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TAXATION OF GIFTS IN TRUST TO CHARITIES RESERVING A LIFE INCOME INTEREST

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I. Tax Policy Considerations and Revenue Ruling 60-370**

The character of every nation is determined in large part by the values and beliefs of its people. A value high in the mores of American society is a settled policy decision to encourage gifts to charities. Governmental policy, federal and state, has been implemented for a long time in various areas of the law by special provisions in favor of charity; and nowhere has the implementation of this policy been more pronounced than in our present tax laws, due in no small part to the high graduated income tax rates applicable to individuals. In order to encourage charities, Congress has provided that charitable contributions may be deducted in computing the federal income,[1] estate[2] and gift[3] taxes. Also, it has provided that the receipts of qualified charities are wholly exempt from income taxation.[4] The intended purpose of both the deductions and the exemption is to provide a subsidy for philanthropic institutions.[5]

Do the provisions for charitable contributions serve merely as a stimulant to benevolence, or have they been perverted in the hands of skillful tax manipulators into vehicles for tax avoidance and private preference? The question has been asked, but neither answered nor discussed.[6] Instead, the suggestion was made that the "tax reformer" is concerned (a) with whether there should be any charitable deductions under the tax laws, or whether the public functions discharged by charities should be undertaken directly by government and financed, in part at least, by the additional taxes which would result from denying the deductions, and (b) upon a more technical level, with whether or not the current law aptly

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** 1960 Int. Rev. Bull. No. 49, at 15.

1. Int. Rev. Code of 1954, § 170.
2. Int. Rev. Code of 1954, § 2055.
3. Int. Rev. Code of 1954, § 2522.
4. Int. Rev. Code of 1954, § 501 (a). For the tax liability of charities on unrelated business income, see §§ 511-514.
5. Surrey, *The Federal Income Tax Base For Individuals,* 58 Colum. L. Rev. 815, 825-26 (1958), reprinted in 1 House Committee on Ways and Means, 86th Cong., 1st Sess., Tax Revision Compendium 1 (Comm. Print 1959). See also the discussion of the Senate Finance Committee in S. Rep. No. 1584, 82d Cong., 2d Sess. (1952), and S. Rep. No. 1662, 83d Cong., 2d Sess. 29 (1954).
6. Lowndes, *Tax Advantages of Charitable Gifts,* 46 Va. L. Rev. 394, 395 (1960).

achieves the purposes for which it was designed.[7] The founders of American philanthropies generally have been "free enterprisers," and the connection between preserving individual freedom and providing facilities for helping-people-help-themselves has in the past been clear. Notwithstanding the suggestion of the tax reformer, agreement seems to persist in both the public mind and in the Congress that certain activities are better handled in our society through private philanthropy than by government or business; and until a way is fonnd for encouraging private philanthropy which is preferable to the present use of the tax system for this purpose, the charitable deduction should not and probably will not be changed.[8] Care is always needed in taxation, however, to prevent abuse or inequity. It will be the purpose of this article to examine one facet of charitable giving—a currently popular method—to see if there is implicit in it a perversion of congressional purpose or policy.

Gifts to charity of assets whose fair market value exceeds the donor's cost basis have been treated as twice blessed for a long time by our tax laws. The donor receives a deduction against his ordinary income for the current fair market value, and he does not have to report his "unrealized" gain as gross income.[9] The Treasury regulation[10] merely provides that the amount of the deduction is determined by the fair market value of the property at the time of the contribution; it does not say that the gift itself is not a realization of that part of the value which equals the appreciation of the property over its basis.[11] But taxpayers and the Treasury have long acted as though this were the unstated consequence of the regulation,[12] and a

7. *Ibid.*
8. Surrey, *supra* note 5.
9. INT. REV. CODE OF 1954, § 170(b)(1)(A) and (B); Treas. Reg. § 1.170-1 (c) 1958; see also Campbell v. Prothro, 209 F.2d 331, 335-36 (5th Cir. 1954); W. K. Frank Trust v. Comm'r, 145 F.2d 411 (3d Cir. 1944); Rev. Rul. 55-410, 1955-1 CUM. BULL. 297; SURREY & WARREN, FEDERAL INCOME TAXATION 321, 965-972 (1960 ed.).
10. Treas. Reg. § 1.170-1(c) (1958).
11. Compare the principle of Helvering v. Horst, 311 U.S. 112 (1940). Is it helpful to draw a distinction between gifts of assets in the nature of ordinary income, *e.g.*, inventory items or assets held for ordinary business sale, and gifts of assets which would be included in the statutory definition of capital assets? *Compare* Griswold, *Charitable Gifts of Income and the Internal Revenue Code,* 65 HARV. L. REV. 84 (1951); Bittker, *Charitable Gifts of Income and the Internal Revenue Code: Another View,* 65 HARV. L. REV. 1375 (1952); Griswold, *In Brief Reply,* 65 HARV. L. REV. 1389 (1952); SURREY & WARREN, FEDERAL INCOME TAXATION 970-972 (1960 ed.).
12. Rev. Rul. 55-410, 1955-1 CUM. BULL. 297 holds that the satisfaction of a dollar pledge to a charity by means of a gift of property which has either appreciated or depreciated in value does not give rise to a taxable gain or a deductible loss, even though the contribution is deductible to the extent of the fair market value at the time of the gift.
Special Ruling dated March 12, 1958, CCH 1958 STAND. FED. TAX REP. ¶ 6807 holds that a transfer of appreciated property to a college in trust to pay the income to the donor for life, then to a secondary beneficiary for

proposed statutory change limiting the deduction to the donor's cost was apparently rejected by the Congress in 1938.[13] The double blessing rule has accordingly evolved and been accepted as a proper implementation of the congressional policy favoring charitable gifts by lower court decisions,[14] revenue rulings[15] and texts.[16] It would seem unlikely that the Treasury would attempt to tax the gift as a realization of income or to amend the regulation so as to limit the deduction to cost without congressional permission,[17] and this seems true despite the fact that much of what Mr. Justice Stone wrote in the *Horst* case fits the charitable gift of appreciated property rather precisely.[18]

A completely different congressional tax policy, not at all connected with the policy to encourage the work of charitable institutions, is that which excludes from gross income the interest on state and local obligations.[19] In 1942 the Treasury Department

life, remainder to the college, does not result in a realization of gain to the donor.

13. Griswold, *Charitable Gifts of Income and the Internal Revenue Code*, 65 HARV. L. REV. 84, 92 n. 21 (1951) states that in 1938 a subcommittee recommended a change to limit the deduction to the cost of the donated property, and this was adopted by the House. See H.R. REP. No. 1860, 75th Cong., 3d Sess. 20 (1938). But the change was rejected by the Senate committee, and was not enacted. See S. REP. No. 1567, 75th Cong., 3d Sess. 14 (1938); H.R. REP. No. 2330 (Conference), 75th Cong., 3d Sess. 35 (1938). See also Campbell v. Prothro, 209 F.2d 331, 336 (5th Cir. 1954).

14. Campbell v. Prothro, 209 F.2d 331 (5th Cir. 1954); W. K. Frank Trust v. Comm'r, 145 F.2d 411 (3d Cir. 1944); White v. Broderick, 104 F. Supp. 213 (D. Kan. 1952); SoRelle, 22 T.C. 459 (1954); Estate of Farrier, 15 T.C. 277 (1950).

15. Rev. Rul. 55-410, 1955-1 CUM. BULL. 297; Rev. Rul. 55-138, 1955-1 CUM. BULL. 223.

16. SURREY & WARREN, FEDERAL INCOME TAXATION 321, 970 (1960 ed.); CCH 1960 STAND. FED. TAX REP. ¶ 1864.432.

17. Bittker, *supra* note 11, at 1378, n. 14.

18. "The taxpayer has equally enjoyed the fruits of his labor or investment and obtained the satisfaction of his desires whether he collects and uses the income to procure these satisfactions, or whether he disposes of his right to collect it as the means of procuring them. . . . Such a use of his economic gain, the right to receive income, to procure a satisfaction which can be obtained only by the expenditure of money or property, would seem to be the enjoyment of the income whether the satisfaction is the purchase of goods at the corner grocery, the payment of his debt there, or such non-material satisfactions as may result from the payment of a campaign or community chest contribution, or a gift to his favorite son." Helvering v. Horst, 311 U.S. 112, 117 (1940).

19. INT. REV. CODE OF 1954 § 103. It is reported that in June 1958 there were about $57 billion of such interest-bearing debt outstanding, and that about 40% of these obligations were held by individual investors. SURREY & WARREN, FEDERAL INCOME TAXATION 175 (1960 ed.). Since the enactment of P. L. 86-69, the Life Insurance Company Income Tax Act of 1959, INT. REV. CODE OF 1954, §§ 801-820, it has been variously reported that life insurance companies are purchasing tax exempt bonds. An estimate for the year 1956 places the amount of this interest excluded by individuals at $500 million, involving $200 million in tax, and for corporations (year 1955) at $400 million and also about $200 million in tax. Pechman, *Erosion of the Individual Income Tax*, 10 NAT'L TAX J. 1, 24 (1957); Hellmuth, *Erosion of the Federal Corporation Income Tax Base*, in JOINT COMMITTEE ON ECONOMIC

strenuously urged that this statutory exclusion be eliminated so that all interest on state and local obligations, either outstanding or to be issued, would be subject to federal income tax. The states unanimously fought the Treasury proposal. In 1951 the Treasury again urged unsuccessfully the taxation of the interest accruing on these obligations.[20] Only recently the exclusion of such interest from the income tax base was described to the Congress as "indefensible from the standpoint of income tax policy."[21] The important point to note for the purpose of this article is that however one may feel about the exclusion of interest on state and local obligations from the tax base, it involves a policy question completely separate from the congressional policy favoring charities.

Out of these two separate and unrelated tax policy decisions, however, there has evolved a dramatic and popular recent method of giving to charity. Referred to variously as the "Pomona Plan" or "Tax-Free Life Income Plan," these tax benefits were often advertised in the leading financial newspapers and magazines[22] as follows: (1) eliminate all tax on capital gain; (2) obtain tax free income for life; (3) receive 30 per cent contribution credit; (4) reduce your income tax; (5) have more spendable income; (6) provide income for your survivor; (7) establish a memorial fund in your name at the college; and sometimes (8) how to make money by giving it away—to charity. The essential elements of the plan are (a) the gift of substantially appreciated property—which frequently provides little or no income —to a charitable institution, under an arrangement in which the charity will (b) sell the property for the current market value and invest the proceeds in tax exempt bonds, (c) pay the income received to the donor for life, and (d) provide a legal (as distinguished from an equitable) remainder to the charity. While different kinds of life income arrangements can be made with various charitable institutions involving annuities and life income contracts,[23] the clearest and most popular plan uses the irrevocable inter-vivos trust concept

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REPORT, 84TH CONG., 1ST SESS., PAPERS ON FEDERAL TAX POLICY FOR ECONOMIC GROWTH AND STABILITY 888, 893 (Comm. Print 1955).

20. SURREY & WARREN, FEDERAL INCOME TAXATION 176 (1960 ed.) For a presentation of the policy considerations pro and con the taxation of interest on state and local obligations, see *id.* at 175-202.

21. Surrey, *The Federal Income Tax Base For Individuals*, in 1 HOUSE COMMITTEE ON WAYS AND MEANS, 86TH CONG., 1ST SESS., TAX REVISION COMPENDIUM 1 (Comm. Print 1959).

22. See for example the advertisements of Pomona College and The University of Notre Dame reprinted in the *U.S. News & World Report* issue dated Dec. 28, 1959, at 73 in an article entitled *How To Increase Income By Giving Money to Colleges*. The Notre Dame advertisement also appeared in the *Wall Street Journal* of March 18, 1960. Many other educational institutions, state and private, have advertised the plan in newspapers, magazines and brochures.

23. See discussion, *infra*, pp. 611 to 616.

with a retained life income interest to the donor. Generally the transfer is to the university or other charity in trust to pay the income to the donor for life, or to the donor and his wife for the life of the survivor, the trust to terminate at the death of the owner of the income interest, with a legal remainder to the charity. It is important that the remainder gift is a legal remainder and not an equitable remainder in order to qualify for the extra 10 per cent deduction allowed by section 170(b) (1) (A) so that a total of 30 per cent of adjusted gross income can be deducted.[24] According to the Committee Report the additional allowance does not apply to payments to a trust under which a charity otherwise qualifying for such allowance is a beneficiary.[25]

This arrangement and the tax consequences resulting from it may be illustrated by the following example: Mr. and Mrs. *A*, ages 49 and 48, have a net taxable income of $36,000 (adjusted gross income of $41,000). Their federal income tax now totals $12,400 and their top bracket is 50 per cent. They had intended to make a gift of $10,000 to the college at the death of the survivor. They have learned, however, of the economic and social advantages of making an inter-vivos gift to the college, reserving a joint income interest which can be made tax exempt, and they have decided to do it. Instead of making a cash gift of $10,000 they transferred appreciated securities which cost them $5,000 but now have a market value of $10,000. Because the securities were stocks of growth companies, the annual dividends were only $150, a gross yield of 3 per cent on cost and 1½ per cent on market, and an after tax yield of 1½ per cent on cost and ¾ of 1 per cent on market value. The securities are transferred to the college as trustee for the life of the survivor of Mr. and Mrs. *A*, remainder to the college. The college, as trustee, sells the securities for $10,000 and invests that amount in state and

24. Section 170(a) allows as a deduction "any charitable contribution." This phrase is defined in § 170(c) to mean a contribution or gift *"to or for the use of"* a qualified charity. The general limitation on charitable contributions is limited to 20 per cent of adjusted gross income. § 170(b) (1) (B). The additional 10 per cent is provided in the special rule of § 170(b) (1) (A) and this is limited to charitable contributions *"to"* the qualified charities specified. Therefore, in order to receive the additional 10 per cent deduction it is essential that the gift of the remainder interest be "to" the charity, and not "for the use of" it. See Treas. Reg. § 1.170-2(b) (1958). A legal remainder to the charity is a gift to it, whereas an equitable remainder in trust is a gift for the use of it. See *Note: Equitable Remainder Subject to a Trust Distinguished From Legal Remainders Subsequent to a Trust,* in LEACH, FUTURE INTERESTS 157 (2d ed. 1940). See also Special Rulings, March 12, 1958, CCH 1958 STAND. FED. TAX REP. ¶ 6807; February 11, 1959, CCH 1959 STAND. FED. TAX REP. ¶ 6356.

25. H.R. REP. No. 1337, 83d Cong., 2d Sess. A 53 (1954); S. REP. No. 1622, 83d Cong., 2d Sess. 207 (1954) reported in 3 U.S. CODE CONG. & AD. NEWS, 83d CONG., 2d Sess. 4621 at 4843 (1954). Lowndes states that it is not clear, however, whether this means an income beneficiary or a remainderman. Lowndes, *Tax Advantages of Charitable Gifts,* 46 VA. L. REV. 394, 419 (1960).

municipal bonds yielding 4 per cent so that $400 of tax exempt interest is distributed annually by the trustee to the income beneficiaries. What are the advantages of this arrangement?

1. No capital gains tax.—If Mr. and Mrs. *A* had sold the stock, they would have been subject to a tax in the amount of $1,250 on their $5,000 capital gain. By transferring the property itself, however, there is no capital gains tax. A gift of appreciated property is not a realization of income, and this is true even though an ordinary income tax deduction is taken for its current market value.[26]

2. Charitable deduction.—Mr. and Mrs. *A* will receive a deduction for the portion of the $10,000 which represents the value of their present gift to the college. This will be the value of the remainder interest, determined from actuarial tables to be the sum of $3,638.[27] This deduction will save for them the sum of $1,819 which would otherwise be paid by them as income tax for the current year.

3. The trustee will pay no capital gains tax.—When a transfer of appreciated property is made by gift, the donee takes the basis of the donor[28] and this is equally true when the gift is made in trust. When the trustee sells the appreciated property transferred by Mr. and Mrs. *A*, it will accordingly realize a capital gain of $5,000. Unless capital gains realized by the trustee are distributable or in fact distributed to the income beneficiary under the terms of the trust instrument or state trust law, however, they are allocated and taxed to the remainder beneficiary and the tax is paid by the trustee;[29] and when the remainder beneficiary is a qualified charitable institution, a deduction is allowed to the trustee for the full amount of the capital gain allocated to corpus.[30] Thus, there will be no income tax paid by the trustee, and the full amount of the $10,000 received upon sale of the appreciated property will be preserved intact for reinvestment in tax exempt bonds.

4. Lower estate taxes.—Because the gift was a transfer with a retained income for life, the value of the trust fund at death must be included in the gross estate of the spouse who owned the securities.[31] Assuming the owner was Mr. *A*, the inclusion would increase the amount available for the marital deduction to Mrs. *A*, and decrease the estate taxes of Mr. *A* both because of the marital deduction and

26. See notes 9-18 *supra*.
27. Treas. Reg. § 25.2512-5(e) (1954); 2 CCH Fed. Estate & Gift Tax Rep. ¶ 8003.55.
28. Int. Rev. Code of 1954, § 1015.
29. Int. Rev. Code of 1954, §§ 643(a)(3); 642(c); Treas. Reg. § 1.643(a) 3(a) (1956).
30. Int. Rev. Code of 1954, § 642(c).
31. Int. Rev. Code of 1954, § 2036.

the charitable deduction.[32] Thus the gift to charity with a retained life income interest will not be subject to an estate tax, and, indeed, may well result in a decrease in the amount that would be payable if an inter-vivos gift were made outright to charity.

5. *Non-taxable income.*—The trustee will receive $400 per year in tax exempt interest and will distribute the full amount without an expense charge to Mr. and Mrs. *A*. Since trust distributions, unlike corporate distributions, have the same character in the hands of the beneficiary as in the hands of the trust,[33] Mr. and Mrs. *A* will have increased their spendable annual income from $75 ($150 less tax at 50 per cent) to $400, an increase of 533 per cent in after tax annual income. Also, when their tax savings No. 1—no capital gains tax ($1,250)—is added to their tax savings No. 2—a charitable deduction ($1,819)—their $10,000 joint and survivor life income contract has cost them actually only $6,931 ($10,000 less $3,069), and their $400 tax-free income provides an annual net yield on their out-of-pocket cost of 5.77 per cent; this compares quite favorably with their net after tax yield of 1½ per cent on their cost before the transfer.

6. *Personal satisfaction.*—Mr. and Mrs. *A* will have the personal and social satisfaction of having made their gift to the college during their lifetime and in giving purpose to the ultimate use of their sum when their needs are no more.

As the advantages of this type of plan became better known, it was understandable that more charitable institutions began to offer it and in some instances advertise it. They found very considerably more interest in the successful accomplishment of their important fund-raising goals when they had life-income plans to offer prospective donors. That the income can be made tax exempt is not the result of the gift to charity; instead it is completely the result of the congressional policy decision on municipal bond interest. When the latter is added to the charitable deduction, however, the combined tax consequences of these two separate policy decisions produce the dramatic tax consequences outlined above. By way of perspective and judgment, however, it would seem appropriate to point out that if Mr. and Mrs. *A* had not made a gift to charity at all, but had sold their securities, paid a capital gains tax of $1,250, and invested the remaining $8,750 in the 4 per cent tax exempt bonds, their fund would be at least $10,500 after five years of accumulation as compared to the fund of $10,375 that they would have had if they had not sold their securities but had accumulated their after-tax dividends during

32. INT. REV. CODE OF 1954, §§ 2056(a), (c); 2055.

33. INT. REV. CODE OF 1954, §§ 652(b), 662(b). *Compare* §§ 301(a), (c)(1), 316(a)(1).

this period.[34] The important point in this regard is that of the two congressional tax policy decisions—the charitable deduction and the exemption of municipal bond interest—the latter has the more far reaching and long-lasting impact; after only five years of accumulating tax exempt income Mr. and Mrs. *A* can give an even larger sum to charity under a tax exempt income plan or not as they please; and by reinvesting the income, the period would be considerably shorter.

It would seem that the advertising and publicity given to the life-income plans offered by the charities should not affect the tax consequences attributable to them. Many investment houses publicize the tax advantages of municipal bonds generally, the tax loss-carry over in certain corporate acquisitions, and other transactions in which tax consequences have the larger economic impact. While it may be that the emphasis was placed more heavily upon the tax-savings aspects of these plans than upon their charitable purpose, educational and other charities currently need mass support—rather than the occasional big gift—in order to pursue their important purposes and their use of the techniques of investments houses to present their plans to the public has not seemed inappropriate. The appeal has accordingly been made to the average citizen who desires to support charity but cannot afford to relinquish the income from his capital during his lifetime. Nevertheless, the Revenue Service became quite concerned over the increasing popularity of these plans. Several months ago it was rumored that the Service was considering a ruling that would, in effect, reverse its prior position[35] and deny some of the tax benefits of the plans.[36] Finally, the Service did rule on December 5, 1960, in Revenue Ruling 60-370.[37] The head-note summarizes the ruling as follows:

> Where a taxpayer transfers appreciated securities or other property to a tax-exempt organization, as trustee, which is under an express or implied obligation to sell such property and invest the proceeds in tax-exempt securities, or exchange the transferred property for tax-exempt

34. No account is taken in this example for either (a) the market value fluctuations of the tax exempt bonds and the securities retained, or (b) the reinvestment of the annual income. The fact is that when people change an investment from what has been a growth stock to a tax exempt interest bond, they have decided upon a different investment purpose.

35. The prior position of the Internal Revenue Service is reflected in Rev. Rul. 55-275, 1955-1 Cum. Bull. 295; Rev. Rul. 57-507, 1957-2 Cum. Bull. 511; Letter rulings to Pomona College dated March 12, 1958, CCH 1958 Stand. Fed. Tax Rep. ¶ 6807, and Feb. 11, 1959, CCH 1959 Stand. Fed. Tax Rep. ¶ 6356; Unpublished ruling to Presbyterian Church Foundation, date 2/6/59.

36. An indication that this was being considered was published in the *Wall Street Journal* during the fall of 1960. George D. Webster suggested this as a possibility in 1958. See Webster, *Estate Planning Techniques: Charitable Gifts and Ownership of Foreign Property*, 25 Tenn. L. Rev. 452, 460 (1958); Penick, *IRS Revocation of Approval of Tax-Exempt Pomona Plans Raises Collateral Questions*, 14 J. Taxation 102 (1961).

37. 1960 Int. Rev. Bull. No. 49, at 15.

> securities, and to pay the income therefrom to the transferor (and a secondary beneficiary for life, if any,) with the trustee acquiring a remainder interest in the trust corpus, the gain from the sale or exchange of the transferred property by the trustee is includible in the gross income of the transferor. Tax-exempt income realized from trust investments and distributed by the trustee to the transferor beneficiary or to the secondary beneficiary retains its exempt status in their hands.

II. The Problems Raised By Revenue Ruling 60-370

A. The Scope of the Ruling

In the fact situation postulated by the ruling the university, as trustee, was under an express obligation to sell or exchange the appreciated property transferred and to purchase tax-exempt securities. From this it was reasoned that "in substance, the transferor did not give the trustee appreciated property to hold in trust, but rather, gave the trustee the proceeds of the sale or exchange of the property which the trustee was required to consummate."[38] Accordingly, it was held that the transferor realizes the gain and that it is to be included in his gross income in the taxable year that the sale is made by the university.[39] The ruling goes on to state that while in the instant case the university, as trustee, was under an express obligation to sell the appreciated property transferred in trust, an obligation to sell or exchange may also arise by implication. "For example, a taxpayer may transfer appreciated property to an educational or charitable organization in reliance upon advertisements or brochures stating that the organization will sell such property and invest the proceeds in tax-exempt securities, or exchange the property for tax-exempt securities."[40]

The ruling strikes deeply at the policy favoring charitable deductions while leaving the policy favoring the exemption of municipal bond interest completely unscathed. It does this by asserting that a gift of appreciated property is a realization of gross income when the circumstances are such that the trustee might be considered under an obligation to sell the gift property,[41] and then only when the obligation of the trustee is to purchase tax-exempt securities. Thus it appears that the purpose and scope of the ruling is to attack only those situations where the agreement between the donor and the charity is for the purchase of tax exempts. But why, pray tell, should these parties not be allowed to contemplate and arrange for the purchase of tax exempts by the trustee as much as any other in-

38. Rev. Rul. 60-370, 1960 Int. Rev. Bull. No. 49, at 15, ninth paragraph.
39. *Id.*, tenth paragraph.
40. *Id.*, thirteenth paragraph.
41. Compare the principle of Helvering v. Horst, 311 U.S. 112 (1940), the essence of which is quoted at note 18 *supra*.

vestor? If tax exempt income is the real concern of the Internal Revenue Service, should it not be as much or more concerned about all investments in such securities as about the small amount arranged for by donors to charity? To the extent that an investor changes from a growth stock to tax exempt interest bond, he has traded inflation protection for income to spend, a basic change in investment purpose. This is not a change in purpose which is limited to donors to charity.

If, on the other hand, the concern of the Service is not limited to the tax exempt interest element in the life-income trust plans of charities, a very serious threat is posed to the scope of the present policy concerning the charitable deduction, in which Revenue Ruling 60-370 would seem to be only the first step. Indeed, it could be even broader than the charitable deduction. The threat is an extension of the *Horst*[42] principle that a gift of appreciated property is a realization of income to the donor. While the basis sections[43] provide an amelioration as to donees other than charities, if the principle that a gift of appreciated property is a realization of income is to be asserted by the Service, it would seem that it would be applicable to all gifts. Why should the Service be interested only in tax exempt income trusts? Suppose the parties agree that the trustee will invest the gift in a balanced mutual fund? Suppose the donor expresses a preference for another investment calculated to produce primarily income to the beneficiary? Is not the "obligation" of the trustee as much in one case as in the other? If the Service can say that an arrangement for investment by the trustee in tax exempts is a realization, it would seem clear that it can say that an arrangement for any other type of investment program for the trust results in a realization of gross income by the donor of appreciated property, and this seems only a "hair-breadth" away from asserting that every gift of appreciated property is a realization of income. Published rulings are issued by the Internal Revenue Service and only important problems or cases are considered by Treasury officials.[44] While we are not advised whether Revenue Ruling 60-370 has been considered by Treasury, it would seem that the important tax policy changes implicit in it—realization generally, the scope of the charitable deduction, and the relation of these two items to the policy concerning tax exempt interest—are broad political tax policy problems for which the President and the Congress should take the responsibility. Because the policy issues involved have much broader and more important significance than the use of life-income arrangements by

42. *Ibid.*
43. See, *e.g.*, INT. REV. CODE OF 1954, § 1015.
44. SURREY & WARREN, FEDERAL INCOME TAXATION 47 (1960 ed.).

charities to encourage contributions, it seems questionable whether or not it is a proper function of a revenue ruling to take action to effectuate a change in policies of such scope.[45]

B. The Necessity of an Obligation To Sell and Purchase Tax Exempts

A careful study of the Ruling makes clear that it limits itself to situations where the charity is under an obligation (1) to sell the transferred property and (2) to purchase tax exempts. No doubt the advertisements of the charitable institutions to encourage this type of giving led to the drafting of trust instruments in which the trustee is expressly obligated to sell and invest in tax exempts. It seems clear that it is the obligation to do these things that will cause the Service to apply its new principle of realization; and the Service forewarns that it will not limit its action to trust instruments in which the obligation is expressed; since "it may be necessary to go beyond the trust instrument to determine whether there is an obligation, either express or implied . . . no advance rulings will be issued as to whether there is such an obligation."[46] Instead, the Service will attempt to determine whether the transfer was made in reliance upon "advertisement or brochures" from which an obligation might be inferred.

Does this mean that every gift of appreciated property to a charity under a life-income trust will result in the realization of income to the donor in any year in which the trustee invests in tax exempts? Suppose there is no express obligation to do so? Suppose a bank or other independent trustee is named? Does this ruling have the effect of forbidding investments in tax exempts by trustees, at the threat of imposing a special tax burden on the donors of remainder interests to charities? It is apparent that the Service wants to stop charitable institutions from entering into tax-exempt income arrangements as a method of encouraging gifts; and it is rumored that in the case of any such plan, when the trustee invests in tax exempts, the Service will assert an implied obligation to do so and try to make the taxpayer prove otherwise.

Both the industry and the professional counsellors concerned with trust administration today generally recommend that trustees be given broad administrative powers, including broad discretion concerning investments. This trend has found expression in recent statutory and court decisional changes from a restricted legal list of investments for fiduciaries to the broader prudent-man principle, and the authorization to purchase the shares of an investment trust,

45. *Id.*, at 36-40 "The Legislative Process"; *id.* at 41-50, "The Administrative Process."

46. Rev. Rul. 60-370, 1960 INT. REV. BULL. No. 49, at 15, second from last paragraph.

or, indeed, to operate the fiduciary's own common trust fund.[47] Broad investment powers provide the needed flexibility[48] in managing investments and eliminate the expense of obtaining court permission to make such changes. The important point is that it is generally regarded as the duty of the trustee to invest trust funds in such a way as to receive an income without improperly risking the loss of the principal, thus having due regard for both the interests of the income beneficiaries and those of the corpus-remainder beneficiaries.[49] Also, it has been the law of trusts for many years that the powers and duties of the trustee in making investments, like his other powers and duties, can be regulated by the terms of the trust instrument.[50]

Under a trust instrument which does not expressly obligate the trustee to invest in tax exempt bonds it would seem that the Service will have a difficult time enforcing its new rule of realization in the courts. In the case of a trust with a high bracket income beneficiary, it would be a duty of the trustee to consider the purchase of tax exempt income investments, and this is true regardless of who is the remainder-corpus beneficiary. As a person grows older and plans for his retirement, it is normal and prudent for the emphasis of his investment program to change from growth securities to those which provide spendable income, and this is all the more true if he is already in a higher income bracket. Accordingly, a trustee in this situation would indeed be prudent to invest all, or the larger part, of the trust principal in tax exempt securities, and thus perform its basic investment duty to invest in a way to receive income without improperly risking the loss of the corpus, and by having due regard for both the interests of the income beneficiary and the corpus-remainderman.

It would appear therefore that the obligation to sell the donated property and to purchase tax exempts which is made the basis for an assertion by the Service of a new and special tax burden on the donor to charity might well be the very obligation of fiduciary administration which the state law of trusts would impose upon the trustee under the circumstances involved. Under existing economic conditions and tax policies a trustee under such circumstances who did not consider thoroughly the desirability of investing in tax

47. See for example the amendment of Tennessee's legal list statute [TENN. CODE ANN. §§ 35-301 to -311 (1956)] by the addition in 1951 of the prudent man rule [TENN. CODE ANN. §§ 35-319 to -325 (1956)] and the enactment in 1953 of the Uniform Common Trust Funds Act [TENN. CODE ANN. §§ 35-401 to -405 (1956)]. See 3 SCOTT, TRUSTS §§ 227 to 227.16 (1956); Stevenson, *Why The Prudent Man?*, 7 VAND. L. REV. 74 (1953).

48. There is an old investment "yarn" that the dinosaur is not around much anymore because he couldn't turn around quickly enough.

49. 3 SCOTT, TRUSTS § 227 (1956).

50. *Id.* § 227.14.

exempts might well be criticized for a breach of fiduciary responsibility. It seems unlikely therefore that the Service will be successful in the courts in asserting its new rule that a gift of appreciated property is a realization of income when the trustee, fulfilling its obligation to exercise prudence, decides to invest in tax exempts. The Internal Revenue Service certainly has no authority to forbid a trustee to make an appropriate trust investment, and there would seem to be no rational basis for imposing or asserting a special tax burden in this case under existing tax policies.

C. Can This Ruling Be Based upon Sections 677(a) and 671?

Section 677(a) provides that the grantor-donor of a trust shall be treated as the owner of any portion of a trust whose income is or may be distributed to the grantor. Section 671 and the Treasury Regulations construing it provide that if a grantor is treated as the owner of any portion of a trust, he takes into account in computing his income tax liability those items of income, deduction and credit, including capital gains and losses, attributable to his portion, as if the trust had not been in existence during the period he is treated as the owner of it.[51] Can Revenue Ruling 60-370 be sustained on the basis of these two sections of the Code? The key words in section 677(a) are "any portion." If the transferor should be treated as the owner of the entire trust because he is the recipient of the entire "income" as defined by the state law of trusts, then the gain on the sale of the transferred property would indeed be taxable gain to him, and this would be so entirely apart from any obligation of the trustee to sell the property or to buy tax exempt securities. The transferor is not the owner of the entire trust, however; he has given the remainder interest away, so that he is the owner of only the life-income interest. Upon analogy it might be argued that since the remainder interest of a trust with a retained life estate is included in the donor's gross estate for purposes of the estate tax, with a credit allowed for the gift tax paid, the transferor who receives the entire income ought also to be treated as the owner of the entire trust for purposes of the income tax, notwithstanding a gift tax paid, or an income tax deduction, if the remainder is given to charity; and, it might be argued, this is consistent with the inclusion in the donor's gross estate of the date of death value of the remainder interest, which will include capital gains realized by the trustee upon the sale of trust assets. This argument assumes that the estate tax treatment is sound, even though inconsistent with the state law of trusts, and it raises in sharp focus

51. Treas. Reg. ¶ 1.671-3(a)(1)(1956). See also Treas. Reg. §§ 1.671-3(b)(1), (c) (1956).

another of the many instances where there is a lack of synthesis in the technical detail of the three separate taxes—income, gift, and estate—with respect to inter vivos trusts. The income and gift taxes have followed the state law of trusts in this instance, and by giving a credit for the gift tax paid, even the estate tax approximates this result. Accordingly, for purposes of the income tax the transferor is not treated as the owner of the entire trust, but, rather, as the owner of only the life income interest as defined by the state law of trusts. The Treasury regulations provide in this situation that the grantor should not include the capital gain realized upon sale by the trustee because "that is not attributable to the portion of the trust that he owns."[52]

Because of the above Treasury interpretation of sections 677(a) and 671 the Internal Revenue Service puts its emphasis in Revenue Ruling 60-370 on the obligation of the trustee and on the argument that the sale was in effect a sale by the transferor, and a realization of the gain by the transferor. Such an argument on realization also would be necessary to the Service in cases where the trust instrument directed the income to be distributed to someone other than the grantor. How far does this argument go? Suppose a sole proprietorship with appreciated inventory incorporates. Clearly it is expected that the inventory will be sold. Does this mean the proprietor must recognize the income? Presumably not.[53]

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52. Treas. Reg. § 1.677(a)-1(g), Ex. (1) (1956); § 1.671-3(b)(1), (c) (1956). See also § 1.642(c)—3 (1956). That profits on the sale of trust assets are generally allocated to the corpus-remainder beneficiary under state law, absent a contrary provision in the trust instrument, see 3 Scott, Trusts § 233.1 (2d ed. 1956); Restatement (Second), Trusts § 233 (1959). For the estate tax treatment, see Int. Rev. Code of 1954, §§ 2036, 2031, 2012. For the gift tax treatment, see Treas. Reg. § 25.2511-1(e) (1958); Smith v. Shaughnessy, 318 U.S. 176 (1943); Robinette v. Helvering, 318 U.S. 184 (1943).

53. See comment by Stanley S. Surrey on Revenue Ruling 60-370, Surrey & Warren, Federal Taxation, Current Law and Practice ¶ 1115, at 701 (1961). Also, in TIR 303, issued February 9, 1961, the Service announced that there will be no more advance rulings on the taxability or non-taxability of an exchange of appreciated securities for the stock of a newly formed investment company. CCH 1961 Stand. Fed. Tax Rep. ¶ 6311. Rev. Rul. 54-172, 1954-1 Cum. Bull. 394 and Rev. Proc. 60-6, 1960-1 Cum. Bull. 880 will be amended to include in the area in which rulings will not be issued the following:

> "Section 351.—Whether the transfer of appreciated stocks or securities to a newly organized investment company in exchange for shares of the stock of such investment company, as a result of solicitation by promoters, brokers or investment houses, will constitute nontaxable exchanges within the meaning of this section."

There is no stated reason for this position and no apparent one, except for the fact that the Service does not like to make repeated admissions of the nontaxability of transactions. For about one year, mutual investment companies have advertised the nontaxability of security exchanges in situations like the kind on which there will be no further advance rulings. See *Taxes on Parade*, No. 14, Feb. 15, 1961, CCH 1961 Stand. Fed. Tax Rep.

III. Types of Life Income Arrangements Offered By Charities

By its terms Revenue Ruling 60-370 does not apply to life income arrangements offered by charities where there is no obligation to invest in tax exempts. Accordingly, the prior established policy which holds that a gift of appreciated property is not a realization of income, and that the donor is entitled to a charitable deduction for the present value of the future remainder interest[54] is not changed with respect to other life income arrangements. In order to formulate a perspective on the probable impact and significance of the Ruling, it might be helpful to consider briefly the other types of life-income arrangements currently available to donors from charities.

There seem to be three basic types of charitable gift agreements which have been calculated to preserve or increase the spendable income of the donor for life, or for joint and survivor lives.[55] They are (A) the gift-annuity, (B) the life-income contract, and (C) the retained life-estate in trust.

A. The Gift-annuity

A gift-annuity from a charitable institution may be defined as a gift to the charity subject to an agreement by the institution to pay a fixed dollar sum to the annuitant. The amount of the transfer to the institution may be considered as the sum of two parts: (1) a donation to its charitable work, plus (2) a single premium for a life annuity. It is the oldest life-income arrangement and, apparently because it has been in use for several generations, it still represents

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54. See note 35 *supra.* See also notes 9-16 *supra.* There is indication, however, that the Service has taken under review certain related aspects of gifts of remainder interests to charitable or educational institutions. For example, Rev. Rul. 60-385, 1960 Int. Rev. Bull. No. 52, at 15, revoked Rev. Rul. 55-620, 1955-2 Cum. Bull. 56 and holds that where there is a gift to charity in trust with a retained life interest and the trust instrument provides that corpus may be invested in the stock of regulated investment companies, if the trust instrument provides that capital gains realized by such companies shall be treated as corpus, the charitable deduction shall be allowed to the donor. If the trust instrument provides that gains realized may be treated as income, however, then the charitable interest is not severable from the non-charitable interest, and therefore no deduction for income, estate and gift tax purposes shall be allowed. This seems to be a sound ruling.

55. It is sometimes said that there are two types of plans, namely, "Annuity Plans" and "Life Income Plans." Moorhead, *Annuity and Life Income Plans Offered by Charitable Organizations,* 10 J. Am. Soc'y C.L.U. 157 (1956); Note, *Gift Annuities and Life Income Contracts Issued By Charitable Organizations Under the Federal Income Tax Laws,* 1957 Wash. U.L.Q. 150. Because there are two types of life income plans, in one of which the gift property is mingled with the endowment funds of the charity and the donor's income rights are purely contractual, and in the other the gift property constitutes a separate trust fund so that the donor's interest constitutes an equitable life estate in property, it has seemed preferable to distinguish them as three plans.

the largest number of income arrangements in effect. A very recent survey of nineteen educational institutions conducted by the American Council on Education indicates that the first annuity gift received by the participants was accepted as far back as 1878, that as recently as 1959 six of the reporting institutions had no annuity contracts, and that there were a total of 304 funds representing $12,837,375, of which one institution had 158 separate funds with a market value of $1,355,490. The survey further indicates that the average number of annuity gifts at all reporting institutions is 11 and that the average gift approximates $42,250. Excluding one institution, the average value of the annuities reserved as compared to the value of the property transferred varied from a low of 2 per cent to a high of 50 per cent.

When a gift is made to a charity subject to an annuity, the amount of the charitable deduction is the difference between the sum transferred and the present value of the annuitant's right to receive payments, such value to be computed with the factors used by reputable commercial life insurance companies.[56] For example, if a donor-annuitant-male age fifty paid $1,000 to a charitable organization for a 4 per cent life annuity, the amount donated to the charity would be $199.36 and the cost of the annuity contract would be $800.64.[57] Since the $40 payments received by the donor will be taxed as an annuity, there is excluded that portion of the $40 received each year which the total cost ($800.64) bears to the expected return ($1,020); thus $31.20 is excluded and $8.80 is taxed as ordinary income each year. If, however, the donor transfers appreciated property having a market value of $1,000, the transaction also results in the realization of a capital gain taxable to the extent that the present value of the annuity exceeds the taxpayer's basis for the property.[58] This will be handled as a private annuity, so that the taxpayer's basis is recovered first from the annual amount ($31.20) excluded, after which this amount is taxed as capital gain for a sufficient number of years to equal the total capital gain realized; thereafter the amount equal to the exclusion ratio will not be taxed.

A number of charitable institutions have found that "gift annuities can be millstones rather than life-preservers."[59] There are several factors contributing to the danger that charitable organizations which

56. Letter Ruling dated September 9, 1955, 4 P-H 1956 Fed. Tax Serv. ¶ 76,312.

57. *Ibid.* This example is used in the Letter Ruling.

58. *Ibid.* See also McGiveran & Lynch, *Private Annuities,* 13 J. Am. Soc'y C.L.U. 14, 22 (1958).

59. Weld, *Donors' Annuities and College Security,* 30 A. of Am. Colleges Bull. 539 (1944) cited in Note, *Gift Annuities and Life Income Contracts Issued by Charitable Organizations Under the Federal Income Tax Laws,* 1957 Wash. U.L.Q. 150, 159.

grant annuities might conceivably find it necessary to divert other charitable assets to meet annuity obligations. When a charitable organization binds itself to pay an annuitant a fixed annual sum during his life, it is taking the risk that the annuitant might live long enough to exhaust the principal and income which the charitable organization received. This could hazard the charity's tax exempt status. There are also problems concerning the spread of their risk over too small a number of lives, merging annuity funds with general funds, and concern over proper annuity accounting practices and the applicability of state law concerning the maintenance of reserves. The activities of the average institution in connection with the administration of such gifts are at best a bare minimum. The recent survey of the American Council on Education indicates that there is frequently no formal plan for receiving or processing gifts subject to an annuity. Instead, such gifts are accepted only when the age of the beneficiary, the amount of the gift and the agreed annuity payment are such that the fund will remain intact and be available for charitable purposes within a relatively short period.

From the standpoint of both the donor and the charitable institution either of the life income arrangements discussed below will ordinarily be preferable. The annuity contract results in a capital gain taxable to the donor, and, unless care is taken, it could conceivably endanger the tax-exempt status of the charity, and confront it with state regulation concerning the accounting and legal reserve requirements of commercial insurance companies.

B. The Life-Income Contract

This is an arrangement under the terms of which the charity accepts either a principal sum or property at market value and agrees to invest it with the organization's general endowment funds. The charitable organization pays to the donor, or his appointee, an income for life, determined by the average yield on the organization's general endowment funds. Because there is a tendency among charities to fail to distinguish between the life income contract and the retained life estate in trust, there was substantial difference in the replies to the questionnaire of the American Council on Education concerning (1) the commingling of these gifts with the charity's own general endowment as compared to maintaining separate funds for each gift, (2) whether or not a trust is created under local law, and (3) whether or not a private individual might be said to own a fractional interest in the charity's general endowment funds. It would seem clear, however, that in a life income contract, as distinguished from a retained life estate in trust, the charity may commingle and the donor owns no estate or property right in the assets of the charity. Instead, the donor owns an in personam contract right to receive an income equal to the average yield on the general endowment funds.

The donor under the life income contract is entitled to a charitable deduction for the present value of the legal remainder interest given to the charity, and under this arrangement there should be no problem about qualifying the gift for the additional 10 per cent allowed by Code section 170(b) (1) (A) because the gift is "to" the charity and not in trust "for the use of" the charity. Differently from the gift annuity, the entire income of the life income contract seems to represent taxable income to the recipient. When appreciated property is transferred, it has not been treated in the past as a realization of gain. While the gift annuity pays a fixed dollar amount, and the life income contract pays a variable amount, this difference would not seem to be sufficient to justify a distinction upon the question of realization.

Differently from the retained life estate in trust, it would not seem possible to arrange for the receipt of tax exempt income under a true life income contract. The rights of the beneficiary would be purely in personam against the charity to receive an income payment equal to the average yield on its general endowment. The trust rules would not apply, and it would seem neither feasible nor desirable to apportion the amount paid each year into interest, dividends, rent, etc., in proportion to the total of each category comprising the charity's total income.

Under this type of arrangement the donor will receive a higher yield than on the gift-annuity. Because of the commingling of the gift with general endowment funds, the amount received annually seems closer to a corporate dividend than a trust distribution, and therefore fully taxable; and for a like reason, the question of realization of capital gain seems to be closer to that in the case of the gift-annuity than it is to that in the case of the retention of a life estate in a trust fund. This plan has been the easiest for the charity to administer, however, because it can commingle the funds and not be concerned with problems of fiduciary administration. There is rumor, however, that the Internal Revenue Service is considering a suggestion that the common investment of life income gifts by charities constitutes an association taxable as a corporation. Whether or not this is limited to life income contracts of the type discussed here is not clear. All of these factors considered, however, it seems clear that the trust concept discussed below is the more clear, desirable and safer to both the donor and the charity.

C. The Retained Life Estate in Trust

While administrators of charities apparently do not always distinguish this arrangement from the life income contract, upon analysis there is in fact very little similarity between the two. The donor transfers cash or property to a trustee who holds the legal title to the assets in trust for the benefit of the beneficiaries, who are said to own the equitable title to the trust assets. The remainder interest can be either equitable or legal, and, as indicated early in this paper, care should be taken to make the remainder legal in order to qualify for the additional 10 per cent charitable deduction. Under this arrangement it is a breach of its fiduciary duty as trustee for the charity to commingle the trust funds with its own general endowment funds;[60] it is the duty of a trustee to keep the trust property separate from other property and to properly designate it as the property of the trust.

The income tax consequences of trust distributions to beneficiaries are very different from those in either the gift-annuity or the in personam life income contract. The most important difference with respect to the trust beneficiary is that the income distributed to him each year has the same character in his hands as in the hands of the trustee. Accordingly, the beneficiary's trust income consists proportionately of dividends, rent, interest, and tax-exempt interest in proportion as each class bears to the total trust income. The charity as a trustee is required to file a fiduciary income tax return even though it has paid out all the income. The powers and duties of the trustee in making investments, like his other powers and duties, can be regulated by the terms of the trust.[61]

D. Comparative Analysis

Charitable institutions prefer outright gifts to gifts with a reservation of income. The recent survey by the American Council on Education indicated that for the last fiscal year gift annuities amounted to less than one per cent of the total value of gifts received by the reporting institutions, and life income arrangements amounted to less than seven per cent of total gifts received. Life income plans are simply an additional method for encouraging gifts and increasing the general endowment funds of the institutions. The charities also recognize that the life income plans enable donors of modest means to make larger gifts than would have been possible by the outright gift method.

The retained life estate in trust in which the trustee is directed to

60. 2 SCOTT, TRUSTS §§ 179-179.3 (2d ed. 1956).
61. *Id.*, § 227.14.

invest in tax-exempt securities would seem to be by far the most attractive arrangement. This is probably true even though the remainder beneficiary is a taxable individual beneficiary and the trustee is an independent one. It is particularly helpful to charities in encouraging gifts, however, because it appeals to both the modest giver as well as the more affluent one. Because of its broader appeal and somewhat more dramatic tax advantages, due entirely to the Congressional tax policy decision on municipal bond interest, this plan was given wide publicity in nationally circulated publications and brochures. It no doubt came to represent some competition to the life insurance agent in approaching an investor who might be in a position to purchase a substantial annuity from a life insurance company. Further, if the rumor that the Service is considering the possibility of taxing the common investment of life income gifts as an association taxable as a corporation could possibly be applied to these separately held trust funds, which seems most unlikely, it would require the transfer of the trusts to an independent trustee, probably a corporate fiduciary. It is conceivable that both the life insurance industry and the trust division of the banking industry have experienced some competition from life income arrangements offered by charities. It is believed, however, that such competition as may exist is not substantial enough to be significant, and this is particularly true in the case of the independent fiduciary.

If it is valid, Revenue Ruling 60-370 will destroy the best "salesleader" for advertising that charities have ever had. It will effectively frustrate an important method of giving on the part of older individuals who are desirous of making gifts to educational institutions before they die. Because of this it is indeed significant that President Kennedy's Special Task Force Committee on Education has recommended that this Ruling be withdrawn in order to encourage contributions to educational institutions. The Committee believes that rescission of the ruling will demonstrate to colleges and universities and to philanthropically inclined individuals that the Kennedy Administration is anxious to do all in its power to stimulate private giving in support of educational institutions.

IV. CONCLUSION

Revenue Ruling 60-370 singles out donors to charity for the assertion of a new rule on realization—that a gift of appreciated property is a realization of gain. This is a proposition which consistently has been rejected by the courts,[62] and upon analogy by the Congress.[63]

62. See note 14 *supra*.
63. See note 13 *supra*.

The new realization rule will be applied, however, only to those donors to charity who make their gifts in the form of a trust in which the trustee is directed to invest in tax exempts. But the Congress has made the tax policy decision to exclude the interest on state and local bonds, and it has put no limitations on when, or in whose hands, such interest is excluded. Further, the Ruling is inconsistent with other rules on realization of income expressed in the Code, Treasury Regulations, and court decisions.

It is believed that Revenue Ruling 60-370 will not be sustained as a proper interpretation of the relevant sections of the Internal Revenue Code. Unfortunately, its very existence will irreparably damage and retard the efforts of charities to attract donors who might not otherwise be interested in making lifetime gifts to charity. It is further believed that the recommendations of the Special Task Force Committee on Education should be adopted by the President, and action taken through the Secretary of the Treasury to request the Internal Revenue Service to revoke the Ruling. The extent to which the work of educational and other charitable institutions should be either encouraged or limited by a tax deduction, and the proper relation of this deduction to the exclusion of municipal bond interest are important tax policy problems for the changing of which the President and the Congress have the political responsibility. It does not seem reasonably within the scope of interpretation of the law to assert a new and special rule on realization which effectively changes existing tax policy.

This is not to say that the exemption of state and local bond interest should be continued, or that the principle of the *Horst*[64] case should not be extended to gifts of property which have appreciated in value. Rather, it is to say that until the Congress and the President make those changes after due consideration and for general application, it does not seem appropriate for the Internal Revenue Service to do this in a narrow, inconsistent, isolated situation, which, nevertheless, is of tremendous importance to the welfare of our society.

64. See notes 11, 18 *supra*.