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## HOW TO SAVE MONEY BY GIVING IT AWAY

HARRY L. WALLACE\*

### I. MOTIVATIONS FOR GIFTS

To a child, reference to gifts may bring forth visions of sugar plums, Santa Claus and Christmas toys. This corresponds to Webster's definition of a gift as "anything voluntarily transferred by one person to another without compensation; a present."<sup>1</sup> Webster designates as obsolete its description of a gift as "a bribe; anything given to corrupt."<sup>2</sup> Most lawyers, perhaps rendered unduly cynical by repeated exposure to the less virtuous aspects of the nature of mankind, would confirm that gifts seldom stem solely from the pure motives inherent in the child's image.

Some gifts clearly do fall in the category of bribes. Contemporary scandals concerning kick backs and five per centers reflect a problem as old as civilization and are not a signal of any sudden breakdown of moral standards. We likewise flatter our ingenuity if we believe that the mink coat and furnished apartment, or the companionship for which they are exchanged, are a modern innovation.

Even when bribery and corruption are absent, selfish considerations have an important influence on many decisions to dispose of property gratuitously. The necessity for the Biblical admonition "that ye do not your alms before men . . . that thine alms may be in secret"<sup>3</sup> reflects an inherent human urge to achieve status from the exercise of generosity. Any lawyer who has worked on a charitable drive is aware of, and has learned to appeal to, the strong incentives embodied in the desire for public acclaim and the fear of community criticism. Support of churches is undoubtedly enhanced by a common desire to make a similar impression on God.

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<sup>1</sup> WEBSTER'S NEW INTERNATIONAL DICTIONARY 1056 (2d ed. 1934).

<sup>2</sup> *Ibid.*

<sup>3</sup> Matthew VI: 1, 4.

Enough people have been known to resort to gifts as a means of frustrating their creditors so as to necessitate a Uniform Fraudulent Conveyance Act.<sup>4</sup> To avoid the impact of such legislation, one who is about to embark on a risky venture which may subject his personal estate to his creditors may be well advised to protect his family by giving away a substantial portion of his estate before he begins. More than one spendthrift has been saved from his own profligacy by being persuaded to give his money away to his family before it has been dissipated.

A gift program may also be an appropriate mechanism for achieving retirement from the obligations of management of a business or an investment portfolio. Lifetime gifts may also be a prudent means of avoiding the delays and breaks in the continuity of management which have wrecked more than one family business while the estate of its founder was being probated.

Resort to lifetime gifts in place of testamentary disposition may also be important to one who wishes to shield his dispositive plan from public view. Such a desire is shared not only by those with family skeletons but also by many who feel that such matters are simply not public business.

Gifts have also been utilized as a remedy for nagging wives. An afflicted husband may utilize lifetime gifts to defeat his wife's statutory right to a portion of his estate. Or he may capitulate early and make gifts to his wife as the price of his freedom. The Internal Revenue Code has recognized that in such a context property transfers are impelled by something other than Christian charity. Accordingly, if properly handled so as to comply with the requirements of the Code, property settlements in connection with a divorce are not gifts for federal gift tax purposes.<sup>5</sup> Moreover, for federal income tax purposes, alimony payments to a divorced wife are deductible by the husband and includible in the income of the wife.<sup>6</sup>

## II. TAX CONSIDERATIONS

### A. *Income Taxes*

It remained, however, for Franklin Roosevelt and the New Deal to provide the primary contemporary stimulus for lifetime gifts through the imposition of sharply progressive federal income and estate taxes. The following representative income tax rates tell the story.

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<sup>4</sup> WIS. STAT. §§242.01-.13 (1961).

<sup>5</sup> INT. REV. CODE OF 1954, §2516.

<sup>6</sup> INT. REV. CODE OF 1954, §§71,215 and 682.

<i>Federal (Joint Return)</i> <sup>7</sup>		<i>Wisconsin</i> <sup>8</sup>	
Income	Marginal Tax Rate	Income	Marginal Tax Rate
\$ 8,000	26%	\$15,000	10%
16,000	34		
32,000	50		
100,000	75		

The successful executive or physician in the 50 per cent federal bracket can save \$3,000 a year in the family's total federal taxes by shifting \$10,000 of income to the 20 per cent bracket of his children or trusts for their benefit. From tax savings such as this, he can send a child to college. Or if he lacks the capital to shift substantial income, he may have a wealthy parent who can be persuaded to create a college fund for the child. It is situations such as these which bring wealthy or successful men and women into the offices of lawyers, so that a few attorneys may likewise be sufficiently successful to embark on a tax-motivated gift program.

Such lawyers are faced with two typical prototypes. One is the elderly client, often a widow, who owns or has access to resources greater than her future needs can conceivably require. Her gifts should ordinarily embody a complete disposition of the property, either outright or in trust, since she should ordinarily not make gifts at all if she may reasonably be expected to need the property or the income therefrom in the future.

If the amount of property is substantial, then a long term trust is called for. Generally speaking, its dispositive provisions should be identical to those which might be contained in a will. The first generation of beneficiaries may have only a life estate so as to save estate taxes on their deaths. Considerable discretion may be conferred on the trustees to sprinkle income among the beneficiaries. If properly drafted, the trust property should be out of the donors estate for both estate and income-tax purposes.

### 1. *Short-Term Trusts*

The 40-year-old executive presents a quite different problem. Whether or not his income has reached its peak, it can be expected to drop drastically when he reaches retirement age. Then he may have real need for the dividend income which at present is largely consumed by the tax collector. A short-term trust, with the property reverting to him upon expiration of its specified term, may be the best answer for him. To achieve its purpose of shifting income to a lower federal tax bracket, such a trust must be for a term of at least ten years (except

<sup>7</sup> INT. REV. CODE OF 1954, §§1(a), 2(a).

<sup>8</sup> WIS. STAT. §71.09 (1am) (1961).

such a trust for charity need only be for two years).<sup>9</sup> It may, however, provide for termination on the death of the beneficiary even if his life expectancy is less than ten years.<sup>10</sup> Thus, such a trust might be used to provide for an aged parent of the donor or his wife. The trust may also terminate on the death of the *donor* if he has a life expectancy of at least ten years.<sup>11</sup> Usually this will be desirable because the death of the donor, and the consequent loss of the principal source of the family income, will drastically alter the family's financial circumstances. The tax savings sought by creation of the trust will have been largely eliminated and replaced by his widow's new need for food and shelter.

If capital gains are treated as principal which will eventually revert to the donor, then he is taxable on the gains even though he does not have the proceeds at the time the gains are realized.<sup>12</sup> Therefore, consideration should be given to the desirability of treating capital gains as income, distributable to the beneficiaries and taxable to them or the trust.

## 2. *Powers to Control Administration or Disposition of Property*

A principal theme underlying the problems in effecting tax savings through gifts is the persistent efforts of taxpayers to have their cake and eat it too—to achieve the tax savings without completely letting go of the property or the right to control its administration or disposition. The most direct method is to reserve the power to amend or terminate the trust. Rebuffed by the tax collector in this attempt, the taxpayer may retain considerable control by conferring very broad powers on the trustee and then designating himself as trustee. Or he may be even more subtle by designating as trustee someone else who he is reasonably certain will abide by his wishes and instructions.

To counter these moves by property owners, Congress has enacted a group of statutes under which the income tax savings sought from creation of a trust can be lost if certain powers are retained by the donor or conferred on any non-adverse party. The first group of such powers are designated in the Internal Revenue Code as powers to control beneficial enjoyment.<sup>13</sup> Most customary powers to exercise discretion with respect to the use of trust income or principal are expressly permitted. However, the discretionary power to sprinkle income among beneficiaries, and the power to distribute principal without reference to a reasonably definite standard to persons other than income beneficiaries of separate shares, can be created without adverse tax consequences to

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<sup>9</sup> INT. REV. CODE OF 1954, §673 (a), (b).

<sup>10</sup> INT. REV. CODE OF 1954, §673(c).

<sup>11</sup> Treas. Regs. §1-673(a)-1(c).

<sup>12</sup> Treas. Regs. §1-677(a)-1(g).

<sup>13</sup> INT. REV. CODE OF 1954, §674.

the grantor only if held by trustees (excluding the grantor), at least half of whom are independent.<sup>14</sup>

A second group of offending powers are classified as administrative.<sup>15</sup> These include the power to deal with the trust property for less than adequate consideration, the power to borrow trust funds without adequate interest or security, and the existence at the end of the taxable year of a loan from the trust to the grantor. Also prohibited are certain general administrative powers, including the powers to control the voting or investment of securities in which the holdings of the trust and the grantor are significant from the standpoint of voting control, and the power to reacquire the trust corpus by substituting other property. The draftsman can readily avoid the pitfalls of this section by expressly negating the existence of all such powers. Only rarely will this create any real obstacle to achievement of the grantor's legitimate desires.

Finally, the grantor will be taxed on the income of a trust if he has the power, effective within ten years, to revoke the trust.<sup>16</sup> Accordingly, the grantor can afford to take advantage of the income tax savings of long or short-term trusts only if he can afford to part irrevocably with the property and income for ten years. He cannot retain the right to change his mind to protect himself against unexpectedly worsened circumstances.

### 3. *Use of Trust Income to Satisfy Grantor's Support Obligations*

A more direct incident of ownership of property than the right to control its administration or disposition among beneficiaries is the right to receive the current income from it. Hence, it is not surprising that the Code taxes the grantor of a trust on income which is or may be distributed to him (or used to pay premiums on insurance on his life).<sup>17</sup> If trust income is used to pay his legal obligations, he is economically benefited just as much as he would be if the income were paid first to him and he in turn used it to pay his bills. This led the Supreme Court to hold some twenty years ago that the grantor was taxable on trust income which could be used to discharge his obligation to support his children, even though it had not been so used.<sup>18</sup> Congress, believing it unfair to tax the grantor under these circumstances, quickly changed the statute to provide that the grantor is only taxable to the extent trust income is actually used to discharge his support obligations.<sup>19</sup>

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<sup>14</sup> INT. REV. CODE OF 1954, §674(c).

<sup>15</sup> INT. REV. CODE OF 1954, §675.

<sup>16</sup> INT. REV. CODE OF 1954, §676.

<sup>17</sup> INT. REV. CODE OF 1954, §677(a).

<sup>18</sup> *Helvering v. Stuart*, 317 U.S. 154 (1942).

<sup>19</sup> INT. REV. CODE OF 1954, §677(b).

Even as so limited, this provision is an obstacle to the grantor who wants to use income shifted to lower tax brackets to send his child to college or for other similar purposes. Under the Regulations, the grantor's support obligation is measured by local law.<sup>20</sup> However, the scope and extent of the obligation under local law is not clear in many borderline cases. Most of the cases involve either divorce litigation<sup>21</sup> or the question of amounts includible for purposes of the exemption for dependents.<sup>22</sup> None are conclusive for purposes of taxability of trust income. In the case of a father whose income is sufficient to make tax savings important, it is probable that a college education is within his legal obligation, although private secondary schooling and summer camps are probably not. Even college may be provided for with a good chance of success by distributing the income to the child regularly before he is ready for college. Then, when he does use it for college, it will have lost its identity as trust income and have become his own property. In most families this can be done without serious risk of the distributed income being used by the child for other purposes.

The statute has extended to others besides the grantor the implications of the economic benefit derived from discharging one's support obligation. Thus, in a typical situation where a grandparent creates a trust for his grandchild and names the child's father as trustee, the father is taxable to the extent he exercises a power (exercisable solely by himself) to use trust income for the support of his child.<sup>23</sup>

However, the Treasury Department has carried this logic one step further. Under its regulations, if trust income is used for the support of a child, the income is taxable to the child's father (or other person obligated for his support) *even though he is not the trustee and has no control over the use or distribution of the trust income.*<sup>24</sup> This makes some sense from an economic standpoint—in such a case the father, not the child, really receives the economic benefit from the trust funds, because in the absence of the availability of funds from the trust, he would have supplied them himself. However, there is little or no justification in the statute for this regulation which purports to interpret a provision dealing with allocation of income between the trust and the beneficiary—not with identification of the beneficiary.<sup>25</sup> If this regulation were justified, there would hardly have been any need for the careful limitations in other sections of the code concerning the taxation of trust funds used to discharge support obligations.

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<sup>20</sup> Treas. Regs. §1.662(a)-4.

<sup>21</sup> *E.g.*, *Esteb v. Esteb*, 138 Wash. 174, 244 Pac. 264 (1926).

<sup>22</sup> *Rivers v. Commissioner*, 33 T.C. 935 (1960); *McKay v. Commissioner*, 34 T.C. 1080 (1960); REV. RUL. 58-67, 1958-1 CUM. BULL. 62.

<sup>23</sup> INT. REV. CODE OF 1954, §678(a), (c).

<sup>24</sup> Treas. Regs. §1-662(a)-4.

<sup>25</sup> INT. REV. CODE OF 1954, §662.

Moreover, the I.R.S. has taken still one further step by extending to custodian relationships its dubious theories with respect to the taxation of trust income used for support obligations. Thus, it has ruled that any person is taxable to the extent income from property held by a custodian is used to discharge such person's support obligation.<sup>26</sup> Under this ruling it is not necessary that the person with the obligation be the custodian—it is only necessary that he receive the economic benefit of the income from the custodial property by virtue of its use to pay his bills for his children.

### B. Gift Taxes

Both the United States and Wisconsin impose a tax on the transfer of the estate of a decedent to his survivors. The federal tax is an estate tax imposed on the entire estate collectively,<sup>27</sup> while Wisconsin has an inheritance tax applied separately to each separate bequest or inheritance.<sup>28</sup> Both governments have enacted gift taxes to preclude complete circumvention of these death taxes.<sup>29</sup> The rates for federal tax purposes may be compared as follows:

<i>Taxable Transfer</i>	<i>Estate Tax</i> <sup>30</sup>	<i>Gift Tax</i> <sup>31</sup>
\$ 100,000	28.4%	22.5 %
500,000	31.0	26.25
1,000,000	33.4	29.25
2,000,000	41.8	36.75

Some savings in transfer taxes can be accomplished by lifetime gifts as a result of the fact that the gift tax rates are significantly lower. Moreover, the estate tax is imposed separately from gifts during lifetime, so that by making lifetime gifts it is possible to divide the estate into two taxable parts, thereby minimizing the effects of the progressive rate structures. Moreover, the gift taxes themselves are removed from the taxable estate.

Finally, the available exemptions and exclusions to the gift tax permit substantial life-time transfers without any tax. Every person can give up to \$30,000 during his lifetime without tax.<sup>32</sup> By utilizing the gift-splitting provisions, a married couple can give \$60,000 free of tax under this cumulative exemption.<sup>33</sup> In addition, a donor can give \$3,000 annually to each of any number of donees free of federal gift tax (\$1,000 for Wisconsin purposes).<sup>34</sup> This annual exclusion may likewise

<sup>26</sup> REV. RUL. 56-484, 1956-2 CUM. BULL. 23; REV. RUL. 59-357, 1959-2 CUM. BULL. 212; see WIS. STAT. §319.64(2) (1961).

<sup>27</sup> INT. REV. CODE OF 1954, §2001.

<sup>28</sup> WIS. STAT. §72.01 (1961).

<sup>29</sup> INT. REV. CODE OF 1954, §2501; WIS. STAT. §72.75 (1961).

<sup>30</sup> INT. REV. CODE OF 1954, §§2001, 2011; see WIS. STAT. §§72.02, .03, .74 (1961).

<sup>31</sup> INT. REV. CODE OF 1954, §2502; see WIS. STAT. §72.77 (1961).

<sup>32</sup> INT. REV. CODE OF 1954, §2521.

<sup>33</sup> INT. REV. CODE OF 1954, §2513; see INT. REV. CODE OF 1954, §2523.

<sup>34</sup> INT. REV. CODE OF 1954, §2503; see WIS. STAT. §72.80(1) (1961).

be doubled by a married couple by appropriate consents. Thus, a grandfather with ten grandchildren can give away \$60,000 annually to his grandchildren free of federal gift tax, and without even using up his \$30,000 cumulative exemption. If he starts such a program when he is 60, he can give away \$600,000 by the time he and his wife reach their allotted three score years and ten.

The principal problem for the lawyer in utilizing the \$3,000 annual exclusion arises from the fact that it is not available for gifts of "future interests."<sup>35</sup> While an outright gift avoids this problem altogether, such a gift is ordinarily not desirable for a minor. One form of trust designed to meet this requirement provides for mandatory distribution of the trust income for the life of the beneficiary. The entire income interest (which approximates 90 per cent of the value of the property in the case of a young child) qualifies for the exclusion.<sup>36</sup> This trust can authorize distributions of principal even though technically such distributions reduce the value of the income interest.<sup>37</sup> It is even possible to qualify the entire life interest as a present interest, and still provide for termination of the trust when the beneficiary reaches a specified age, by giving the beneficiary power to demand payment of all or part of the principal at any time after attaining that age.<sup>38</sup>

Perhaps the most vexing problem created by such a trust is the re-investment of income distributed to the minor beneficiary. Purchase of securities in the minor's name presents no problem, but their subsequent sale is ordinarily impossible. Many parents prefer not to limit investments to savings accounts and treasury bills. Yet the appointment of a guardian would entail expenses which are often out of proportion to the amounts involved. One solution is to use the minor's money to purchase securities in the name of a nominee—the child's mother, for example. This may give rise to an inquiry from the tax authorities, but with proper documentation the risks are not overwhelming.

An alternative to this kind of trust is one that terminates when the beneficiary reaches 21. Income can be accumulated, but the entire income and principal must eventually be payable to the beneficiary, or if he dies before reaching 21, as he may appoint by will.<sup>39</sup> However, since in Wisconsin most minors cannot exercise a testamentary power of appointment,<sup>40</sup> it is possible to provide in the trust for a gift over in default of appointment, which will control the disposition of the trust

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<sup>35</sup> INT. REV. CODE OF 1954, §2503(b).

<sup>36</sup> *Sharp v. Commissioner*, 3 T.C. 1062 (1944), *aff'd*, 153 F.2d 163 (9th Cir. 1946), *acq.*, 1953-1 CUM. BULL. 6; RUL. 54-3DD, 1954 CUM. BULL. 319.

<sup>37</sup> INT. REV. CODE OF 1954, §2503(b).

<sup>38</sup> See Treas. Regs. 25.2503-3(b), (c).

<sup>39</sup> INT. REV. CODE OF 1954, §2503(c).

<sup>40</sup> WIS. STAT. §238.01 (1961).

property in the event of the premature death of the beneficiary.<sup>41</sup> The trust can give the beneficiary power to extend it beyond age 21, but cannot require any affirmative action on his part to effect its termination.<sup>42</sup>

The advantage of the life income trust is that it can continue beyond age 21, an age at which many beneficiaries are not sufficiently mature to manage substantial sums of money. Its disadvantage is that the income must be distributed. Neither type is inherently preferable. The choice will depend on the circumstances and the preferences of the donor.

If there is no objection to the property being owned outright by the beneficiary when he reaches 21, consideration should also be given to a statutory custodianship.<sup>43</sup> The entire interest in property given to a custodian for a minor qualifies for the gift tax exclusion.<sup>44</sup> But if income is used for the beneficiary's support, it will be taxed to the person obligated to provide such support.<sup>45</sup> Moreover, if the donor is custodian, it will be included in his estate if he dies before the custodianship terminates.<sup>46</sup>

While the custodian arrangement is quite similar to a trust terminating at 21, it has some disadvantages. The tax risks for the donor and the beneficiary's parent can be minimized with a trust. The trust provides another useful taxable entity. Perhaps most important, the investment powers of the custodian are limited.<sup>47</sup> Finally, the trust can provide for a successor in the event of the death of the initial fiduciary without the delays and expense of a court proceeding.

### C. Estate Taxes

In most cases the savings sought through utilization of the gift tax exclusions, exemptions and lower rates will be lost if the property is not successfully removed from the donor's estate for estate tax purposes. As in the case of the income tax, there are several bases upon which the government may attempt to impose an estate tax upon property given away by the decedent during his lifetime. All gifts within three years of the donor's death are presumed to be gifts in contemplation of death, and subject to the estate tax, unless proved to the contrary.<sup>48</sup> The lawyer can do little to avoid this risk—in fact it may well be de-

<sup>41</sup> Treas. Regs. §25.2503-4(b).

<sup>42</sup> REV. RUL. 60-218, 1960-1 CUM. BULL. 378.

<sup>43</sup> WIS. STAT. §§319.61-71 (1961).

<sup>44</sup> REV. RUL. 56-86, 1956-1 CUM. BULL. 449; REV. RUL. 59-357, 1959-2 CUM. BULL. 212.

<sup>45</sup> REV. RUL. 56-484, 1956-2 CUM. BULL. 23; REV. RUL. 59-357, 1959-2 CUM. BULL. 212; see WIS. STAT. §319.64(2) (1961).

<sup>46</sup> REV. RUL. 57-366, 1957-2 CUM. BULL. 618; REV. RUL. 59-357, 1959-2 CUM. BULL. 212.

<sup>47</sup> WIS. STAT. §319.64(5) (1961).

<sup>48</sup> INT. REV. CODE OF 1954, §2035.

sirable to go ahead with a gift even if it is likely to be treated as a gift in contemplation of death, since the gift tax will be removed from the estate and at the same time credited against the estate tax.<sup>49</sup>

Under another section, the taxable estate includes property with respect to which the decedent has retained the possession or enjoyment of or the right to the income from the property, or the right to designate who shall have such rights with respect to the property.<sup>50</sup> This statute is designed to impose the tax on property with respect to which the decedent retained a life estate—which, after all, is all any of us really has. Understandably, this statute has been relied on to subject to the estate tax property held by a trust which was used to discharge the decedent's support obligations.<sup>51</sup> However, it has also been interpreted to apply to situations in which the decedent's retention of control over the property was relatively tenuous. The most notable example is the *State Street Trust* case<sup>52</sup> which held that the decedent's taxable estate included property in a trust he created because, as a co-trustee, he had the power to invest in low-income producing or wasting assets and, without reference to any standard, to allocate receipts between income and principal, and the trustees were liable only for wilful defaults.

Still a different section provides for taxation of property transferred by a decedent if possession of the property can be obtained only by surviving the decedent and if the decedent retained a reversionary interest which exceeded 5 per cent of the value of the property at the time of death.<sup>53</sup> The applicability of this section can be avoided readily by appropriate provisions in the trust agreement eliminating any reversionary interest in the donor.

Finally, the decedent's estate is taxable with respect to transferred property if he had the power to alter, amend, revoke, or terminate the transfer.<sup>54</sup> Just as in the case of the similar provision with respect to income taxes, this provision makes perfect sense—a donor has not really given property away so long as he has the power to reclaim it. This section, as well as all the others relating to includibility of transferred property in the federal taxable estate, has a counterpart in the Wisconsin Statutes.<sup>55</sup>

The principal problem for the lawyer engaged in estate planning is often to reconcile the donor's conflicting desires to achieve tax savings and at the same time to retain such rights to the property as the right to the current income, or the right to the property or the income at some

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<sup>49</sup> INT. REV. CODE OF 1954, §2013.

<sup>50</sup> INT. REV. CODE OF 1954, §2036.

<sup>51</sup> *Estate of Lee v. Commissioner*, 40 T.C. 1064 (1960).

<sup>52</sup> *State Street Trust Co. v. United States*, 263 F. 2d 635 (1st Cir. 1959).

<sup>53</sup> INT. REV. CODE OF 1954, §2037.

<sup>54</sup> INT. REV. CODE OF 1954, §2038.

<sup>55</sup> WIS. STAT. §72.01(3)(b) (1961).

time in the future, or the power to control the use of the property and its ultimate disposition among the beneficiaries, or the power to manage and control the investment of the property. Even if he is willing to give up all beneficial interest in the property, he is likely to want to be a trustee, or to control the trustees. Only in extraordinary circumstances are the tax risks worth the control thereby retained. Unfortunately, many a property owner will choose to forego a desirable estate planning program rather than give up control over his property during his lifetime.

### III. THE LOW COST OF CHARITABLE GIVING

The people of Wisconsin and the country, acting through their governments, have generously exempted charitable bequests from state and federal death taxes.<sup>56</sup> Charitable gifts are likewise exempt from gift taxes.<sup>57</sup> Neither of these exemptions is likely to incite a flood of charitable giving. It is hard enough to persuade a property owner to give his property away to his family.

The real tax incentive for making charitable gifts lies in their deductibility for income tax purposes.<sup>58</sup> Consider, for example, a man with an income of \$40,000, a wife, and a normal amount of deductions and exemptions. He will be in the 50 per cent bracket for federal income tax purposes. His effective Wisconsin tax rate will be another 5 per cent (taking into account the deductibility of the Wisconsin tax for federal tax purposes). Few people today adhere to Biblical instructions to devote a tithe (10 per cent) of their income to their church—or to charity generally. Yet for such a man, the after-tax cost of tithing would be only \$1,800.

Even this cost can be considerably reduced if the gift can be made with appreciated securities which are deductible at their fair market value without recognition of gain.<sup>59</sup> For example, compare the results for our hypothetical taxpayer of a sale of securities worth \$4,000 and a basis of \$1,000, with a gift of such securities.

<i>Sale</i>			<i>Gift</i>	
Value	\$4,000	\$4,000	Value	\$4,000
Basis	1,000		Tax Savings:	
Gain	<u>\$3,000</u>		Federal	\$2,000
Federal Tax	\$ 750		Wisconsin	<u>200</u>
Net Wis. Tax	<u>150</u>			
Total Tax		<u>900</u>	Total Tax	
Net Proceeds			Savings	\$2,200
to Taxpayer		\$3,100		

<sup>56</sup> INT. REV. CODE OF 1954, §2055; WIS. STAT. §72.04(1)-(3) (1961).

<sup>57</sup> INT. REV. CODE OF 1954, §2522; WIS. STAT. §72.79 (1961).

<sup>58</sup> INT. REV. CODE OF 1954, §170; WIS. STAT. §71.05(6) (1961).

<sup>59</sup> REV. RUL. 55-410, 1955-1 CUM. BULL. 297.

Thus, the taxpayer could make a gift of \$4,000 to charity at a real cost of only \$900. For a taxpayer in the 90 per cent bracket, the results of such a gift are even more dramatic. Since his tax savings would be about \$3,600, he would actually have \$500 more after giving such securities away than he could obtain by selling them.

Still another way for a taxpayer to save money by giving it away to charity is to make a gift of the remainder interest in property following his death. He can retain the use and enjoyment of, and income from, the property for the rest of his life—all he personally can have from it in any event. Nevertheless, he can obtain an income tax deduction equal to the present actuarial value of the remainder interest.<sup>60</sup> Anyone who has provided in his will for charitable bequests should certainly consider the potential income tax savings of a present gift of the remainder interest. This is a popular method of disposition of non-income producing property such as art objects and outdated mansions.<sup>61</sup> In part because of difficulties in valuing such property, it is not unheard of for a donor to acquire a community reputation as a philanthropist and still realize more in tax savings than he could have done by selling the property. Charitable gifts of remainder interests have proved equally attractive for securities, particularly when coupled with subsequent investment in tax-exempt municipals, leaving the donor with a guaranteed tax-free annuity.<sup>62</sup>

#### IV. CHOICE OF ASSETS TO GIVE AWAY

Once a person has determined to make a gift, he will be faced with the problem of determining what property to give away. If the gift is substantial, he is unlikely to have sufficient cash or its equivalent. Frequently, he will be limited to choosing among his portfolio of securities. His choice will be affected by the resulting basis of donated property for income tax purposes. For Wisconsin tax purposes the donee's basis is the fair market value at the time of the gift;<sup>63</sup> hence, it is irrelevant whether the property has appreciated or depreciated.

Because of the federal tax consequences, however, it is usually undesirable to give away *depreciated* property, either to charity or as a family gift. The charitable deduction is limited to the fair market value at the time of the gift,<sup>64</sup> while such fair market value is likewise the basis for determining loss of a non-charitable donee.<sup>65</sup> Thus, in either

<sup>60</sup> REV. RUL. 55-275, 1955-1 CUM. BULL. 295; REV. RUL. 57-562, 1957-2 CUM. BULL. 159.

<sup>61</sup> REV. RUL. 57-293, 1957-2 CUM. BULL. 153; REV. RUL. 58-455, 1958-2 CUM. BULL. 100.

<sup>62</sup> See Pomona College, Estate Planning and Education (1960); Treas. Regs. 1.170-1(d); REV. RUL. 55-620; 1955-2 CUM. BULL. 56, REV. RUL. 57-562, 1957-2 CUM. BULL. 159, REV. RUL. 60-370, 1960-2 CUM. BULL. 203.

<sup>63</sup> WIS. STAT. §71.03(1)(g) (1961).

<sup>64</sup> Treas. Regs. §1.170-1(c).

<sup>65</sup> INT. REV. CODE OF 1954, §1015(a).

case the donor's unrealized loss will be lost for tax purposes if he gives away depreciated property. If depreciated property is all he has available, the prospective donor should ordinarily sell the property first to establish his loss, and then give away the proceeds.

As discussed above, there are tax advantages to be derived from charitable gifts of *appreciated* property. However, it is ordinarily disadvantageous to give away appreciated property in connection with a family gift program. In such a case the donee takes the donor's basis (increased by any federal gift tax attributable to the gift).<sup>66</sup> If the donor instead retains the property until his death, the transferee will get a stepped-up basis equal to the value of the property upon his death (or one year thereafter if the executors so elect).<sup>67</sup> Thus, by retaining the property until death the income tax on the appreciation can be avoided.

Frequently, the choice of assets may be between closely held securities and other property. If the closely held stock entails control, it will ordinarily be better not to utilize it in a gift program. The owner will probably feel it necessary to retain sufficient strings on the property to make solution of the tax problems difficult. If control is not involved, however, gifts of closely held stock may be highly desirable. The donor is likely already to be in need of diversifying his portfolio, a problem which would be minimized by a gift of closely held stock but accentuated by using any other property. The investment responsibility of the donee or trustees is minimized because it is not anticipated that the property will be sold and reinvested frequently. This may be particularly important in the case of a ten year trust to avoid the problem created by the fact that the donor is ordinarily taxable on capital gains realized by the trust, even though he does not have present access to the proceeds of the sale as a source for paying the taxes. Use of comparatively small gifts of closely held stock may help to establish a value of the stock under circumstances where not enough tax is involved to justify the government in making an extensive fight.

Life insurance policies may also be desirable subjects of gifts. This is particularly true of group insurance which has no value. For example, instead of naming his wife as beneficiary of his group insurance, an employee can make a present assignment to his wife of all his rights under the policy. Since the insurance has no value, there are no gift tax consequences. Nevertheless, although the result has not yet been clearly established by regulation or decision, it appears that the effect should be to exclude the insurance proceeds from the insured's estate in the event of his death.

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<sup>66</sup> INT. REV. CODE OF 1954, §1015(a)(d).

<sup>67</sup> INT. REV. CODE OF 1954, §1014; WIS. STAT. §71.03(1)(g) (1961).

Commercial life insurance may be similarly used. Substantial amounts of insurance can be purchased for annual premiums which do not exceed the annual gift tax exclusions. Thus, by arranging for his wife or other beneficiary to own his insurance policies, the insured can exclude the proceeds from his taxable estate with no offsetting gift tax cost. If the owner dies first, the amount includible in her estate is limited to the fair market value of the policies, so the tax consequences of her death are not serious.

Another gift frequently made without full realization of the tax consequences is the purchase of a residence by a husband and wife as joint tenants with funds belonging to the husband. Under federal law, this transaction is not treated as a gift unless the taxpayer so elects.<sup>68</sup> The gift is postponed until the property is sold. However, for Wisconsin purposes, one-half of payments on the purchase price (including subsequent payments of principal on any mortgage loan) are gifts from the husband to his wife and should be so reported.

#### V. SUMMARY AND CONCLUSIONS

While many motives contribute to decisions to make gifts, the primary contemporary stimulus comes from tax considerations. By carrying out a well conceived estate planning program over a period of several years, a well-to-do property owner can save many thousands of dollars in taxes imposed on the transfer of his estate to his family. Because of the very high federal income tax rates, the potential aggregate savings in income taxes are often much greater than the possible death tax savings. Ironically, under the present income tax rate structure, some property owners can realize more by giving their property to charity than by selling it. In light of all these factors, many property owners would be well advised to undertake a continuing gift program for their families and charities even though they have no immediate expectation of departing this life. However, the lawyer's principal problem in this field will continue to be to persuade clients to start giving away their property with no strings retained. Not even the New Deal has changed human nature.

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<sup>68</sup> INT. REV. CODE OF 1954, §2515.