax Reform Act of 1969, *supra* note 3, § 201(a)(1)(B), 83 Stat. at 556 (codified at I.R.C. § 170 (f)(2)(B)).

84. *See* Treas. Reg. § 20.2055-2(e)(1)(i) (as amended in 2003).

85. *Id.* (emphasis added).

act or the happening of a precedent event in order that it might become effective, an interest in property will be considered to pass for a private purpose unless the possibility of occurrence of such act or event is so remote as to be negligible."[86] The regulation illustrates this latter interpretation in the following example:

> H bequeaths the residue of his estate in trust for the benefit of A and a charity. An annuity of $5,000 a year is to be paid to charity for 20 years. Upon termination of the 20-year term the corpus is to be distributed to A if living. However, if A should die during the 20-year term, the corpus is to be distributed to charity upon termination of the term. An interest in the residue of the estate has passed from H for charitable purposes. In addition, an interest in the residue of the estate has passed from H for private purposes, unless the possibility that A will survive the 20-year term is so remote as to be negligible.[87]

The regulations[88] explain the distinction between a charitable split-interest and a charitable donation of an undivided portion of the decedent's entire property interest, which does not need to be in the statutory prescribed formats. For the decedent to transfer an undivided portion of his entire property interest he must leave the charity a fraction or percentage of each of his substantial interests in the property and that gift must exist during the entire term of his property interest.[89] The regulations specify that if the decedent had transferred a life estate in property to his wife while retaining a reversionary interest and then transferred one-half of his reversionary interest in that property to a charity at his death, that charitable transfer is not a deductible one.[90] However, if he had only ever owned a life estate in property (instead of once having owned all of the interests in the property), he could transfer that partial interest to a charity and qualify for a deduction.[91]

86. *Id.* While generally contingent interests are will disqualify a split-interest trust, the statute allows certain "qualified contingencies." I.R.C. § 664(f)(1). Those particular contingencies provide that on an event occurring, the income payments in a CRT "will terminate not later than such payments would otherwise terminate under the trust." I.R.C. § 664(f)(3). *See also* note 21 and accompanying text.

87. Treas. Reg. § 20.2055-2(e)(1)(i), Ex. 4.

88. *See* Treas. Reg. §§ 1.170A-7(b)(1) (as amended in 1999), 20.2055-2(e)(2)(i), & 25.2522(c)–3(b)(1) (1958).

89. *See* Treas. Reg. §§ 1.170A-7(b)(1), 20.2055-2(e)(2)(i), & 25.2522(c)–3(b)(1).

90. The current regulation states:

> For example, if the decedent transferred a life estate in an office building to his wife for her life and retained a reversionary interest in the office building, the devise by the decedent of one-half of that reversionary interest to charity while his wife is still alive will not be considered the transfer of a deductible interest; because an interest in the same property has already passed from the decedent for private purposes, the reversionary interest will not be considered the decedent's entire interest in the property.

Treas. Reg. § 20.2055-2(e)(2)(1).

91. *See* Treas. Reg. § 1.170A-7(a)(2)(i).

D. Case Law

To determine the deductibility of a charitable split-interest, the rules obviate a facts and circumstances analysis in favor of statutorily prescribed formats.[92] Under the plain meaning of the statute, when a charitable split-interest in trust, is not established in one of the prescribed formats such as a CRT or CLT, the taxpayer receives no deduction for his gift to charity.[93] Moreover, not only must the trust instrument satisfy certain requirements, the trust must actually make its mandatory payments.[94] When a taxpayer creates a trust that provides for a remainder interest to pass to a charity and she transfers property to that trust, she receives several tax benefits in addition to those accorded taxpayers who make an outright cash donation: (1) she does not have to pay income tax on the property's appreciation either before or after the transfer and (2) she receives a current charitable deduction for a gift that does not benefit the charity until a later date.[95]

Although for the most part strictly applying the plain language of the statute, some courts have allowed a deduction when there is an event that intervenes to convert the defective charitable interest into an outright charitable donation.[96] These cases reject the government's attempts to distinguish between a surviving spouse's right to take her elective share and an intestate heir's right to institute a will contest that ultimately results in a different disposition of the decedent's property than that found in the

92. *See* Estate of Edgar v. Comm'r, 74 T.C. 983, 987–988 (1980), wherein the court rejected the taxpayer's argument that factually the trust produced sufficient income for the non-charitable beneficiaries so that there would be little chance of invading the trust principal, stating that "permitting economic factors to be considered would directly contradict Congress' intent to establish specific rules in this area[,] . . . such an interest must in all events conform to the statutory requirements."

93. *See, e.g.*, Galloway v. United States, 492 F.3d 219 (3d Cir. 2007); Estate of Johnson v. United States, 941 F.2d 1318 (5th Cir. 1991); *Edgar*, 74 T.C. 983.

94. *See* Estate of Atkinson v. Comm'r, 309 F.3d 1290, 1296 (11th Cir. 2002) Although the CRAT was required to make annuity payments to the decedent during her life, the facts showed "that the estate produced no copies of these [supposedly sent] checks or the cover letters that supposedly accompanied the checks to Atkinson, nor did the annuity trust's ledger reflect any outgoing annuity payments to Atkinson during her lifetime." *Id.* at 1292. Referring to the Tax Court opinion, the Eleventh Circuit explained that the payout requirement "ensures that the trust does not accumulate untaxed wealth for charities, which would sidestep the income distribution requirements of private foundations." *Id.* at 1294.

95. The court in Atkinson stated that:

> [i]n exchange for the significant benefits of allowing a present charitable deduction, even when the actual charitable donation is not to occur until the remainder interest in the property becomes possessory, and in allowing the assets of the trust to grow tax-free, the Code requires adherence to the CRAT rules.

See id. at 1296.

96. Estate of Jackson v. United States, 408 F. Supp.2d 209, 211 (N.D. W. Va. 2005) (allowing a charitable deduction for a cash settlement amount under 2055(e), which had resulted when a disqualifying charitable split-interest trust was terminated as part of a will contest).

will.[97] To some degree, however, those cases rely on the pre-1969 "ascertainable interest" test that "the non-charitable beneficiaries' interests were then capable of being measured and severed from the charitable property."[98]

The distinction between a surviving spouse's right to take her elective share and an intestate heir's right to institute a will contest, however, reflects the different results in two prominent income tax cases: *Lucas v. Earl*[99] and *Poe v. Seaborn*.[100] The rationale for the different outcomes in those cases, where a married couple tried to split-the husband's income as earned or owned one-half by each spouse, is that in *Lucas* the court saw the couple's agreement to assign income as a voluntary act occurring after the property interest in the income vested in the earner-husband whereas in *Seaborn* Washington's community property laws controlled so that, from the instant the husband earned income, each spouse owned one-half of the aggregate income amount.[101] Certainly, a spouse's elective share right is a property interest like in *Seaborn*, but by contrast, an heir's right to contest a will merely gives him a cause of action against the decedent's estate—it does not guarantee him a property interest in decedent's estate. Indeed, the settlement of a will contest is a voluntary agreement incorporating the parties' assessment of multiple and varied factors.

Taxpayers have argued that some of the flawed charitable split-interest trusts constituted "undivided interests" under the regulations and that they therefore met the criteria for a deduction.[102] With some of those cases, like *Johnson*, that argument clearly lacked merit. In *Johnson*, the estate contended that there were essentially three separate trusts because the decedent's trust had three objectives: (1) to support his sisters, (2) to oversee family graves, and (3) to provide for the education of religious persons in the Catholic Church.[103] But, those three purposes did not reflect one-third interests in the entire trust. The will "unambiguously designate[d] the crea-

97. *See* Flanagan v. United States, 810 F.2d 930, 934 (10th Cir. 1987); First Nat'l Bank of Fayetteville, Arkansas v. United States, 727 F. 2d 741 (8th Cir. 1984); Oetting v. United States, 712 F.2d 358 (8th Cir. 1983). However, courts have properly not allowed this result where a defective charitable split-interest trust was terminated solely to obtain a charitable deduction. *See* Burdick v. Comm'r, 979 F.2d 1369, 1372 (9th Cir. 1992) (holding that under Pennsylvania law, because there was no will contest or reason for the settlement other than to skirt the law and to obtain relief by a means not specifically permitted under § 2055(e)(3), the estate was not entitled to a charitable deduction).

98. *First Nat'l Bank of Fayetteville*, 727 F.2d at 747.

99. 281 U.S. 111, 114–15 (1930).

100. 282 U.S. 101, 117 (1930).

101. *See Lucas*, 281 U.S. at 114–15; *Seaborn*, 282 U.S. at 117.

102. *See, e.g.*, Galloway v. United States, 492 F.3d 219 (3d Cir. 2007); Estate of Johnson v. United States, 941 F.2d 1318 (5th Cir. 1991); Zabel v. United States, 995 F.Supp. 1036 (D. Neb. 1998).

103. *Johnson*, 941 F.2d at 1318.

tion of one trust to serve three separate purposes, only one of which involve[d] a charitable bequest."[104] With three competing interests, the charitable interest was not an undivided one under the definition in the regulations.[105]

Zabel is another case that although correctly decided under the plain meaning of the statute, might be viewed as a charitable gift of an undivided half interest in the entire trust. Here, the decedent had created a trust passing a 50 percent income interest and a 100 percent remainder interest to two charities.[106] The plaintiff contended that: "[a]s to that 50% portion, the charities occupy all of the space. They get all of the income from inception, all of the principal. It is not a split-interest."[107] However, the court rejected that argument as well and stated that the charities did not receive the same degree of protection that they would under the statutorily required formats and posed the example of the trustees investing all the trust assets into junk bonds so that the income beneficiaries would benefit to the possible disadvantage of the charity, which held 100 percent of the remainder.[108] The court held that this was a charitable split-interest trust, that it was not in one of the three prescribed forms for split-interest trusts, and that it was not reformed according to rules of the statute.

Finally, although the decedent literally created a defective charitable split interest trust, *Galloway* is a case where none of the interests had to be valued by means of the actuarial tables. In *Galloway*, the decedent had left

104. *Id.* at 1320.

105. *Id.* at 1321.

106.

> During the life of said testamentary trust, said Trustee shall prudently invest the trust assets and at end of each calendar quarter pay over all net trust income remaining after trust expenses on the following basis: (1) Twenty (20) percent to my nephew, *Lee O. Gillespie*, now of Charlotte, North Carolina, for a period of 21 years or until his death, whichever comes first; (2) Thirty (30) percent to my great niece, *Elaine Gillespie*, for a period of 21 years or until her death, whichever comes first; (3) Twenty-five (25) percent to the *Trinity United Methodist Church of Lincoln, Nebraska* for a period of time equal of the life of the Trust; (4) Twenty-five (25) percent to the *Nebraska Masonic Home* located in *Plattsmouth, Nebraska*, for the period of time equal to the life of the Trust; and (5) In the event of the death of either Lee O. Gillespie or Elaine Gillespie prior to the expiration of twenty-one years after my death, their income share shall be divided on a prorata basis among the remaining income beneficiaries for the remaining life of the Trust; (b) After the death of both the said Lee O. Gillespie and Elaine Gillespie, OR the expiration of 21 years from the date of my death, whichever event occurs first; the Trust shall be terminated and all net trust funds then remaining on hand, both principal and income, after final trust expenses, shall be distributed to the following two charitable beneficiaries: One-Half share of the distributable trust assets to: The Trinity United Methodist Church of Lincoln, Nebraska; and One-Half share of the distributable trust assets to: The Nebraska Masonic Home, situated in Plattsmouth, Nebraska . . . .

Zabel, 995 F.Supp. at 1039.

107. *Id.* at 1044–1045.

108. *Id.* at 1047–1048. Except for "standards of prudence," the trust instrument did not prevent this action.

his property in trust to two charitable beneficiaries and to two non-charitable beneficiaries, which under the plain meaning of the statute meant that they had to be in one of the prescribed statutory forms, which concededly they were not. Under the terms of the trust, half of the value of the trust was to be distributed on January 1, 2006, one-fourth to each beneficiary, and the remaining assets in the trust were to be distributed the same way ten years later.[109] The circuit court acknowledged that the denial of deduction in this case, although the proper result under current law, was "unfortunate" since there was little opportunity for abuse. "Each beneficiary of the Trust, charitable and non-charitable, shares equally in the risk of loss and the benefit of good investing as each beneficiary receives an equal share in the property."[110]

III. PROBLEMS WITH THE CHARITABLE SPLIT-INTEREST RULES

A. Complexity

A testament to the complexity of the 1969 legislation was the continual extension for document reformations in multiple pieces of tax legislation.[111] The series of continual requests for extensions occurred despite that

109. Galloway v. United States, 492 F.3d 219, 220 (3d Cir. 2007). Moreover, the trust also provided that if an individual is not alive at the distribution date(s), "his or her share will be distributed to the remaining beneficiaries in equal parts." *Id.*

110. *Id.* at 224.

111. The Tax Reform Act of 1969, Pub. L. No. 91-172, § 201, 83 Stat. 487, 526, 549, generally applied to decedents dying after 1969; however, there was a transition rule for a trust created after July 31, 1969 if the governing instrument was amended to satisfy the new requirements by December 31, 1972. *See* H.R. REP. NO. 93-1405 at 3 (1974) (Conf. Rep.), *reprinted in* 1974 U.S.C.C.A.N. 33372, 33372. The Act of Oct. 26, 1974, Pub. L. No. 93-483, § 3, 88 Stat. 1457, adding I.R.C. § 2055(e)(3), provided that:

> In the case of a will executed before September 21, 1974, or a trust created before such date, if a deduction is not allowable at the time of the decedent's death because of a failure of an interest in property which passes from the decedent to a person, or for a use described in subsection (a), to meet the requirements of subparagraph (A) of paragraph (2) of this subsection, and if the governing instrument is amended or conformed on or before December 31, 1975, or, if later, on or before the 30th day after the date on which judicial proceedings begun on or before December 31, 1975 (which are required to amend or conform the governing instrument), become final, so that the interest is in a trust which is a charitable remainder annuity trust, a charitable remainder unitrust (described in section 664), or a pooled income fund (described in section 642(c)(5)), a deduction shall nevertheless be allowed.

This amendment applied to estates of decedent's dying after 1969. *Id.* § 3, 88 Stat. at 1458. The Tax Reform Act of 1976, Pub. L. No. 94-455, § 1304, 90 Stat. 1520, 1715–16 (amending Section 2055(e)(3)) provided "(1) by striking out 'September 21, 1974.' and inserting in lieu thereof 'December 31, 1977.' and (2) by striking out 'December 31, 1975' each place it appears and inserting in lieu thereof 'December 31, 1977.'" In addition, the Act extended the period for filing a claim for a refund of estate tax paid allowable under section 2055(e)(3), providing that such a claim "shall not be denied because of the expiration of the time for filing such a claim under section 6511(a) if such claim is filed not later than June 30, 1978." § 1304(b), 90 Stat. at 1716. These amendments "shall apply in the case of in the interim the Treasury and Congress expressed their belief either that an extension was unnecessary or that there would be no further delays. Specifically, the first postponement to allow reformations until the end of 1974 was coupled with expressions from the Treasury that there had already been sufficient time for settlors to reform their trusts[112] and it was not alone in that opinion.[113] The additional extension through the end of

decedents dying after December 31, 1969." § 1304(c), 90 Stat. at 1716. The Revenue Act of 1978, Pub. L. No. 95-600, § 514, 92 Stat. 2763, 2883–84, amended Section 2055(e)(3) to read:

> In the case of a will executed before December 31, 1977, or a trust created before such date, if a deduction is not allowable at the time of the decedent's death because of the failure of an interest in property which passes from the decedent to a person, or for a use, described in subsection (a) to meet the requirements of subparagraph (A) or (B) of paragraph (2) of this subsection, and if the governing instrument is amended or conformed on or before December 31, 1978, or, if later, on or before the 30th day after the date on which judicial proceedings begun on or before December 31, 1978 (which are required to amend or conform the governing instrument), become final, so that interest is in a trust which meets the requirements of such subparagraph (a) or (B) (as the case may be), a deduction shall nevertheless be allowed.

Also, "in the case of trusts created before December 31, 1977," the applicable estate and gift tax provisions were likewise conformed. § 514(b), 92 Stat. at 2884. The Miscellaneous Revenue Act of 1980, Pub. L. No. 96-605, § 301, 94 Stat. 3521, 3530, amended section 2055(e)(3) to read: "(1) by striking out 'December 31, 1977' and inserting in lieu thereof 'December 31, 1978'; and (2) by striking out 'December 31, 1978' each place it appears and inserting in lieu thereof 'December 31, 1981'." *See* H.R. REP. NO. 98-432, pt. 2, at 1516 (1984), *reprinted in* 1984 U.S.C.C.A.N. 697, 1155–56 ("Congress first permitted reformation of charitable remainder trusts in 1974 and since that time, the Congress has extended the period for reformations several times and extended the procedure to other types of split-interest charitable contributions.").

112. STAFF OF JOINT COMM. ON INTERNAL REVENUE TAXATION, 93RD CONG., DESCRIPTION OF TECHNICAL AND MINOR BILLS LISTED FOR A HEARING BY THE COMMITTEE ON WAYS AND MEANS ON DECEMBER 10, 1975 48 (Comm. Print 1975), *as reprinted in* 4 TAX MANAGEMENT—PRIMARY SOURCES (BNA) II at § 2055 (1977):

> The Treasury Department believes that transitional rules must come to an end sometime and notes that 6 years have passed since the enactment of the charitable remainder trust rules. However, it would not object to a one year extension if it is made clear that further extensions will not be granted.

113. *See, e.g.*, Estate of Gillespie v. Comm'r, 75 T.C. 374, 380 (1980) stating:

> Moreover, had the petitioner desired to obtain an estate tax charitable deduction, albeit at the expense of losing the trust's flexibility, the trustee could have applied to the Oregon State courts to reform the trust so as to qualify it under section 2055(e)(2). See sec. 2055(e)(3) and the regulations thereunder.

Id.; *see also* Estate of Sorenson v. Comm'r, 72 T.C. 1180, 1188, 1191 (1972). In response to the estate's contention that "the time limitations of section 201(g)(4)(B) [of the Tax Reform Act of 1969] should not apply to property which is considered a bequest of a decedent as long as the will creating the power met those limitations," the court held that:

> [t]he effective date provision, section 201(g)(4)(B) of the Tax Reform Act of 1969, moderated the harshness of the deduction disallowance clause. Congress surely anticipated that if a person chose not to modify existing arrangements otherwise subject to section 2055(e)(2), then such person's estate would suffer the consequences of that decision. *Here, decedent had 4 years (from December 30, 1969, the effective date of section 201(g)(4)(B)(ii) of the Tax Reform Act of 1969, to January 24, 1974, date of death)* to exercise her power of appointment and to place the assets in a trust qualifying for a charitable deduction. It was entirely decedent's choice to forego her opportunity to exercise her power of appointment. . . . Thus, the new rules of section 2055(e) are applicable to decedent.

Id. at 1188, 1191 (emphasis added). Although *Sorenson* refers to the effective date of the 1969 Act extension, rather than a liberal period for reformation, the point the court made is essentially the same.

1977, which again was deemed "the last extension permitted," was tied to allowing the government to have a campaign to update the public on the new requirements for split-interest trusts.[114] In 1978, Senator Bumper introduced a floor amendment to the Revenue Act of 1978 in order to delay the reformation provisions for one additional year through 1978 to amend CRT and CLT instruments for income, estate, and gift tax purposes; specifically, he wanted to aid Arkansas College, which had received a large bequest after 1977.[115] In 1980, because Congress found "a number of meritorious cases" that would result in charities having to pay estate taxes if trust instruments were not reformed, Congress wanted a two-year extension through the end of 1980; additionally, Congress understood "that the Treasury is studying the possibility of proposing a permanent rule on this issue."[116]

In 1984, Congress permanently amended the split-interest provisions to allow taxpayers a limited post-death ability to comply with the strict rules.[117]

> [I]t has come to the attention of the committee that there are still many instruments providing for split-interest charitable contributions which do not meet the requirements for qualification under the rules of the Tax Reform Act of 1969. . . . In light of the repeated need to extend the period to reform such governing instruments and the fact that failure to meet the

114. H.R. REP. NO. 94-1268, at 3 (1976):

> While your committee has concluded that an additional extension of two years is appropriate at this time under the circumstances, your committee believes that this should be the last extension permitted by Congress. By the end of this extension, there will have been eight years since the general effective date of the new requirements for deduction under section 2055(e) of the Code. Your committee believes that such an eight-year period should be more than enough time for taxpayers and their lawyers to learn the new rules and to implement them in their estate planning.
>
> Also, your committee intends that the Internal Revenue Service make every effort to publicize to taxpayers' attorneys, trust companies, etc., the requirements of the 1969 Act with respect to charitable remainder trusts. Your committee solicits the assistance of commercial tax services to similarly publicizing these requirements.

Id.; S. REP. NO. 94-938, pt. I, at 600–01 (1976), *reprinted at* 1976 U.S.C.C.A.N. 3438, 4024–25; *see also* STAFF OF THE JOINT COMM. ON TAXATION, 94TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, 397–98 (Comm. Print 1976). Because that extension was limited to CRTs for estate tax purposes only, in 1977, Congress enacted an extension through December 31, 1977 for both CRTs and CLTs for income and gift taxes and to CLTs for estate taxes. *See* H. R. REP. NO. 95-700, at 88 (1977); S. REP. NO. 95-745, at 103 (1977).

115. Revenue Act of 1978 at § 514, 92 Stat. at 2884; *see* STAFF OF THE JOINT COMM. ON TAXATION, 95TH CONG., GENERAL EXPLANATION OF THE REVENUE ACT OF 1978, 292–93 (Comm. Print 1979). According to Senator Dale Bumpers (D. Ark.), the college received a very large gift but needed the legislation to be extended to the end of 1978 to allow the school to reform the charitable bequest and, thereby, to save itself $40,000 in estate tax costs. 124 CONG. REC. 34,383 (Oct. 6, 1978) (statement of Sen. Bumpers).

116. H.R. REP. NO. 96-2178, at 44 (1980).

117. Tax Reform Act of 1984, Pub. L. No. 98-369, § 1022, 98 Stat. 494 (amending I.R.C. §§ 170(f), 664(f), 2055(e), and 2522(c)).

> 1969 Act rules often results in reduced amounts passing to charity, the Committee believes that a permanent rule permitting reformation of split-interest charitable contributions should be permitted so long as there are adequate safeguards to avoid abuse.[118]

Immediately prior to the 1984 Act, the law allowed for the reformation of some charitable split-interest trusts that were created before the end of 1978;[119] with the new law, certain reformations are available currently,[120] *forty years* after the enactment of the 1969 legislation. In addition, the government has published sample split-interest trust forms since 1989.[121] However, even with all of this help, there continue to be instances where wealthy taxpayers and venerable charities cannot adhere to the charitable split-interest rules despite the availability of government guidance and the statute's very generous reformation provision.[122] Thus, while split-

118. H.R. REP. NO. 98-432, pt. 2, at 1516 (1984) *reprinted in*, 1984 U.S.C.C.A.N. 697, 1156. Congress feared that allowing the reformation of trusts without restrictions would invite taxpayers to create abusive trusts that would conform to the statutory format only if, and when, audited.

119. The Miscellaneous Revenue Act of 1980, Pub. L. No. 96-605, § 301, 94 Stat. 3521, 3530, amended the then-current version of the extension of section 2055(e)(3), which provided for the allowance of trust instrument reformations in the case of a will executed before December 31, 1977, or a trust created before such date "(1) by striking out 'December 31, 1977' and inserting in lieu thereof 'December 1, 1978'."

120. *See* H.R. REP. NO. 98-861, at 1242 (1984) (Conf. Rep.), *reprinted in* 1984 U.S.C.C.A.N. 1445, 1930 stating:

> The House bill provides a permanent rule permitting reformation of charitable split-interest trusts if certain requirements are satisfied. Under this provision of the House bill, the relative values of the charity and the noncharity interests in the trust may not vary by more than 5 percent as a result of the reformation. Additionally, unless the reformation proceedings are begun within 90 days after the due date of the Federal estate tax return (or the first trust income tax return if no estate return is due), the trust must, as executed, provide for an annuity trust or unitrust amount.

Id. Under section 2055, to be a "qualified reformable interest," either all payments must be expressed as specific dollar amounts or a fixed percentage of the fair market value of the trust property, I.R.C. § 2055(e)(3)(C)(ii) (2006), or a judicial proceeding must be initiated by "the 90th day after . . . the last date (including extensions) for filing [the estate tax] return." § 2055(e)(3)(C)(iii)(I).

121. The government has published samples in order to obviate the need for private ruling requests for taxpayers who adopt the use of its forms. *See, e.g.*, Rev. Proc. 07-46, 2007-29 I.R.B. at 102; Rev. Proc. 07-45, 2007-29 I.R.B. at 89; Rev. Proc. 05-59, 2005-34 I.R.B. at 412; Rev. Proc. 05-58, 2005-34 I.R.B. at 402; Rev. Proc. 05-57, 2005-34 I.R.B. at 392; Rev. Proc. 05-56, 2005-34 I.R.B. at 383; Rev. Proc. 05-55, 2005-34 I.R.B. at 367; Richard L. Fox, *A Guide to the IRA Sample Charitable Remainder Trust Forms*, 33 N.Y. EST. PLAN. 13, 13–14 (Jan. 2006) (criticizing some aspects of the government forms and suggesting some alternatives).

122. *See, e.g.*, Estate of Tamulis v. Comm'r, T.C.M. (RIA) 2006-183, 2–7 (2006), wherein decedent, a Catholic priest, had created a testamentary trust with a life estate in real property to his brother and sister-in-law, or the survivor, with the trust paying the real estate taxes on that property during their lives, and certain fixed annual amounts, with some of them conditional bequests, with any remaining net income each year to go equally to two grandnieces. At the end of the longer of 10 years or his brother and sister-in-law's joint lives, the remainder of the assets was to go to the Roman Catholic Diocese of Fall River, Massachusetts. The estate stipulated that the trust did not qualify for a charitable deduction at the time of the decedent's death because it failed to comply with the statutory requirements of section 2055(e); however, it made several arguments that the remainder interest was "a reformable interest" that was reformed as required by section 2055(e)(3). The court, however, rejected that contention because the payments for real estate taxes for the non-charitable beneficiaries and payments of the

interest trusts continue to be popular with the wealthy,[123] they are evidently too complex or problematic for some donors or charities.[124]

B. Overly Inclusive Definition?

The original definition of a charitable split-interest trust, which appears in the preliminary 1969 Tax Reform Act material,[125] as well as the rationale for the 1969 legislation[126] clearly envisions a much more limited definition of that term than the language adopted in the 1969 statute without comment.[127] That is, the Treasury and the House report definition comprehended successive temporal property interests in trust that rely on actuarial valuation, such as income and remainder interests. There is an array of case law in which the courts refer to the unfortunate result of non-compliance with the statutory mandates for charitable split-interest trusts wherein they plainly pertain.[128] A particularly severe result is the outcome in *Galloway* where the charitable and non-charitable beneficiaries share the same fate regardless of the trust investments.[129]

remaining net income to non-charitable beneficiaries were not expressed either as a fixed dollar amount or as a fixed percentage of the fair market value of the property as required by the reformation statute. Consequently, the only available route for reformation was beginning a judicial reformation proceeding within 90 days of the estate tax return's due date; no such proceeding was ever instituted. The court rejected the estate's claims that a return statement constituted an amendment of the trust or a commencement of a judicial proceeding and the court held that, although the trustee administered the trust as if it were a qualified unitrust, the estate had not shown that it was entitled to have the doctrine of substantial compliance apply. *Id.* at 21–23.

123. Lisa Schreiber, *Split-Interest Trusts, Filing Year 2007*, I.R.S. STAT. OF INCOME BULL. at 46 (Winter 2009), *available at* http://www.irs.gov/newsroom/article/0,,id=204956,00.html (for 2007, "[e]nd-of-year net asset values reported for split-interest trusts increased to $115.4 billion. . . . In 2007, some 115,754 returns for charitable remainder trusts were submitted, a decrease of 0.3 percent . . . . Trustees for charitable lead trusts submitted 6,377 returns in 2007, an increase of 1.3 percent over 2006 filings"); I.R.S. News Release, *I.R.S. Issues Winter 2009 Statistics Of Income Bulletin*, IR-2009-17 (Mar. 3, 2009), *available at* http://www.irs.gov/newsroom/article/0,,id=204956,00.html ("Split-interest trusts reported $12.2 billion in total net income in filing year 2007, an increase of 22.1 percent since 2006. Total accumulations, including ordinary income, short-term and long-term capital gains, and nontaxable income, also increased, from $66.3 billion in filing year 2006 to $73.1 billion in 2007.").

124. *See* Estate of Gillespie v. Comm'r, 75 T.C. 374, 379 (1980) ("[Section 2055(e)(2)] certainly adds substantial complexity to an area already complex.").

125. *See supra* notes 74–78 and accompanying text.

126. *See* Valerie H. Kuntz, Galloway, *Split-Interest Trusts, and Undivided Portions: Does Disallowing the Charitable Contribution Deduction Overstep Legislative Intent?* 20 REGENT U. L. REV. 125 (2007); *see also supra* Part I.B.

127. *See supra* Part I.A.

128. *See, e.g.*, Galloway v. United States, 492 F.3d 219, 224 (3d Cir. 2007) (granting that the result in the case was "unfortunate" because there was little opportunity for abuse. "Each beneficiary of the Trust, charitable and non-charitable, shares equally in the risk of loss and the benefit of good investing as each beneficiary receives an equal share in the property."); Estate of Gillespie v. Comm'r, 75 T.C. 355, 379 (1980) (acknowledging that "the application of section 2055(e)(2) may result in some unfairness").

129. *See Galloway*, 492 F.3d at 224.

On the other hand, Congress has clearly embraced this definition. When it enacted the permanent reformation provision in 1984, the legislative history no longer referred to successive actuarially determined interests; rather it denoted a trust that contained any combination of charitable and non-charitable beneficial interests. Thus, the 1984 House report defines a charitable split-interest in trust as a trust which is "part charitable and part non-charitable."[130] In addition, the courts have explained how the statute's broad compass prevents additional abuse.[131]

C. CRTs and CLTs: Unanticipated Tax Abuse

By only focusing on matching the amount of the taxpayer's donation to the amount received by the charity[132] and by not anticipating certain excessive tax benefits flowing to the donor, a CRT and, most especially, a CLT provide the donor with an "*unwarranted tax advantage which is not a necessary inducement to charitable giving*."[133] A CRT allows the donor to avoid income taxes by timing the donor's deduction before the actual charitable gift,[134] and overvalues the charitable deduction by undervaluing the non-charitable interest,[135] a NICRUT and a NIMCRUT serve as unintentional and gratuitous retirement saving and deferral devices,[136] and a CLT

130. H.R. REP. NO. 98-432, pt. 2, at 1516 (1984), *reprinted in* 1984 U.S.C.C.A.N. 697, 1155 (under the rules adopted by the Tax Reform Act of 1969, a charitable interest in a split-interest trust is a trust which is part charitable and part noncharitable); *see* H.R. REP. NO. 98-861, at 1242 (1984) (Conf. Rep.), *reprinted in* 1984 U.S.C.C.A.N. 1445, 1930 ("Trusts having both charities and noncharities as beneficiaries generally must be structured as unitrusts or annuity trusts to qualify for a charitable deduction.").

131. *See, e.g.*, Zabel v. United States, 995 F. Supp. 1036, 1047–48 (D. Neb. 1998), where the court explained, despite the plaintiff's argument that the charities would not be harmed, "the trust instrument does not provide the charities with the same level of protection that section 2055(e)(2)(A) requires." The court then gave the example of a trustee's investing in junk bonds to produce a large income return, but where ultimately the remainder might be worthless. *Id.* at 1048. Under the facts in *Zabel*, where the charities owned fifty percent of the income interest and 100 percent of the remainder and the non-charitable beneficiaries owned the remaining fifty percent of the income interest, with such an investment, the charities' interests in this trust would be less protected than under the statutory format. *Id.* Likewise, in *Atkinson* the CRAT required annuity payments, which were not in fact paid to the annuitant, to prevent the accumulation of untaxed wealth, thereby bypassing the income distribution requirements applied to private foundations. Estate of Atkinson v. Comm'r, 309 F.3d 1290, 1294–96 (11th Cir. 2002).

132. *See supra* note 40.

133. In 1969, Congress used this language to criticize the then benefit of a CLT, i.e., a double income tax benefit of allowing a charitable deduction for amounts already not included in the taxpayer's income. *See* H.R. REP. NO. 91-413, *supra* note 7, at 61; *supra* notes 47–49 and accompanying text.

134. *Atkinson*, 309 F.3d at 1296.

135. The non-charitable interest is valued using the life expectancies of the average person whereas the life expectancies of the wealthy are actually longer than for the average person. *See infra* note 140.

136. The types of CRT primarily used as a retirement format are the popular NICRUT, *see* I.R.C. § 664(d)(3) (2006); Treas. Reg. § 1.664-3(a)(1)(i)(b)(1) (as amended 2004), and NIMCRUT, *see* Treas. Reg. § 1.664-3(a)(1)(i)(b)(1) (as amended 2004).

allows a settlor to avoid transfer taxes on gifts to non-charitable beneficiaries.[137]

Much of the unintended tax benefits from these charitable split-interest trusts stem from the inherent flaws of valuing an interest by means of the actuarial tables[138] at the time of the creation of the trust. The tables are touted for their simplicity, historical acceptance, and universal application, but not for their accuracy or their ability to predict future investment outcomes in any particular case.[139] That is, the tables only truly match the partial interest in property's actual value in the "average" case. Because it is the taxpayer who chooses the format in which to make his charitable gift, he can plan to use the actuarial tables, although theoretically neutral, only when that choice is more likely to serve his advantage.

A CRT provides additional benefits to the taxpayer and other family members who are life beneficiaries in the trust since the wealthy, for a number of reasons, live longer than the general public on whose lives the actuarial tables are based.[140] They therefore are likely to receive more total annuity or unitrust payments than are reflected in the value of that interest as that interest is calculated by means of the tables. Thus, the non-charitable income interest in a CRT is likely to be undervalued while the charitable remainder interest is correspondingly overvalued.

137. At the termination of a CLT, all trust asset appreciation passes to non-charitable beneficiaries transfer tax-free. In addition, with a CLAT, all income that exceeds the required annuity payouts passes to those individuals without any additional transfer taxes.

138. Annuities and other partial interests in property, such as remainders, must be valued by the actuarial tables. I.R.C. § 7520 (2006). Even before that statute's enactment in 1988, Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 5031(a) (1988), the regulations dealing with estate and gift tax valuation indicated their usage. See Treas. Reg. § 20.2031-7(c) (as amended 2000), which indicates the applicable regulation and tables for valuing interests in decedent's estate from before Jan. 1, 1952 to the present date, and I.R.C. § 25.2512-5A(a) for parallel valuation instructions for gift tax purposes.

139. The required use of the actuarial tables indicates "[t]he intention of the lawmakers . . . that the computation of the tax should be made . . . on the basis of a law of averages." Sinclair Ref. Co. v. Jenkins Petroleum Process Co., 289 U.S. 689, 698 (1933); *see* Ithaca Trust Co. v. United States, 279 U.S.151, 155 (1929) (Congress had mandated that decedent's wife's life interest had to be computed by the actuarial tables at the time of decedent's death in 1921); Wendy C. Gerzog, *Annuity Tables Versus Factually Based Estate Tax Valuation:* Ithaca Trust *Re-visited*, 38 (ABA) REAL PROP., PROB., & TRADE J. 745, 755 (2004).

140. *See* BARRY JOHNSON & JENNY WAHL, THE MISMEASURE OF MAN'S WELL-BEING: REFINING REALIZED INCOME MEASURES WITH WEALTH, PORTFOLIO, AND MORTALITY INFORMATION 4 (2004), *available at* http://www.irs.gov/pub/irs-soi/04johnta.pdf:

> To compensate for the age bias and produce estimates more representative of the living population, we re-weight the file using reciprocals of mortality rates (by age and sex), *adjusted by a differential that reflects the lower mortality rates experienced by the wealthy. Richer people tend to live longer because they enjoy access to better healthcare, safer occupations, and superior nutrition.*

(emphasis added).

Some of the main benefits of a CRT, moreover, are the income tax benefits that include (1) an immediate charitable deduction for a transfer that the charity can only enjoy some time in the future;[141] (2) avoiding capital gains on sales of trust assets so that the untaxed proceeds from those sales can produce more income;[142] and (3) the ability to defer tax until income is needed some time in the future.[143] In that last role, a CRT, generally a NICRUT OR NIMCRUT, is often used as an optimal retirement vehicle;[144] that is, not subject to the contribution limitations currently imposed on the various government retirement accounts, which exist primarily for a retirement purpose, a CRT can invest in low or no-income products for years when income is not currently desired and make up for the lack of earlier payments when the donor turns 65 or 70, for example.[145]

While the Senate proposed the net income and net income with makeup provision CRT for both the CRAT and the CRUT, the Conference report restricted these forms to a CRUT, thus creating the NICRUT and NIMCRUT versions of a CRUT.[146] The Senate stated that the purpose for these flexible formats was to prevent a shortfall of the required income payment and thus to protect the charity's remainder interest. The potential

141. *See* Ron Shoemaker & David Jones, *K. Charitable Remainder Trusts: The Income Deferral Abuse and Other Issues*, 1997 EO CPE Text 13.24 at 141 (1997), *available at* http://www.irs.gov/pub/irs-utl/topic-k.pdf.

142. The donor of a CRT is not taxed on capital gains since they adhere to the charity, a tax-exempt entity. Often, the donor contributes appreciated real property or other illiquid assets to the CRT to avoid capital gain taxes and to enable her to receive higher income payments once the property is sold and can be re-invested. *See* KATHRYN G. HENKEL, ESTATE PLANNING AND WEALTH PRESERVATION: STRATEGIES AND SOLUTIONS ¶33.01 (Warren, Gorham & Lamont RIA, abridged student ed. 2003).

143. *See* Shoemaker & Jones, *supra* note 141, at 140 stating:

> IRC 664(d)(3) was enacted to give trustees breathing room. If, in any year, trust income dropped and the distributions to the noncharitable beneficiaries originally intended by the donor could not be met using trust income, the trustees could temporarily reduce the current payout, or could otherwise adjust the unitrust's portfolio to generate sufficient income for future years.
>
> However, the net income and makeup provisions of IRC 664 are now being used not to gain flexibility in the normal management of the portfolio, but for a tax deferral purpose not contemplated by Congress.
>
> To achieve a maximum deferral for a noncharitable beneficiary, a trust's assets must be manipulated in such a manner so that the net income and makeup provisions can be used to avoid payout in the early years of the trust and to realize income, including the makeup amount, only in later years when the noncharitable income beneficiary may be in a lower tax bracket. This device is called an income deferral NIMCRUT.

144. Besides the NICRUT OR NIMCRUT, which are both statutory devices, the regulations sanction the one time flip CRUT, which begins as a NICRUT OR NIMCRUT and, on a triggering event, such as birth, marriage, divorce, death, or sale of an unmarketable asset, *see* Treas. Reg. § 1.664-3(a)(1)(i)(d) (as amended 2000), the trust "flips" to an ordinary CRUT. *See* Treas. Reg. § 1.664-3(a)(1)(i)(e), Ex.5. These rules are effective for CRTs established on or after December 10, 1998. *See* Treas. Reg. § 1.664-3(a)(1)(i)(f).

145. Those plans include, *inter alia*, the traditional IRA, sections 401(k), 403(e), and 457(b) plans that have contribution and other limitations.

146. *See supra* notes 56–57, 70 and accompanying text.

need for an invasion of principal in a year when trust income is insufficient, however, would more likely occur with a CRAT, which requires an income payout of the same required fixed annuity amount than with a CRUT, which has an income payout of an amount that varies as a fixed percentage of each year's trust asset value.[147] Inexplicably, the NICRUT and NIMCRUT options do not require the trustee to invest in a way aimed to meet the required income payout amounts.

By contrast, the CLT is chiefly well-liked by the very wealthy as the family cannot access trust assets during the term of the trust, during which time this device provides annual payments to a charity. Very popular with most universities,[148] almost all major charities from the Red Cross[149] to PETA[150] promote their use. Essentially, by using a CLT instead of making a direct gift of a remainder interest in property to family members without incorporating a charitable donation, when the property actually grows or earns more than the assumptions incorporated in the actuarial tables more value passes to those non-charitable beneficiaries transfer-tax free.[151]

147. That is, while income varies with actual interest rates from year to year and so the CRUT as well as the CRAT can have an income underperformance, the asset value also varies from year to year, but only the CRUT, and not the CRAT, takes that factor into account.

148. *See, e.g.*, Gift Planning Tools at BYU Marriott School, http://marriottschool.byu.edu/giving/clt.cfm (last visited Jan. 11, 2010); Duke University Gift Planning, http://giving.duke.edu/giftplanning/giftplans/charitableleadtrusts/ (last visited Jan. 11, 2010).

149. *See* Gift Planning at Redcross.org, http://www.redcrosslegacy.org/GIFTcharitlead.php (last visited Jan. 11, 2010) which extols the following benefits of a CLT:

> You qualify for a gift tax deduction for the present value of the annuity payments to the Red Cross. The annuity payments and the term of the trust can be specified in such a way so as to reduce or even eliminate the transfer taxes due when the principal reverts to your heirs. All appreciation that takes place in the trust goes tax-free to your heirs. You can use your available estate tax credit to further reduce taxes on transfers to your heirs. You can have the satisfaction of making a significant gift to the Red Cross now that reduces the taxes due on transfers to your heirs later.

150. Planned Giving at Peta.org, http://www.peta.org/jnew/leadtrusts.asp (last visited Jan. 11, 2010) ("The value of the nongrantor trust is that it can help you to transfer assets to loved ones, generally children or grandchildren, at a reduced cost while providing significant support to PETA's programs.")

151. *See Outside the Box on Estate Tax Reform: Reviewing Ideas to Simplify Planning: Hearing Before the Comm. on Finance*, 110th Cong. 2, at 6 (2008) (statement of Diana Aviv, President and CEO Independent Sector), *available at* http://www.senate.gov/~finance/hearings/ testimony/2008test/040308datest.pdf. For example:

> Dad transfers $1,000,000 in property to a CLAT with a ten year charitable term and an eight percent payout rate. The property earns ten percent (after-tax) yearly, and the [I.R.C. §] 7520 rate at the time of the transfer is eight percent. The remainder interest is valued at $463,192 at the time of the transfer. At the end of the charitable term, the value transferred to Dad's children is $1,318,748.49. Had Dad initially made a gift of property worth $463,192 rather than creating the CLAT, the gifted property would be worth $1,201,400.76 at the end of ten years, assuming it grew at ten percent (after-tax) each year.

HENKEL, *supra* note 142, at ¶ 35.09. Of course, with either a CLT or CRT, there is a risk that the asset may not perform as well as expected; however, that risk is tipped in favor of the taxpayer since it is he who decides whether to create such a device and what property he will use to fund the trust.

Moreover, the charitable gift and the gift to family members can be "zeroed out," so that the taxpayer can transfer property to her family for little or no taxes.[152]

The benefit of a CLT is transfer tax avoidance regarding the remainder interest that ultimately passes to the donor's beneficiaries. Like with a CRT, the assumptions incorporated in the actuarial tables may in themselves create that benefit. The actuarial tables assume a fixed rate of growth based on current interest rates, which at any time but particularly when interest rates are low, are unlikely to be accurate over a fixed term of 20 years, for instance. When, as now, interest rates are historically low, the charitable deduction for a CLAT[153] is larger.[154] Moreover, the donor chooses the property she will transfer to the CLT; that property grows tax-free in the trust; and it is likely that the actuarial value of the remainder will not match and underestimate, for transfer tax purposes, the present value of the amount that the family members will ultimately receive. That difference produces an underestimation and an understatement of transfer taxes and, consequently, an unintentional tax loophole, which Congress did not anticipate when it amended the CLT provisions in 1969.[155]

IV. SOLUTIONS

A. Simplicity

The charitable split-interest rules are not simple; however, Congress has provided for a reform provision and the government has published sample forms, which comply with the statute. Congress could certainly simplify the charitable trust provisions, but most of the simple solutions are ones that would be unacceptable to the taxpayer because they would defeat her ability to receive additional tax advantages beyond the benefit of a charitable deduction.

The simplest—and fairest rule—and the one least susceptible to manipulation would be the requirement that, to receive any charitable deduction, all donations be in cash.[156] That rule would remove valuation

152. Where the value of the income interest qualifying for the gift tax charitable deduction equals the value of the remainder interest that passes to the non-charitable recipient, the gift is "zeroed out."

153. "If the CLT property is expected to appreciate, a CLAT is usually the better choice, since the annuity remains fixed and more property can go to the family beneficiaries." HENKEL, *supra* note 142, at ¶ 35.08.

154. *See id.* at ¶ 35.01[3][a] ("The value of an annuity varies inversely with interest rates, so a lower interest rate will produce a higher charitable deduction, all other factors being equal.").

155. *See supra* notes 41–42 and accompanying discussion.

156. That requirement would eliminate the tax driven charitable split-interest trusts with their complexities and costs. Simply, a donor or an executor should be required to sell all assets that are to be

difficulties and the necessity for the use of the actuarial tables, with their inherent inaccuracy, susceptibility to manipulation, and indefensible revenue loss. In 1969, there were voices for the end to the unwarranted tax breaks accruing only to the rich[157] by requiring cash contributions just as there are today.[158] If all deductible donations had to be made in cash, the charitable gifts of the wealthy would be in the same medium as those of the poor. However, for most taxpayers, this proposal would resemble one from Jonathan Swift.[159] Yet, there is some good common sense (applicable then and now), as well as a comeuppance, in the words of the elder Senator Albert Gore:

> The donor of appreciated property is clearly $25 ahead of his counterpart who gave out of his income. Colleges and universities, during the Finance Committee hearings, strongly objected to introducing tax equity into the treatment of charitable gifts by taxing in any manner appreciation on capital assets. The distressing feature of the stance adopted by colleges and universities was that they did not address themselves to the issue of tax fairness. Their representatives simply asserted that because they were the beneficiaries of an unfair tax system, that system should

donated in order to receive a charitable deduction. More than merely resolving the problem of complexities with regard to charitable split-interest trusts, Congress would be able to eliminate almost all of the complicated limitations on charitable gifts. For example, you would eliminate the need for the Section 170(b) percentage limitations, the Section 170(e) required contribution value reductions, and the Section 170(f) split-interest rules since the abuse protection embodied in a mandatory cash requirement charitable deduction law would make them superfluous. Moreover, this solution satisfies all of the purported goals of a tax system: equity, neutrality, and simplicity. These goals are also sometimes referred to as "fairness, efficiency, and administrability." *See generally* 1 U.S. TREASURY DEP'T, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH–GENERAL EXPLANATION OF THE TREASURY DEPARTMENT PROPOSALS 13–19 (Nov. 1984).

157. S. REP. NO. 91-552, *supra* note 4, at 334–35 (individual views of Sen. Albert Gore):

> From the standpoint of tax justice, there is no basis for the present treatment of charitable gifts of appreciated property. Tax reform must ultimately encompass the full taxation of appreciation on property given to charity. Only in this way can gifts of property and gifts out of income, which most citizens make, be treated equally. . . . There is no rational reason why the Government should subsidize the two gifts in a different amount.

158. *See, e.g.*, George K. Yin, *JCT Chief Discusses the Tax Gap*, 107 TAX NOTES 1449, 1450 (2005):

> Many taxpayers, in effect, are provided with the equivalent of a deduction equal to much more than 100 cents for each dollar of property value given to charity. . . .Finally, contrast further the incentive given to cash gifts by taxpayers who do not itemize. They are allowed a deduction equal to zero cents for each dollar given—no tax inducement at all. Now add one additional fact—which I think is beyond dispute—that cash gifts are less susceptible to noncompliance than are gifts of property with uncertain values, and we see a rather odd outcome.

159. JONATHAN SWIFT, A MODEST PROPOSAL FOR PREVENTING THE CHILDREN OF POOR PEOPLE IN IRELAND FROM BEING A BURDEN TO THEIR PARENTS OR COUNTRY, AND FOR MAKING THEM BENEFICIAL TO THE PUBLIC (1729) (suggesting that they would be served up for dinner: "I have been assured by a very knowing American of my acquaintance in London, that a young healthy child well nursed is at a year old a most delicious, nourishing, and wholesome food, whether stewed, roasted, baked, or boiled; and I make no doubt that it will equally serve in a fricassee or a ragout.").

not be changed. This is precisely the argument made by the oil companies for percentage depletion.[160]

Because of their inherent abuse potential, it would be difficult to simplify the rules of a charitable split-interest trust. Simplicity combined with equity would dictate removing the split-interest.

B. Definition of a "Split-Interest"

The current definition works well in most instances. While some cases, like *Zabel*[161] and *Tamulis*,[162] may seem harsh, where *Zabel* could have been divided into two trusts, and *Tamulis* had relatively minor non-charitable interests that could have been provided for in another way,[163] nevertheless, they both could have been subject to at least some of the manipulation Congress tried to prevent in the 1969 Act.[164] Moreover, regardless of whether the plain statutory definition of charitable split-interest embodies the original Congressional intent,[165] Congress clearly has embraced that definition, most notably in its major reformation of the split-interest rules in 1984.[166]

Therefore, while the statutory definition of a charitable split-interest is broader than the original one, its over-inclusiveness harms few donors. However, if Congress were to contemplate changing that definition, that modification should be limited to including an exception for a case like *Galloway*,[167] wherein 100% of each interest, whether charitable or non-

160. S. REP. NO. 91-552, *supra* note 4, at 335 (individual views of Sen. Albert Gore). Put another way by Representative Wilbur Mills in 1969:

> If ever there is a loophole in the law, it is in this business of being able to give property that has appreciated tremendously in value. It is possible to get a tax break and save money under the tax law, doing it all under the guise of charity. This is a part of the bill with which I do not agree completely. But we backed off of it, I guess because the people running the museums said, "If you do not let them donate property and receive a tax deduction, they will sell the property for the benefit of Europeans and we will be deprived of the opportunity to see it."

115 CONG. REC. 40,872 (Dec. 22, 1969) (statement of Rep. Mills).

161. *See supra* notes 106–108 and accompanying text.

162. *See supra* note 122 and accompanying text.

163. From the estate tax return describing a CRUT, there is no reason why the estate did not reform the trust as allowed by the statute. But, in terms of the decedent's estate plan, as one example, he could have created a small trust (if he could not have been persuaded to make outright gifts to his family) to cover the conditional gifts and the expense allowance for costs associated with his brother's and sister-in-law's anticipated real estate liabilities. Since the decedent wanted almost all of his estate to benefit the Catholic diocese, he could have passed most of his estate to it in an outright gift.

164. *See supra* note 131. In *Tamulis*, while the trust may well in fact have been operated as a CRUT, there was no assurance that it would continue to conform to those rules because the governing instruments did not require the trustee to follow the CRUT requirements. *See supra* note 122.

165. *See supra* Parts I.B, II.B.

166. *See supra* note 130 and accompanying text.

167. *See supra* notes 109–110 and accompanying text.

charitable, is treated equally throughout the term of the trust and where there can be no manipulation advantaging the non-charitable interest at the expense of the charitable interest. Thus, the current definition of charitable split-interest might accordingly be modified to include an exemption from the charitable split-interest rules: *"where the value of any interest in the trust does not need to be determined by the use of the actuarial tables and where there is no abuse potential in valuing either the charitable or non-charitable interests."*[168] With this modification, the charitable split-interest rules would allow a deduction for trusts like in *Galloway* that lack income and remainder interests and share proportionately in the trust's investment outcomes.[169]

C. Curtailing the Abuse in Charitable Split-Interest Trusts

This article proposes two ways to limit the income tax deferral inherent in a CRT. One, instead of allowing an income tax charitable deduction when the donor establishes a CRT, the statute should time the charitable deduction with the charity's receipt when the remainder vests.[170] Two, the ability to defer income tax is also a consequence of the statutory enactments of the NICRUT and the NIMCRUT and the regulatory allowance of a "flip" trust, which converts one of the two CRUT variations into an ordinary CRUT at some triggering event.[171] These variations of a CRUT should be eliminated.

168. Regarding the statutory reformation provisions, Congress could increase the time period to more than 90 days (such as six months), but since the legislation is forty years old and the I.R.S. publishes sample forms, there's really little excuse for noncompliance; also, Congress' stated policy of not allowing trusts to remain defective until the I.R.S. audits them would likely be contravened with such an extension of time. *See supra* Part III.A.

169. *See supra* notes 109–110 and accompanying text. Note that in *Galloway*, the charities received fifty percent of the trust assets and the non-charitable beneficiaries received the other fifty percent. If, however, the trust were to benefit those interests disproportionally, such as an 80-20 split favoring the non-charitable beneficiaries, the trust would not qualify under this exception. (An alternative view would minimally require that the value of the charitable minority interest, and deduction, be discounted.)

170. That reform will consequently provide a matching between the amount of the taxpayer's deduction and the benefit to the charity because it will all be happening in real time. In 1969, the Treasury stated that "[t]he charitable contribution deduction for a trust interest given to a charity is based on an assumed actuarial calculation made at the time the trust is created. . . . The proposal would restrict the deduction to the amount that the charity actually receives." 1969 TREASURY STUDIES AND PROPOSALS, *supra* note 2, at 38, *as reprinted* at § 170.32. No longer dependent upon actuarial estimates, this reform will ensure that desired result. "The problem [i.e., the lack of correlation between the donor's deduction and the charity's benefit] arises because of the need to value the charity's interest at the time the trust is created. The interest is valued for these purposes by determining present values using actuarial life expectancy tables and an assumed interest rate." *Id.*

171. *See supra* note 143 and accompanying text.

The other major reform that Congress should undertake is to change the CLT rules. In 1969, Congress focused on matching the amount of the charitable donation to the amount the charity received. Today, Congress needs to focus on the match between the value of the property transferred to the non-charitable beneficiary and the amount that is subject to transfer tax.[172]

While a CLT that outperforms the assumptions of the actuarial tables is allowed to increase the benefits accruing to the non-charitable beneficiaries without additional transfer taxes, there is no remedy for a CLT that underperforms the tables; while the donor has the disadvantage that he would consequentially have with any bad investment, that donor has already received a tax benefit for amounts not received by the charity. Because there is no "recovery" and because transfer taxes are not income taxes, which are payable annually, the tax benefit rule[173] is inapplicable to transfer taxes. The absence of a remedy is especially problematic with respect to a testamentary CLT.

Additional recommendations to reform the CLT rules center on correcting the flaws of actuarial valuation in this context: (1) a recapture provision; (2) a requirement that the CLT investment be a U.S. Treasury debt instrument; or (3) a requirement that the initial valuation of the charitable deduction be discounted to reflect investment marketability and risk allowed in the trust instrument. That is, Congress should adopt a recapture provision[174] when the remainder vests in the non-charitable beneficiary to

172. *See supra* notes 148–153 and accompanying text. In 1969, the Treasury did not anticipate this side of the equation. "The fact that in addition to producing income the trust principal may appreciate or depreciate in value is irrelevant." 1969 TREASURY STUDIES AND PROPOSALS, *supra* note 2, at 192, *as reprinted* at § 170.37. Likewise, the Treasury stated:

> If the annuity format is used—irrespective of whether the charity has the annuity or remainder interest—the trustee would have no incentive to manipulate trust investments or misallocate deductions or receipts. In all events either income, or to the extent necessary, principal would be used to pay the annuity and sound business judgment would dictate that the trustee invest the property in the most profitable manner possible since neither interest could benefit from a different investment policy.

Id. at 183, *as reprinted* at § 170.34.

173. *See* I.R.C. § 111 (2006); Hillsboro Nat'l Bank v. Comm'r, 460 U.S. 370, 372 (1983).

174. Note that the 1969 legislation adopted a recapture provision for the income tax deductions where a grantor trust loses that status and thus is not taxed on the income. Section 170(f)(2)(B) provides:

> If the donor ceases to be treated as the owner of such an interest for purposes of applying section 671, at the time the donor ceases to be so treated, the donor shall for purposes of this chapter be considered as having received an amount of income equal to the amount of any deduction he received under this section for the contribution reduced by the discounted value of all amounts of income earned by the trust and taxable to him before the time at which he ceases to be treated as the owner of the interest. Such amounts of income shall be discounted to the date of the contribution.

I.R.C. § 170(f)(2)(B) (2006).

adjust for any prior overvaluation of the charitable interest deduction and any undervaluation of the transfer taxes imposed on the non-charitable interest. Alternatively, Congress should require the tax effects to occur only when actual transfers take place (either to the charity or the non-charitable beneficiary). Focusing on the investment of a CLT in order to eliminate or substantially reduce transfer tax abuse, Congress should require a CLT to hold only specific types of investments, such as U.S. Treasury debt instruments, that have predictable outcomes. Alternatively, Congress should heavily discount the value of the charitable gift depending on the types of investment allowed under the trust instrument, thereby increasing the value of the non-charitable interest.

CONCLUSION

How should the charitable deduction split-interest rules be reformed (again)? The current definition of charitable split-interest should exempt from the charitable split-interest rules a trust *"where the value of any interest in the trust does not need to be determined by the use of the actuarial tables and where there is no abuse potential in valuing either the charitable or non-charitable interests."* In addition, Congress should repeal the statutory provision allowing the NICRUT and the NIMCRUT forms of a CRUT, because while the intention of those devices was to preserve the charitable remainder interest, they are routinely used to provide taxpayers with the income deferral associated with retirement accounts while avoiding the congressionally approved limitations and requirements of those options. Finally, Congress should modify the CLT rules either (1) to restrict investment options to provide for more predictable outcomes that will prevent transfer tax avoidance or (2) when the remainder interest becomes possessory, to subject the non-charitable remainder interest to additional

As explained in the Joint Committee's Explanation of the 1969 Act:

> The Act provides a special rule where under the rules set forth above the taxpayer is allowed a charitable deduction for income tax purposes for an income interest transferred in trust to charity but subsequently for any reason ceases to be taxable on the trust income. In this case under the general rule, the grantor would receive a double tax benefit with respect to the future trust income—he would not be taxed on that income but would have received a charitable deduction with respect to it. To prevent this result, the Act provides for the recapture of that part of the charitable contribution deduction previously received by the taxpayer with respect to the income of the trust which will go to the charity but on which he will not be taxed. This is accomplished by treating the donor at the time he ceases to be taxable on the trust income as having received income to the extent the deduction he previously was allowed exceeds the value of the income previously earned by the trust and taxable to him. For this purpose, these amounts of income are discounted to their value at the time of the contribution to the trust.

JOINT COMMITTEE EXPLANATION, *supra* note 5, at 88.

transfer taxation to reflect any disproportionate appreciation or income production accruing only to the non-charitable beneficiary.