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## Why the Buffett=Gates Pledge Requires Limitation of the Estate Tax Charitable Deduction

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# FLORIDA TAX REVIEW

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## WHY THE BUFFETT-GATES GIVING PLEDGE REQUIRES LIMITATION OF THE ESTATE TAX CHARITABLE DEDUCTION

by

Edward A. Zelinsky\*

### Abstract

*The Buffett-Gates Giving Pledge, under which wealthy individuals promise to leave a majority of their assets to charity, is an admirable effort to encourage philanthropy. However, the Pledge requires us to confront the paradox that the federal estate tax charitable deduction is unlimited while the federal income tax charitable deduction is capped. If a Giving Pledger leaves his wealth to charity, the federal fisc loses significant revenue since the Pledger thereby avoids federal estate taxation as charitable bequests are deductible without limit for federal estate tax purposes. Despite its laudable qualities, the Giving Pledge is a systematic (albeit inadvertent) threat to the estate tax base.*

*The Giving Pledge requires the amendment of the federal estate tax to restrict an estate's charitable deduction to a percentage of the estate, just as the income tax charitable deduction is limited to a percentage of the taxpayer's income. In this fashion, the sensible compromise embedded in the income tax charitable deduction would be carried over to the federal estate tax to simultaneously encourage charitable giving while ensuring that all large estates pay some federal estate tax.*

*The Giving Pledge need not be the death knell of the estate tax. It should instead be the catalyst to reform the tax by limiting the estate tax charitable deduction.*

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## I. INTRODUCTION

The emergence of the Giving Pledge<sup>1</sup> is a propitious development in contemporary America, an admirable effort to encourage philanthropy. The Giving Pledge is the effort by Warren Buffett and Bill Gates, Jr. to encourage their fellow billionaires to promise to “give the majority of their wealth to philanthropic causes or charitable organizations either during their lifetime or in their will.”<sup>2</sup> However, there is considerable tension between the Giving Pledge and another Buffett-Gates project, the preservation of the federal estate tax.<sup>3</sup> If a Giving Pledger leaves his wealth to charity, the federal fisc loses significant revenue since the Pledger thereby avoids federal estate taxation<sup>4</sup> as charitable bequests are deductible without limit for federal estate tax purposes. Despite its laudable qualities, the Giving Pledge is a systematic, albeit unintended, threat to the federal estate tax base.

The Giving Pledge thus requires us to confront the paradox that the federal estate tax charitable deduction is unlimited while the federal income tax charitable deduction<sup>5</sup> includes detailed limitations which restrict the proportion of an individual taxpayer’s income which may be deducted as a

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1. THE GIVING PLEDGE, <http://givingpledge.org> (last accessed Jan. 6, 2014).

2. *Frequently Asked Questions*, THE GIVING PLEDGE, <http://givingpledge.org/faq.aspx> (last updated Feb. 20, 2014).

3. *Signers of Responsible Wealth Statement in Support of Estate Tax*, AM. FOR TAX REFORM, Dec. 11, 2012, <http://www.americansfortaxfairness.org/files/Signers-of-Responsible-Wealth-Statement-in-Support-of-Estate-Tax-12-11-12-1030-am.pdf>. Bill Gates, Sr. has been particularly outspoken in support of estate taxation. However, Bill Gates, Jr. has made clear that he, too, supports the federal estate tax. Dan Farber, *A New Comedy Act: Buffett and Gates*, CBS NEWS, May 4, 2009, <http://www.cbsnews.com/news/a-new-comedy-act-buffett-and-gates>.

4. The federal gift tax backstops the federal estate tax. All of my observations about the federal estate tax apply to the federal gift tax, as well. For ease of exposition, I generally refer only to the federal estate tax. However, such references also encompass the gift tax and should be so understood.

5. I.R.C. § 170.

charitable contribution.<sup>6</sup> Through these limits, the income tax charitable deduction implements the ethic that everyone—even taxpayers who devote their entire incomes to charity—should pay some federal income tax, while the Code simultaneously countenances the total avoidance of the federal estate tax via charitable bequests.

The central argument of this Article is that the Giving Pledge requires the amendment of the federal estate tax to restrict an estate's charitable deduction to a percentage of the estate, just as the income tax charitable deduction is limited to a percentage of the taxpayer's income. The limits of the income tax charitable deduction embody a sensible compromise which requires every charitable donor to pay some income tax even if he gives all of his income to charity. This approach should be carried over to the estate tax<sup>7</sup> charitable deduction so that every estate<sup>8</sup> large enough to trigger federal estate liability will pay some estate tax, even if that estate devolves in its entirety upon charitable recipients.

Ideally, the federal estate tax should incorporate the limits the Code today imposes on the income tax deductibility of charitable contributions. Alternatively, less robust restrictions could be fashioned for the estate tax charitable deduction such as a deduction limit only applicable to bequests to private foundations or to certain private foundations.

The Giving Pledge need not be the death knell of the federal estate tax. The Giving Pledge should, instead, be the catalyst to reform the tax by limiting the estate tax charitable deduction.

I come to these conclusions by revisiting important issues which have generated much fine legal scholarship and public debate: Why permit charitable tax deductions? Why levy an estate tax? Ultimately, the argument for the limitations of the income tax charitable deduction is the desirability of compromise among the contending rationales for and against a charitable deduction. The income tax charitable deduction is conventionally defended either as (1) an incentive for the donor to contribute his resources to charity, or (2) as a recognition that the charitable donor sacrifices personal resources by relinquishing control of donated funds and consequently reduces by such donations his capacity to pay personal income tax. Counterbalancing these considerations are the public fisc's need for revenue, the belief that all taxpayers should contribute something for the governmental services they utilize, and the view that charitable donations may in important respects

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6. I.R.C. § 170(b).

7. Since the federal gift tax backstops the federal estate tax, the gift tax charitable deduction should be limited in the same way. *See* I.R.C. § 2522 (unlimited gift tax charitable deduction).

8. However, if the deduction limit were to apply only to bequests to private foundations, large estates could still avoid all federal estate tax if such estates were devoted solely to public charities. I discuss *infra* a charitable deduction limit applying only to bequests to private foundations.

constitute personal consumption by the donor. Allowing but limiting the income tax charitable deduction balances these contending considerations by requiring all charitable donors to pay some income tax, even if they contribute all of their incomes to charity. The Code's lower deduction limit for contributions to nonqualifying private foundations reflects an assessment that privately controlled and privately supported charities are less worthy of a tax subsidy than are public charities. This limit also acknowledges that donations to such nonqualifying private foundations look more consumption-like than do donations to public charities which entail more sacrifice and less donor control.

The federal estate tax should strike a similar compromise by permitting, but limiting, charitable deductions and thereby ensuring that all large estates pay some federal estate tax. On the one hand are the policies of encouraging charitable bequests to maintain a vibrant charitable sector and of recognizing that resources transferred to charity do not directly descend to the decedent's family. On the other hand, the public fisc has legitimate claims for the services it provided during the decedent's lifetime. The estate tax is the final accounting for the governmental benefits the decedent received while alive. The estates of many contributors to the Giving Pledge will largely consist of assets with substantial unrealized appreciation. For these estates, estate taxation provides a rough substitute for the income tax that the deceased never paid on this unrealized appreciation while alive. Bequests to a private foundation may, in dynastic fashion, perpetuate substantial economic and political power for the decedent's family which controls that foundation.

Permitting, but limiting, the estate tax charitable deductible would balance these competing concerns. Ideally, such a limit would require that all large estates pay some federal estate tax, even if they are totally devoted to charity.

The first Part of this Article describes the evolution and current limits of the federal income tax charitable deduction. The second Part of this Article contrasts the limits of the federal income tax charitable deduction with the unbounded nature of the federal estate tax charitable deduction. The third Part reviews the arguments for and against the income tax charitable deduction and the political dynamic underpinning the compromise embedded in the limitations of the current law on the income tax charitable deduction. The fourth Part of this Article discusses the debate between proponents and opponents of the federal estate tax. The fifth and final Part argues that, in light of this background, the limitations of the federal income tax charitable deduction strike a plausible and stable balance among the contending policies and that the same or a similar compromise should be incorporated into the federal estate tax charitable deduction to ensure that all large estates pay at least some federal estate tax. Permitting, but limiting, the estate tax

charitable deduction would be a sensible compromise of the contending policies as it is a sensible compromise in the context of the income tax.

The Giving Pledge is an admirable effort to channel wealth to charity. The Giving Pledge's commendable success, however, highlights the tension between the limited nature of the federal income tax charitable deduction and the unlimited federal estate tax charitable deduction. This tension is exacerbated by (1) the large amounts the Pledgers have committed to leave to charity; (2) the fact that much of that wealth will, under current law, never be subjected to federal income or estate taxation; and (3) the contending policies for and against charitable deductions. As worthy as the Giving Pledge is, the Pledge is a systematic (albeit inadvertent) threat to the federal estate tax base. The success of the Giving Pledge will, under current law, cost the federal Treasury significant revenue because of the estate tax's unlimited charitable deduction.

In light of the contending considerations and the success of the Giving Pledge, the compromise embedded in the Code's restrictions on the income tax deductibility of charitable donations should be incorporated into the federal estate tax to ensure that all large estates pay some federal estate tax.

## II. THE LIMITS OF THE INCOME TAX CHARITABLE DEDUCTION

The limits of the income tax charitable deduction evolved over half a century, from the Revenue Act of 1917 through the Tax Reform Act of 1969. There have been three hallmarks to that evolution. First, over time, the limits on the income tax charitable deduction have been liberalized even as the perpetuation of those limits has never been seriously challenged. Second, these limits are bifurcated with higher charitable deduction caps applying for income tax purposes to donations to public charities and to qualifying private foundations and lower deduction caps governing donations to all other private foundations. Third, these deduction limits, having evolved over several generations, have been stable since 1969. Thus, the Code today embodies the settled policy that a charitable donor should pay some income tax, even if he contributes all of his income to charity.

Shortly after the modern federal income tax was established in 1916,<sup>9</sup> the Revenue Act of 1917 added to the income tax a limited deduction for individuals' contributions "to corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children or animals,

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9. Revenue Act of 1916, Pub. L. No. 64-271, 39 Stat. 756.

no part of the income of which inures to the benefit of any private stockholder or individual.”<sup>10</sup>

This original version of the federal income tax charitable deduction was restricted to 15 percent of the donor’s taxable income calculated without the charitable deduction.<sup>11</sup> In this initial formulation, the income tax charitable deduction treated alike all charitable contributions as an individual taxpayer’s contributions to the charities enumerated in the statute were deductible up to 15 percent of the taxpayer’s taxable income.<sup>12</sup> This limit initiated the principle, now deeply embedded in the Code, that a taxpayer who donates all of his income to charity still pays federal income taxes.

The next important innovation in this area was the adoption of the Internal Revenue Code of 1954 which both increased and, for the first time, bifurcated the limit on individuals’ charitable contribution deductions. The 1954 Code distinguished contributions to churches, hospitals, and schools from donations to all other charities, favoring contributions to the former over donations to the latter. As part of this change, the Code created the concept of an individual taxpayer’s “contribution base,”<sup>13</sup> the taxpayer’s adjusted gross income for the year calculated without any net operating losses carried over to such year.<sup>14</sup>

Section 170 of the original 1954 Code provided that an individual taxpayer could deduct for income tax purposes contributions to churches, hospitals, and schools up to 30 percent of her contribution base. In contrast, the deduction for contributions to all other charities was limited to 20 percent of the individual taxpayer’s contribution base. If a taxpayer’s donations to these other, less favored charities met or exceeded 20 percent of the taxpayer’s contribution base, the taxpayer could still deduct up to an additional ten percent of his contribution base for donations to schools, hospitals, and churches.

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10. War Revenue Act of 1917, Pub. L. No. 65–50, § 1201(2), 40 Stat. 300, 330.

11. *Id.* In this original incarnation, there was no carryover of contributions in excess of the current year’s deduction. Thus, if an individual donated to any specified charity an amount equal to 25 percent of his current year’s taxable income computed without a charitable deduction, the portion of the contribution up to the 15 percent ceiling was deductible but the rest contributed to charity was permanently nondeductible.

12. In 1936, Congress extended to corporations a similarly limited charitable deduction. The Revenue Act of 1936 permitted a corporation to deduct charitable contributions up to five percent of its taxable income computed without such deduction. This limit is today embodied in section 170(b)(2)(A) which limits the corporate charitable deduction to ten percent of the corporation’s taxable income calculated without reference to the charitable deduction. I.R.C. § 170(b)(2)(A).

13. I.R.C. § 170(b)(1)(G).

14. *Id.*

Thus, almost four decades after the Revenue Act of 1917 inaugurated the income tax charitable deduction, the 1954 Code both increased the limits of that deduction and embraced the principle that individuals' contributions to some donees—initially defined as churches, schools and hospitals—are subject to higher deduction limits than are contributions to all other charitable donees. By continuing to limit the charitable deduction, the 1954 Code confirmed the policy that all charitable donors, including those who contribute their entire incomes to charity, must pay some federal income tax.

In 1956, the higher 30 percent deduction limit was expanded to include individuals' contributions to certain hospital-affiliated "medical research organization[s]." <sup>15</sup> In 1962, Congress applied the higher 30 percent limit to contributions to entities supporting public colleges and universities. <sup>16</sup> In 1964, this favored treatment was extended further to individuals' contributions to states and localities <sup>17</sup> and to charitable organizations which "normally receive[] a substantial part of [their] support" from state or local government or "from the general public." <sup>18</sup>

The 1964 Act, by subjecting charities supported by "the general public" to the higher, 30 percent contribution limitation, foreshadowed the Tax Reform Act of 1969. <sup>19</sup> The 1969 Act framed the income tax's charitable deduction limits as we know them today and introduced into the Code the distinction between "private foundations" and "public charities." <sup>20</sup>

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15. Act of Aug. 7, 1956, ch. 1031, 70 Stat. 1117.

16. Act of Oct. 23, 1962, Pub. L. No. 87-858, § 2, 76 Stat. 1134, 1134.

17. Revenue Act of 1964, Pub. L. No. 88-272, § 209(a), 78 Stat. 19, 43.

18. I.R.C. § 170(b)(1)(A)(vi); Revenue Act of 1964, Pub. L. No. 88-272, § 209(a), 78 Stat. 19, 43. The 1964 Act also added carryover provisions which permitted charitable deductions in excess of the current year's limit to be carried over and deducted in subsequent years. Revenue Act of 1964, Pub. L. No. 88-272, § 209(c)(1), 78 Stat. 19, 45.

19. Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487.

20. The distinction between private foundations and public charities was also presaged by section 331 of the Revenue Act of 1950, Pub. L. No. 81-814, 64 Stat. 957, which added section 3813 and section 3814 to the 1939 Code. Section 3813 of the 1939 Code became section 503 of the 1954 Code. Before the Tax Reform Act of 1969 became effective in 1970, section 503 proscribed "prohibited transactions" with certain section 501(c)(3) charities. The charities subject to the prohibited transaction rules of section 503 were defined residually as all exempt organizations other than the groups today labeled as public charities under section 509(a)(1). Thus, section 503 largely applied to the institutions classified as private foundations by the Tax Reform Act of 1969. Section 503 remains in the Code in highly attenuated form. It has largely been superseded by section 4941 (penalizing "self-dealing" between private foundations and persons positioned to control them) and section 4975 (penalizing "prohibited transactions" between tax-exempt retirement trusts and persons positioned to control them).



As a result of the 1969 Act, the Code classifies all section 501(c)(3)<sup>21</sup> organizations as either “public charities”<sup>22</sup> or “private foundations”<sup>23</sup> and subjects the latter to regulation inapplicable to the former.<sup>24</sup> In contrast to private foundations, public charities are regulated less heavily because public charities “either have broad public support or actively function in a supporting relationship to such [publicly supported] organizations.”<sup>25</sup>

As a result of the 1969 Act, four categories of section 501(c)(3) organizations are denominated as “public charities.” The Code then defines private foundations residually, as any section 501(c)(3) tax-exempt charity which does not fit into one of these four public charity categories.<sup>26</sup>

First, under section 509(a)(1), a section 501(c)(3) entity is a public charity, rather than a private foundation, if it is one of the entities favored before 1969 with the higher 30 percent deduction limit, that is, a church, a school, a hospital, a hospital-affiliated medical research organization, an organization supporting a public college or university, a state or locality, or a charitable organization normally receiving substantial support from state or local government or from the general public.<sup>27</sup>

Second, under section 509(a)(2), a section 501(c)(3) entity (even though not one of these listed entities) is a public charity, rather than a private foundation, if it meets two arithmetic tests to demonstrate that it is normally publicly supported.<sup>28</sup> An example of a public charity under section

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Section 331 of the Revenue Act of 1950 also added to the 1939 Code section 3814 denying tax exemption to organizations if their income was accumulated unreasonably, used for nonexempt purposes, or invested in a manner which jeopardized the organization’s exemption function. These ideas are today implemented in more elaborate form by the network of regulatory taxes pertaining to private foundations. *See* I.R.C. §§ 4942 (penalty tax on private foundation’s “failure to distribute income”); 4945 (penalty tax on private foundation’s “taxable expenditure”); 4944 (penalty tax on private foundation which “invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes”).

21. I.R.C. § 501(c)(3).

22. Rev. Rul. 2003–13, 2003–1 C.B. 305.

23. I.R.C. § 509.

24. I.R.C. §§ 4940–46.

25. Reg. § 1.509(a)–1.

26. I.R.C. § 509.

27. I.R.C. § 509(a)(1).

28. The first of these arithmetic tests for section 509(a)(2) public charity status is that a section 501(c)(3) entity must “normally” receive more than “one third of its support” from any combination of “gifts, grants, contributions, [ ] membership fees” and “gross receipts from admissions, sales of merchandise, performance or services, or furnishing of facilities.” I.R.C. § 509(a)(2)(A). Second, the entity must not “normally” receive more than “one-third of its support” from passive

509(a)(2) is a nonprofit museum which qualifies as tax-exempt under section 501(c)(3), which receives no endowment income and which supports itself solely from annual membership dues, patrons' admissions fees when they enter the museum, and revenues from a gift shop which sells art-related books, reprints, and souvenirs. This museum is supported solely from membership dues, receipts from admissions, and sales of art-related merchandise, and therefore qualifies as a public charity under section 509(a)(2).

In contrast, assume that a nonprofit museum endowed by a wealthy donor receives more than one-third of its support from the passive investment income generated by this endowment.<sup>29</sup> This museum is a private foundation since it is neither one of the traditionally favored forms of charity specified in section 509(a)(1) nor does it meet the mathematical tests for public support under section 509(a)(2). Consequently, as a private foundation rather than a public charity, this museum must comply with the tighter regulation that private foundation classification entails.<sup>30</sup>

The third form of public charity under section 509(a)(3) is an organization which supports either a section 509(a)(1) public charity (one of the previously favored section 501(c)(3) groups such as a school, church, or hospital) or which supports a section 509(a)(2) public charity (such as our hypothetical museum which receives all its income from membership fees, admissions receipts, and art-related sales).<sup>31</sup> In effect, a section 509(a)(3) support organization piggybacks off the public charity status of the tax-exempt entity the section 509(a)(2) organization supports.

Finally, section 501(c)(3) entities "organized and operated exclusively for testing for public safety" are public charities.<sup>32</sup>

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"investment income" and "unrelated business taxable income." I.R.C. § 509(a)(2)(B).

29. A well-known example would be the J. Paul Getty Museum, operated by the J. Paul Getty Trust, a private foundation. *See* Form 990-PF (Return of Private Foundation) for fiscal year ending 6/30/10 of the J. Paul Getty Trust <http://www.getty.edu/about/governance/pdfs/990pf-2010.pdf>.

30. I.R.C. §§ 4940–46.

31. I.R.C. § 509(a)(3).

32. I.R.C. § 509(a)(4). Organizations undertaking public safety testing have a unique status since they are tax-exempt under section 501(c)(3) but contributions to such organizations are not income tax deductible under section 170(c). *Compare* I.R.C. § 501(c)(3) ("testing for public safety" is a tax-exempt function) *with* I.R.C. § 170(c)(2)(B) (not listing such testing as a charitable activity). In its interpretation of the term "testing for public safety," the IRS has distinguished testing which "principally serves the private interest of the manufacturers" from safety testing of "consumer products used by the general public." Rev. Rul. 78-426, 1978-2 C.B. 175.

Any section 501(c)(3) organization which fails all four statutory tests for public charity status is, by default, classified as a private foundation.<sup>33</sup> Such classification causes the private foundation to be subject to the network of regulatory excise taxes added to the Code by the 1969 Act.<sup>34</sup>

Instructive in this context is the legislative history of the Tax Reform Act of 1969. This legislative history enumerates the concern which animated the distinction between public charities and private foundations and the tighter regulation applying to the latter, namely, the susceptibility of private foundations to abuse by the persons controlling them: “it is clear that vigorous and extensive administration is needed in order to provide appropriate assurances that private foundations will promptly and properly use their funds for charitable purposes.”<sup>35</sup>

Among the abuses requiring tighter regulation of private foundations were the “use of a private foundation to improperly benefit those who control the foundation”<sup>36</sup> as well as the “unreasonable” accumulation of wealth inside private foundations.<sup>37</sup> A particular concern was “[t]he use of foundations to maintain control of businesses, particularly small family corporations.”<sup>38</sup> “Those who wish to use a foundation’s stock holdings to retain business control in some cases are relatively unconcerned about producing income to be used by the foundation for charitable purposes.”<sup>39</sup>

To combat the abuse of private foundations and their resources, the Tax Reform Act of 1969 added to the Code the network of regulatory taxes applying to such foundations.<sup>40</sup> Among these are a penalty tax levied on private foundations which fail to distribute for charitable purposes an annual amount equal to at least five percent of the fair market value of their assets<sup>41</sup> and a penalty tax on “self-dealing” transactions between private foundations and the insiders who control them.<sup>42</sup>

The 1969 Act, even as it liberalized the limits of the income tax charitable deduction, reinforced the bifurcated nature of those limits: the deduction for individuals’ donations to nonqualifying private foundations is capped at a lower percentage of the donor’s contribution base (30 percent)

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33. I.R.C. § 509(a).

34. I.R.C. §§ 4940–46.

35. H.R. Rep. No. 91–413, pt. 1, at 19 (1969).

36. *Id.* at 20.

37. *Id.* at 25.

38. *Id.* at 27.

39. *Id.* Among other abuses motivating the reforms of the 1969 Act were private foundations’ “use [of] their money for ‘educational’ grants to enable people to take vacations abroad, to have paid interludes between jobs, and to subsidize the preparation of materials furthering specific political viewpoints.” *Id.* at 33.

40. I.R.C. §§ 4940–46.

41. I.R.C. § 4942.

42. I.R.C. § 4941.

than is the deduction for donations to public charities and to certain private foundations.<sup>43</sup>

A higher 50 percent deduction limit applies to gifts to public charities<sup>44</sup> as well as to donations to private foundations deemed less prone to dynastic accumulations. Specifically, contributions to a private foundation qualify for the 50 percent income tax deduction limit if the foundation satisfies one of three statutory tests. The first of these tests is that the foundation be a “private operating foundation” engaged in the “active conduct” of charitable functions.<sup>45</sup> For example, an endowed museum might be a private operating foundation if it meets the necessary statutory requirements indicating that it conducts active operations.<sup>46</sup> The second type of private foundation qualifying for the 50 percent deduction limit is a pass-thru foundation which distributes, rather than accumulates, all contributions made to it.<sup>47</sup> Third, donations to a private foundation are subject to the 50 percent income tax deduction limit if the donee foundation would have qualified as a section 509(a)(3) support organization but for the ability of substantial contributors to designate the particular recipients of the foundation’s support.<sup>48</sup>

Individuals’ income tax deductions for contributions to all other private foundations are limited to 30 percent of the donor’s contribution base.<sup>49</sup> If, for example, an endowed museum, which is a private foundation,

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43. Compare I.R.C. § 170(b)(1)(A) with I.R.C. § 170(b)(1)(B). This bifurcation is bolstered by special limits added to the Code for individuals’ in-kind charitable contributions of “capital gain property” such as appreciated stocks and bonds. If, instead of contributing cash, an individual taxpayer donates capital gain property to a public charity or to a qualifying private foundation, the applicable deduction limit is 30 percent of the donor’s contribution base. However, if an individual taxpayer instead transfers capital gain property to a nonqualifying private foundation, that is, a private foundation which is not an operating, pass-thru, or supporting foundation, the deduction is limited to 20 percent of the donor’s contribution base. I.R.C. §§ 170(b)(1)(C)(i), 170(b)(1)(C)(iv), 170(b)(1)(D)(i).

44. While public testing organizations are tax-exempt under section 501(c)(3), donations to such testing organizations do not qualify as charitable under section 170(c). See *supra* note 32.

45. I.R.C. §§ 170(b)(1)(A)(vii), 170(b)(1)(F)(i).

46. Reg. § 53.4942(b)-1(d), Ex. 1.

47. I.R.C. §§ 170(b)(1)(A)(vii), 170(b)(1)(F)(ii).

48. I.R.C. §§ 170(b)(1)(A)(vii), 170(b)(1)(F)(iii).

49. I.R.C. § 170(b)(1)(B). The Tax Reform Act of 1969 left intact the 20 percent deduction cap for donor’s contributions to private foundations. The Deficit Reduction Act of 1984 subsequently increased the deduction limit for cash contributions to private foundations to 30 percent of the donor’s contribution base while retaining the 20 percent deduction limit for in-kind contributions of property. See Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 301(a), (c), 98 Stat. 494, 777-79.

fails to qualify as an operating foundation, as a pass-thru foundation, or as a support foundation, an individual donor to that museum may, for income tax purposes, deduct contributions to such museum only up to 30 percent of the donor's contribution base for the year.<sup>50</sup>

Three themes emerge from the evolution of the limitations of the federal income tax charitable deduction: liberalization, bifurcation, and stability. Since the Tax Reform Act of 1969, individual donors have been able to deduct up to 50 percent of their respective contribution bases for donations to public charities and to qualifying private foundations. This 50 percent deduction limit is over three times the original 15 percent deduction limit established by the Revenue Act of 1917. Even the lower limit which today caps deductions for gifts to nonqualifying private foundations—30 percent of the donor's contribution base—was the pre-1969 limit for contributions to favored charities as they were then defined. Thus, the direction of the tax law has been the liberalization of the limits on the income tax charitable deduction.

However, the existence of charitable deduction limits has never been seriously contested. Thus, the liberalization of the restrictions on the income tax charitable deduction has been constrained by the assumptions that such restrictions will continue to exist and that all charitable donors will pay some income tax, even if they donate all of their incomes to charity.<sup>51</sup>

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50. Any contribution above that limitation would carryover for possible deductibility in subsequent years. The deduction carryover for contributions to private foundations was added to the Code by section 301(b) of The Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494, 778.

51. Instructive in this context is an "unlimited" charitable deduction, available under rarefied circumstances between 1939 and 1969. Section 120 of the Internal Revenue Code of 1939, I.R.C. § 120 (1939), permitted an individual taxpayer to deduct for income tax purposes all of her charitable contributions in the current year if, in that current year "and in each of the ten preceding taxable years," federal income, "war-profits" and "excess-profits" taxes plus charitable contributions absorbed more than 90 percent of the taxpayer's taxable income determined without a charitable deduction. Slightly modified, this unlimited charitable deduction was continued in the Internal Revenue Code of 1954 but was phased out by the Tax Reform Act of 1969. In the Tax Reform Act of 1976, this unlimited charitable deduction was repealed altogether. *See* I.R.C. § 170(b)(1)(C) (1954); Tax Reform Act of 1969, Pub. L. No. 91-172, §201(a), 83 Stat. 487, 549 (phasing out the unlimited charitable deduction); Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (eliminating the unlimited charitable deduction).

At one level, this unlimited charitable deduction was something of a curiosity as it was available only under very esoteric circumstances, namely, an individual taxpayer who, for a decade, spent more than 90 percent of her taxable income on federal income taxes and charity. On the other hand, the policy implemented in the Tax Reform Acts of 1969 and 1976 is instructive: as the limits of the income tax charitable deduction were liberalized for most individual taxpayers,

Moreover, the deduction limits, as they have evolved, are bifurcated, privileging for income tax purposes individuals' transfers to publicly-supported organizations and to qualifying private foundations (*i.e.*, operating, pass-thru and support foundations.) Donations to the former are subject to the higher, 50 percent deduction limit while transfers to all other private foundations are subject to the lower 30 percent deduction limit. These nonqualifying private foundations, while charitable in nature, are less favored under the tax law because they are deemed less public and more prone to abuse than are public charities and qualifying private foundations.

A third theme emerging from the evolution of these rules is stability. While the limitations of the income tax charitable deduction for individual taxpayers have been tweaked since 1969,<sup>52</sup> the basic structure has remained intact since then, restricting the charitable deduction to a percentage of the donor's contribution base even if she donates all of her income to charity.

### III. THE ESTATE TAX CHARITABLE DEDUCTION

In contrast to the federal income tax charitable deduction, the federal estate tax charitable deduction has been unlimited since its inception and remains so today. The Revenue Act of 1916<sup>53</sup> established the modern federal estate tax. The Revenue Act of 1918<sup>54</sup> added a deduction to the estate tax for

[t]he amount of all bequests, legacies, devise, or gifts, to or for the use of the United States, any State, Territory, any political subdivision thereof, or the District of Columbia, for exclusively public purposes, or to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to a trustee or trustees exclusively for such religious, charitable, scientific, literary, or educational purposes.<sup>55</sup>

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the importance of those limits was affirmed by the abolition of the unlimited deduction available to the few taxpayers meeting the stringent tests introduced by the 1939 Code.

52. *See supra* notes 43 and 51.

53. Revenue Act of 1916, ch. 463, §§ 200–12, 39 Stat. 756, 777.

54. Revenue Act of 1918, ch. 18, 40 Stat. 1057.

55. *Id.* at § 403(a)(3), 1098.

Over the years, Congress has expanded the definition of charities for estate tax purposes just as Congress has enlarged the scope of the definition of charitable donees for income tax purposes. Thus, today entities encouraging amateur sports<sup>56</sup> as well as veterans groups<sup>57</sup> qualify as donees for both the income tax and estate tax charitable deductions. Nevertheless, today's unlimited federal estate tax deduction is recognizably the unlimited deduction first promulgated in 1918.

#### IV. WHY HAVE CHARITABLE DEDUCTIONS?

Among the seminal figures in the debate about the charitable deduction was Professor Stanley Surrey who first formulated the theory of tax expenditures, that is, some deductions, credits and other provisions of the tax law are designed, not to measure a taxpayer's ability to pay, but to subsidize, penalize, or reward certain forms of behavior. Tax expenditures, Professor Surrey influentially argued, should be compared with direct spending programs designed to subsidize, penalize, or reward the same behavior.<sup>58</sup> For Professor Surrey and his followers, the income tax charitable deduction is classic tax expenditure, a feature of the Code which does not measure the taxpayer's capacity to pay tax. Rather, the income tax's charitable deduction is "a method of providing federal financial assistance to private philanthropy."<sup>59</sup>

Federal tax expenditure budgets reflect this characterization, classifying the federal income tax charitable contribution deduction as a major tax expenditure.<sup>60</sup> As a tax expenditure, the deduction is projected to entail a revenue loss for fiscal 2014 in excess of \$40 billion.<sup>61</sup>

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56. I.R.C. §§ 170(c)(2)(B), 2055(a)(2).

57. I.R.C. §§ 170(c)(3), 2055(a)(4).

58. Professor Surrey's seminal articulation of the tax expenditure theory was Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705 (1970) [hereinafter Surrey, *Tax Incentives*]. Among his other important writings on tax expenditures were STANLEY S. SURREY, *PATHWAYS TO TAX REFORM* (1973) [hereinafter SURREY, *PATHWAYS*] and STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* (1985) [hereinafter SURREY & MCDANIEL, *TAX EXPENDITURES*].

59. SURREY, *PATHWAYS*, *supra* note 58, at 224.

60. *See, e.g.*, STAFF OF JOINT COMM. ON TAX'N, 113TH CONG., *ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012-2017* 39 (Comm. Print 2013) ("deduction for charitable contributions to educational institutions"); *id.* at 40 ("deduction for charitable contributions, other than for education and health"); *id.* at 41 ("deduction for charitable contributions to health organizations").

61. *Id.*

The charitable deduction is subject to all of Professor Surrey's substantive and procedural<sup>62</sup> criticisms of tax expenditures including his strongest critique, namely, tax expenditures' "upside-down"<sup>63</sup> nature: a charitable "gift of \$100 cash and a consequent deduction of \$100 is worth \$70 to the person in the 70 percent bracket—he saves a \$70 tax and thus allocates \$70 of public funds—and only \$14 to a person in the first bracket."<sup>64</sup>

In contrast, others reject the tax expenditure label as applied to the charitable deduction and conclude that the deduction is an appropriate provision for measuring the taxpayer's ability to pay. For these observers, charitable donations represent sacrifice of personal resources rather than consumption and are thus properly deducted in determining the taxpayer's income tax base.

In this vein, another seminal figure in the debate about the charitable deduction, Professor William D. Andrews, started with the famous Haig-Simons definition of income as the sum of the taxpayers' savings and consumption. From this premise, Professor Andrews argued that consumption for income tax purposes should mean "private consumption" or, even more restrictively, "private, preclusive household consumption."<sup>65</sup> From this vantage, resources transferred by a taxpayer to charity should be deducted to properly measure the taxpayer's net income since those transferred resources benefit the community at large or some significant segment of that community rather than the taxpayer herself.<sup>66</sup> The income tax charitable deduction thus defines the base of the income tax to measure the net income on which the taxpayer should pay tax.

Professor William J. Turner summarized this argument for the income tax charitable deduction as a means of measuring the taxpayer's capacity to pay:

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62. As a procedural matter, Professor Surrey's chief claims were that, in the legislative process, tax expenditures are less visible than are direct outlays and that tax expenditures are formulated and administered by tax institutions rather than by institutions with expertise in the areas the expenditures address. For discussion and criticism of these arguments, see Edward A. Zelinsky, *Do Tax Expenditures Create Framing Effects? Volunteer Firefighters, Property Tax Exemptions, and the Paradox of Tax Expenditure Analysis*, 24 VA. TAX REV. 797 (2005); Edward A. Zelinsky, *James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 YALE L. J. 1165 (1993).

63. Surrey, *Tax Incentives*, *supra* note 58, at 722; SURREY & MCDANIEL, TAX EXPENDITURES, *supra* note 58, at 79.

64. SURREY, PATHWAYS, *supra* note 58, at 225.

65. William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 313, 371 (1972) [hereinafter Andrews, *Personal Deductions*].

66. *Id.* at 344.



Because our income tax is an individual, rather than a societal, tax, only the benefit that each individual derives from public programs should be designated as consumption .... It is therefore necessary to adopt a definition of consumption grounded on the view that an out flow of funds resulting in a diminution of an individual's net worth shall not be deemed consumption if the outflow provides a substantial benefit to the general public and an insignificant private benefit to the party making the expenditure.<sup>67</sup>

This vantage buttresses the bifurcated nature of the individual income tax limits on charitable contributions since donations to public charities are more public in nature than are contributions to private foundations, which often entail significant private, consumption-like benefit for the donor and his family.

Professor Boris Bittker was also a tax expenditure critic and viewed the charitable deduction as an appropriate, base-defining feature of an income tax, given the judgments inherent in designing tax and budget policies:<sup>68</sup> “[t]he assertion that a deduction for charitable contributions is inconsistent or incompatible with a proper measure of taxable income is devoid of merit.”<sup>69</sup>

Professor Bittker favored an unlimited charitable deduction, contending that the income tax limits of section 170 only make sense “as a compromise between those who believe in a [charitable] deduction and those who would repeal it.”<sup>70</sup> Since Professor Bittker strongly believed in the deduction, he went so far as to label such compromise “preposterous.”<sup>71</sup> As I will discuss below, the compromise which Professor Bittker viewed negatively is now a long-standing feature of the federal income tax. It makes sense to extend that compromise, in the form of deduction limits, to the estate tax charitable deduction to ensure that all large estates pay some estate tax—or to at least get closer to that ideal.

As the debate over the income tax charitable deduction has progressed, commentators have both elaborated these initial themes and introduced new ones. Professor Mark P. Gergen, for example, is highly critical of Professor Andrews' defense of the income tax charitable

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67. William J. Turner, *Evaluating Personal Deductions in an Income Tax — The Ideal*, 66 CORNELL L. REV. 262, 274 (1981).

68. Boris I. Bittker, *Charitable Contributions: Tax Deductions or Matching Grants?*, 28 TAX L. REV. 37 (1972) [hereinafter Bittker, *Matching Grants*].

69. *Id.* at 56.

70. *Id.* at 62.

71. *Id.*

deduction<sup>72</sup> as a base-defining measure and is equally critical that the deduction is granted for donations to “sports museums, jazz festivals, and singing groups.”<sup>73</sup> However, Professor Gergen views the income tax charitable deduction more favorably in other contexts as an antidote to freeriding problems and the consequent underfunding of desirable public goods.<sup>74</sup> Moreover, the “upside-down” effect benefitting higher bracket donors is offset when the charity that such high bracket donors fund serves the disadvantaged.<sup>75</sup> This leads Professor Gergen to favor the income tax charitable deduction for donations to “social welfare charities, such as the Salvation Army.”<sup>76</sup>

Professor John D. Colombo similarly views the charitable deduction, along with tax exemption, as a means of channeling assistance to organizations which suffer from underfunding because of freeriding.<sup>77</sup>

Professor Ray D. Madoff<sup>78</sup> is perturbed that the subsidy embedded in the income tax charitable deduction “is only available to the charitable donations of the very wealthy . . . those who itemize their deductions.”<sup>79</sup> Moreover, she finds this subsidy for the charitable donations of the affluent

particularly troubling due to the fact that wealthy Americans tend to make very different types of bequests than their countrymen. While most Americans direct their charitable dollars to religious organizations, approximately three quarters of all bequests reported on estate tax returns go either to private foundations or educational institutions.<sup>80</sup>

Private foundations, Professor Madoff argues, expend inordinate amounts of their tax-subsidized resources compensating the trustees and professional investment managers who manage such foundations and such foundations’ endowments.<sup>81</sup>

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72. Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1414–26 (1988).

73. *Id.* at 1450.

74. *Id.* at 1398, 1448.

75. *Id.* at 1405.

76. *Id.* at 1447.

77. John D. Colombo, *The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657 (2001).

78. Ray D. Madoff, *What Leona Helmsley Can Teach Us About the Charitable Deduction*, 85 CHI.-KENT L. REV. 957 (2010).

79. *Id.* at 965.

80. *Id.* at 966.

81. *Id.* at 973.

In a similar vein, Professor Ilan Benshalom<sup>82</sup> criticizes the charitable deduction as it

“promotes a nondemocratic decision-making process for allocating public money. Rather than deciding the allocation of public funds through majoritarian decision-making processes, charitable relief allows individuals to decide how to allocate a share of public resources at the expense of the majority.”<sup>83</sup>

In contrast to the critique of the charitable deduction as antidemocratic, Dean Saul Levmore views the charitable deduction as a form of “direct democracy.”<sup>84</sup> Each donor’s contribution to a particular charity is his “ballot” by which he channels publicly-funded tax subsidy to the charity of his choice. In light of the imperfections of conventional electoral and legislative decisionmaking, “the charitable deduction may be a relatively clever tool”<sup>85</sup> for “gathering information about majoritarian or other preferences.”<sup>86</sup>

Moreover, Dean Levmore suggests that the charitable deduction may have other benefits in maintaining a vibrant charitable sector. For example, the charitable deduction

induce[s] citizens not only to choose for themselves where to apply personal and government funds, but also to develop a sense of commitment to the chosen charities. Thus, they become involved individually as volunteers in ways that they would not if their tax money were simply allocated to the charities by the legislature or by government bureaucrats.<sup>87</sup>

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82. Ilan Benshalom, *The Dual Subsidy Theory of Charitable Deductions*, 84 IND. L.J. 1047 (2009).

83. *Id.* at 1050.

84. Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. REV. 387, 426 (1998).

85. *Id.* at 409. See also *id.* at 413 (“one advantage of balloting through charitable donations (as precursors to later deductions) is a reduction in the collective choice problem associated with appropriating funds through either a conventional popular ballot or a checkoff device. This form of balloting through the tax system is likely to be a superior collective choice procedure.”).

86. *Id.* at 409.

87. *Id.* at 406.

Professor Eric Zolt has recently summarized this debate.<sup>88</sup> The arguments initially advanced by Andrews, Bittker, and Turnier “were donor-focused, positing that income transferred for charitable purposes was not personal consumption and, as it was no longer in the control of the donor, should be excluded from tax.”<sup>89</sup> Subsequent advocates of the income tax charitable deduction went beyond the defense of the deduction as a base-defining-measure, calculating the taxpayer’s capacity to pay. Rather, these advocates asserted that the deduction “helps correct market or political failures” and thereby increases public goods “that are otherwise underprovided because of free-rider and other challenges.”<sup>90</sup> Yet other proponents laud the charitable deduction because it “helps decentralize the spending process.”<sup>91</sup>

[s]upporters note both the diversity and the higher quality of charitable goods and services that come from programs funded by individuals who devote money, and often time and expertise, in selecting, managing, and monitoring activities that often benefit society at large, rather than those programs selected by some Washington bureaucrat and managed and monitored by government employees.<sup>92</sup>

On the other hand, Professor Zolt notes that the income tax charitable deduction has its costs, including “foregone revenue”<sup>93</sup> and, as Professor Surrey first observed, the deduction’s “upside-down” effect. To Professor Surrey and those who have followed his lead, charitable donations represent consumption which properly remains part of the income tax base rather than sacrifice of personal resources properly giving rise to a deduction. In political terms, the compromises embedded in the limits on the income tax charitable deduction reflect a stable stalemate between, on the one hand, the charities benefitting from the deduction and, on the other, the federal Treasury as the gatekeeper protecting public revenues. The charitable sector is a well-organized and well-financed lobbying force in Washington.<sup>94</sup> In

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88. Eric Zolt, *Tax Deductions for Charitable Contributions: Domestic Activities, Foreign Activities, or None of the Above*, 63 HASTINGS L.J. 361 (2012).

89. *Id.* at 364.

90. *Id.*

91. *Id.*

92. *Id.* at 365.

93. *Id.*

94. See, e.g., *Policy & Advocacy*, INDEP. SECTOR, last accessed Sept. 25, 2014, [https://www.independentsector.org/policy\\_advocacy](https://www.independentsector.org/policy_advocacy) (“We serve as a voice and source of information on the most pressing legislative, regulatory, and economic issues facing the nonprofit sector.”); MOLLY CORBETT BROAD, AM. COUNCIL ON

tension with it, the Treasury keeps score of tax expenditures,<sup>95</sup> an influential task in a world of budgetary constraint. The charities receiving deductible donations would undoubtedly prefer further liberalization of the deduction limits. The tax expenditure budget annually tells Congress the cost of the current deduction and, by implication, the revenues to be gained by limiting the deduction further, as well as the expense to the Treasury of further liberalizing the deduction's limits. For two generations, these contending forces have, in political terms, offset each other, leaving intact the income tax charitable deduction limits Congress fashioned in 1969.

## V. SHOULD THERE BE A FEDERAL ESTATE TAX?

Just as the federal income tax charitable deduction has triggered exhaustive debate, the federal estate tax has been the subject of extensive discussion. Among the arguments advanced by estate tax proponents are that the tax raises revenues for the federal fisc, that the estate tax contributes to the overall progressivity of federal taxation, that the estate tax backstops the federal income tax, and that the estate tax disperses inherited concentrations of wealth. Some opponents of the estate tax support these goals but argue that the estate tax does not effectively implement them. Other opponents of the estate tax challenge these goals while denouncing the estate tax as immoral and inefficient. Because this debate has focused on whether there should be an estate tax, little attention has been given to the implications of the estate tax's unlimited charitable deduction.

Prominent among estate tax proponents is Bill Gates, Sr. Attorney Gates is a leader of Responsible Wealth, a pro-estate-tax lobbying effort supported by affluent individuals including Warren Buffett, George Soros, Robert Rubin, John Bogle, Dr. Abigail Disney, Dr. Richard Rockefeller, Robert Crandall, and Norman Lear.<sup>96</sup> Attorney Gates' support of the estate tax derives from the premise "that society has a just claim on the accumulated wealth of its most prosperous citizens."<sup>97</sup> This claim stems from "the undervalued role of society's investment in each of us. This investment is substantial and often invisible."<sup>98</sup>

Starting from this premise, Attorney Gates identifies several virtues of the federal estate tax. Chief among these is that the estate tax is "a

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EDUC., COMMENTS TO THE HOUSE WAYS AND MEANS COMMITTEE TAX REFORM WORKING GROUP ON CHARITABLE/EXEMPT ORGANIZATIONS (2013).

95. See *supra* note 60.

96. Signers of Responsible Wealth Statement in Support of Estate Tax, *supra* note 3.

97. WILLIAM H. GATES SR. & CHECK COLLINS, WEALTH AND OUR COMMONWEALTH: WHY AMERICA SHOULD TAX ACCUMULATED FORTUNES 110 (2002) [hereinafter GATES SR. & COLLINS, WEALTH AND OUR COMMONWEALTH].

98. *Id.*

dependable and highly progressive source of revenue”<sup>99</sup> and that the tax furthers economic and political equality and opportunity by diminishing inherited concentrations of wealth.<sup>100</sup> “[t]he estate tax both limits the power of concentrated wealth and generates revenue to pay for government from those most able to pay.”<sup>101</sup>

Attorney Gates also argues that the estate tax is “a considerable incentive to charitable giving.”<sup>102</sup> As I will discuss, there is tension between, on the one hand, the arguments that the estate tax raises revenue and deconcentrates wealth and, on the other, the unlimited nature of the estate tax charitable deduction. The deduction both costs the federal fisc revenue and, at least as to gifts to private foundations, may perpetuate dynastic fortunes.

Attorney Gates makes clear his agreement with estate tax opponents that, before President George W. Bush’s estate tax reforms, the tax applied too broadly. In 2001, the tax was levied on taxable estates over \$675,000.<sup>103</sup> In contrast, Attorney Gates states that an exemption of \$3,500,000 per decedent is “fair” and “targets the tax on those most able to pay.”<sup>104</sup> He also identifies a household net worth of \$15,000,000 as the threshold at which further accumulations go “beyond the point of meeting [the household’s] needs and aspirations of itself and its heirs.”<sup>105</sup> It thus appears that the current federal estate tax, which exempts for each decedent \$5,000,000 of wealth adjusted for inflation,<sup>106</sup> falls within or close to the parameters of a Gates-acceptable estate tax.

Former Federal Reserve Chairman Paul A. Volcker allies himself with Attorney Gates’ arguments for a federal estate tax “on truly huge fortunes.”<sup>107</sup>

[T]he concept of equality of opportunity and dispersion of wealth and economic power has been a part of the American psyche. The inheritance of huge fortunes, far beyond any

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99. *Id.* at 9.

100. *Id.* at 13–25.

101. *Id.* at 8.

102. *Id.* at 132.

103. See I.R.C. section 2010(c) as in effect for 2001 as result of amendment by section 501(a)(1)(B) of the Taxpayer Relief Act of 1997, Pub. L. No. 105–34, 111 Stat. 788, 845 (“applicable exclusion amount” for 2001 was \$675,000).

104. GATES SR. & COLLINS, *WEALTH AND OUR COMMONWEALTH*, *supra* note 97, at 138.

105. *Id.* at 17.

106. I.R.C. § 2010(c)(3) (defining “basic exclusion amount” as \$5,000,000 adjusted for inflation).

107. Paul A. Volcker, *Foreword to WILLIAM H. GATES SR. & CHECK COLLINS, WEALTH AND OUR COMMONWEALTH: WHY AMERICA SHOULD TAX ACCUMULATED FORTUNES*, at xiii (2002).

reasonable need for education, for medical care, and for a comfortable—even luxurious—standard of living has never rested easily with that political philosophy.<sup>108</sup>

Professor Joel Dobris is skeptical of the estate tax as a revenue raiser or as a means of effectively deconcentrating wealth.<sup>109</sup> He instead favors the tax as a desirable exercise in “political theater and culture.”<sup>110</sup>

[T]he crucial purpose of the tax is to assert the hegemony of the common people and the egalitarian nature of our society; to undermine oligarchy. To put it crudely, I think the purpose of the tax is to take a little bite out of rich people’s butts, to remind them of the essential nature of this country.<sup>111</sup>

For Professor Dobris, “it is vital to draw a very bright line between the prosperous upper middle class and the really rich.”<sup>112</sup> He favors an estate tax exemption of \$10,000,000 per decedent but “would settle for” a \$5,000,000 exemption<sup>113</sup>—which, with inflation adjustment, is what Congress has now legislated.<sup>114</sup>

Professor Reginald Mombrun favors the estate tax “to prevent uncontrolled wealth accumulation.”<sup>115</sup> While he favors the estate tax’s role as a revenue raiser, as a repayment for the public services which help to create wealth, and as a backstop to the income tax, Professor Mombrun’s principal defense of the tax is that it “promotes equality of economic opportunities by lessening concentrations of wealth.”<sup>116</sup>

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108. *Id.* at xii.

109. Joel C. Dobris, *Federal Transfer Taxes: The Possibility of Repeal and the Post Repeal World*, 48 CLEV. ST. L. REV. 709, 725 (2000) [hereinafter Dobris, *Possibility of Repeal*].

110. *Id.*

111. *Id.* at 711.

112. *Id.* at 725.

113. *Id.*

114. I.R.C. § 2010(c)(3) (defining “basic exclusion amount” as \$5,000,000 adjusted for inflation).

115. Reginald Mombrun, *Let’s Protect Our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax*, 33 OHIO N.U. L. REV. 61, 63 (2007).

116. *Id.* at 98.

In a similar vein, Professor Anne Alstott focuses upon “the significant political, economic and social power that possession of wealth confers.”<sup>117</sup>

[P]rivate wealth remains a source of current social, economic, and political power that goes beyond the potential use of wealth for consumption. In addition to the social and political influence that wealth creates, the possession of wealth confers significant economic security; one need not consume wealth to bask in its benefits.<sup>118</sup>

The federal estate tax, Professor Alstott argues, reduces inequality by “modestly curbing inheritance.”<sup>119</sup>

Professor Michael J. Graetz is skeptical of the federal estate tax as either a revenue raiser<sup>120</sup> or as a device for eliminating great concentrations of inherited wealth.<sup>121</sup> However, he supports the tax as “providing an important element of progressivity in the federal tax system.”<sup>122</sup>

Professor Edward J. McCaffery is an opponent of estate taxation who sympathizes with the underlying goals of the estate tax but who argues that the tax fails to implement those goals effectively:<sup>123</sup> “[t]he gift and estate tax has long since ceased to be a major part of any compelling policy objective – such as, to name four, raising revenue, instilling progressivity into the tax system, ‘backing up’ the income tax, or breaking up large concentrations of wealth.”<sup>124</sup>

Though these objectives “are more pressing than ever,”<sup>125</sup> the estate tax as adapted by Congress and approved by President Obama in 2012 “is now largely irrelevant” to these goals.<sup>126</sup> It is accordingly time to abandon federal estate taxation and instead concentrate reformist energies on more

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117. Professor Anne L. Alstott, *The Uneasy Liberal Case Against Income and Wealth Transfer Taxation: A Response to Professor McCaffery*, 51 TAX L. REV. 363, 366 (1996).

118. *Id.* at 371.

119. *Id.* at 375.

120. Michael J. Graetz, *To Praise the Estate Tax, Not To Bury It*, 93 YALE L. J. 259, 269 (1983).

121. *Id.* at 271.

122. *Id.* at 270–73.

123. Edward J. McCaffery, *Distracted from Distraction by Distraction: Reimagining Estate Tax Reform*, 40 PEPP. L. REV. 1235 (2013).

124. *Id.* at 1236.

125. *Id.*

126. *Id.*



productive possibilities like “a carryover basis or a realization-on-death regime.”<sup>127</sup>

While Professor Lily Batchelder is not as critical of the estate tax,<sup>128</sup> she nevertheless concludes that it would be better to replace the federal estate tax with “a comprehensive inheritance tax with a basic lifetime exemption and a small annual exemption as well.”<sup>129</sup> An inheritance tax would “more fairly allocate economic burdens among heirs”<sup>130</sup> than does the estate tax while simultaneously improving “the incentives faced by donors and heirs”<sup>131</sup> and reducing “the level of tax complexity to some degree.”<sup>132</sup> Moreover, Professor Batchelder argues, an inheritance tax would be more transparent than is the estate tax.<sup>133</sup> She would couple an inheritance tax with carryover basis for inherited assets.<sup>134</sup>

In contrast to those who criticize the estate tax while agreeing with the objectives underlying such a tax, others oppose the estate tax because inherited wealth should not be taxed. As Professors Graetz and Shapiro observe,

those fighting to repeal the death tax are tapping into a few tenets widely felt by the American public: distaste for imposing a tax when the family’s breadwinner dies; desire to mark one’s success in life by building up wealth—a legacy—and passing it on to children or grandchildren; admiration of entrepreneurship, small businesses, and family farms; and the inherent unfairness of “double taxation.”<sup>135</sup>

Curtis S. Dubay of the Heritage Foundation advances this critique, arguing that the federal estate tax “slows economic growth, destroys jobs, and suppresses wages because it is a tax on capital and on entrepreneurship.”<sup>136</sup> Like other opponents of the estate tax, Mr. Dubay emphasizes the harm the tax inflicts on family-owned businesses, contending that the tax “reduces the ability of family-owned businesses to expand, hire

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127. *Id.* at 1237.

128. Lily L. Batchelder, *What Should Society Expect from Heirs? The Case for a Comprehensive Inheritance Tax*, 63 TAX L. REV. 1, 68 (2009).

129. *Id.* at 60.

130. *Id.* at 67.

131. *Id.*

132. *Id.*

133. *Id.*

134. *Id.* at 88.

135. MICHAEL J. GRAETZ & IAN SHAPIRO, DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH 83 (2005).

136. Curtis S. Dubay, *The Economic Case Against the Death Tax*, 2440 HERITAGE FOUND. BACKGROUNDER 1, 2 (2010).

new workers, and pay higher wages.”<sup>137</sup> This economic harm, he asserts, cannot be justified by the revenue the estate tax raises, “just above 1 percent of total federal tax collections.”<sup>138</sup> Moreover, Mr. Dubay contends, the tax is not “necessary to prevent the accumulation of wealth in a limited few families.”<sup>139</sup>

In this vein, the Family Business Estate Tax Coalition (FBETC) favors “full, permanent repeal of the estate tax” because of the tax’s impact on family-owned businesses.<sup>140</sup> Chief among FBETC’s concerns is the illiquid nature of family businesses “which can force the new owner to sell the business’s assets to pay the tax.”<sup>141</sup> Moreover, FBETC objects to the costs of the planning necessitated by the tax: “Planning costs associated with the estate tax are a drain on business resources, taking money away from day to day operations and business investment. These additional costs make it more difficult for the business owner to expand and create new jobs.”<sup>142</sup>

For the libertarian commentator Laurence M. Vance, economic concerns are secondary to the ethical objections to estate taxation:

To the libertarian, the arguments against the estate tax all come down to liberty and property. It doesn’t matter if “the rich” and his heirs can “afford it.” The right of the deceased to dispose of his accumulated wealth – whether it is earned or “unearned” – is a natural and inviolable right. He may in fact wish to leave his entire fortune to the government to be redistributed as bureaucrats see fit. But that must be his decision, not the state’s. Every American should have the liberty to dispose of his property – in life or in death – as he sees fit.<sup>143</sup>

In political terms, the debate has, until now, focused on whether there should be a federal estate tax. Thus, little attention has been devoted to the unlimited nature of the estate tax charitable deduction. However, the commendable success of the Giving Pledge now gives the deduction salience as the Pledge constitutes a systematic (albeit inadvertent) threat to the federal estate tax base. As I suggest in the next section, the Giving Pledge requires

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137. *Id.* at 3.

138. *Id.* at 5.

139. *Id.*

140. FAMILY BUS. ESTATE TAX COAL., <http://www.estatetaxrelief.org> (last accessed Sept. 26, 2014).

141. *Id.* at *About Us*.

142. *Id.*

143. Laurence M. Vance, *A Libertarian View of the Estate Tax*, THE FUTURE OF FREEDOM FOUND., (Dec. 6, 2010), <http://fff.org/explore-freedom/article/libertarian-view-estate-tax>.

limits on the estate tax charitable deduction to ensure that all large estates pay some estate tax.

## VI. THE ARGUMENT FOR LIMITING THE ESTATE TAX CHARITABLE DEDUCTION

Against this background, I conclude that, in light of the laudable success of the Giving Pledge, the federal estate tax should be amended to restrict an estate's charitable deduction to a percentage of the estate, just as the income tax charitable deduction is limited to a percentage of the taxpayer's income. The limits on the income tax charitable deduction represent a sensible compromise among contending policies, a compromise which should be incorporated into the federal estate tax to ensure that every large estate pays some estate tax—even if such an estate is totally left to charity.

A limit to the estate tax charitable deduction could take any of several forms. The ideal form would be the insertion into the federal estate tax of the bifurcated limits the Code today imposes on the income tax deductibility of charitable contributions. Alternatively, less robust restrictions could be fashioned for the estate tax such as a charitable deduction limit only applicable to bequests to private foundations or to certain private foundations. However, less hardy restrictions along these lines would still permit large estates to avoid federal estate taxation if such estates are devoted solely to public charities.

It is sensible to encourage charitable bequests to maintain a vibrant charitable sector and to recognize for tax purposes that charitable bequests, in important respects, sacrifice personal resources by devoting them to public purposes. On the other hand, the selection of charitable donees is a consumption-like power. Charitable bequests, particularly to family-controlled private foundations, can have a dynastic quality. Much, if not most, of the wealth of the Giving Pledgers (and other rich decedents) represents either unrealized appreciation never taxed under the Code or capital gain taxed at more favorable income tax rates than ordinary income. Death is the final opportunity for the federal fisc to obtain compensation from the deceased for the social overhead which helped to create his fortune. Permitting, but limiting, the estate tax charitable deduction would be a sensible compromise of these contending policies, as it is a sensible compromise in the context of the income tax to ensure that everyone pays some tax, even if they donate all of their income to charity.

For the foreseeable future, the basic features of the federal estate tax will remain as they are today. There is currently little chance that the federal estate tax will be abolished or that it will be applied more broadly to smaller estates. As a result of the compromise reached by President Obama and Congress in 2012, the Code now embodies the Gates-Volcker-Dobris vision

of an estate tax which exempts from death taxation what are sometimes called the “mass affluent.”<sup>144</sup> The federal tax today reaches only the estates of individuals leaving over \$5,000,000 adjusted for inflation.<sup>145</sup>

While Presidents Reagan and Bush sought to abolish the estate tax, paradoxically, the reforms they achieved saved the federal estate tax by alleviating the strongest political pressures to abolish the tax. As a result of the unlimited marital deduction signed into law by President Reagan,<sup>146</sup> no estate tax is due when the first spouse dies. The increases in the unified credit initiated during the Bush Administration culminated in the exclusion from taxation of estates under \$5,000,000 adjusted for inflation.<sup>147</sup> Thus, a total of \$10,000,000 (inflation adjusted) can be left tax-free by a surviving spouse on his or her demise.<sup>148</sup> With the tax today falling exclusively on the largest estates when the surviving spouse dies, much of the political pressure to abolish the tax has been abated.

In part because the estate tax is now focused exclusively on the largest estates, the revenue yield of the federal estate tax is modest compared to the enormous amounts generated by fiscal behemoths like the federal income and payroll taxes. The roughly \$7 billion produced annually by the federal estate tax constitute a mere 0.3 percent of total federal tax revenues.<sup>149</sup> On the other hand, the fortunes of the Giving Pledgers and their fellow billionaires are immense. Even without the obligatory reference to Everett Dirksen,<sup>150</sup> the federal estate tax raises funds in amounts which are

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144. Erik J. Greupner, Comment, *Hedge Funds Are Headed Down-market: A Call for Increased Regulation?*, 40 SAN DIEGO L. REV. 1555, 1573 (accepting the definition of the “mass affluent” as “those with a net worth between \$1 million and \$5 million”); Jacqueline Doherty, *B of A’s Biggest Bet Ever: Big Risks, and Rewards*, BARRON’S, Sept. 22, 2008, at 27 (defining “mass affluent” as those “with assets of \$100,000 to \$3 million”).

145. For 2014, the estate tax’s inflation-adjusted “basic exclusion amount” is \$5,340,000. Rev. Proc. 2013–35, 2013–47 I.R.B. 537, § 3.32.

146. Section 403(a)(1)(A) of the Economic Recovery Tax Act of 1981, Pub.L. No. 97–34, 95 Stat. 172 amended section 2056 of the Code to eliminate the ceiling on the federal estate tax marital deduction.

147. Section 2010(c) provides the basic exclusion amount of \$5,000,000 increased by post-2011 inflation. I.R.C. § 2010(c).

148. Section 2010(c)(4) facilitates estate planning by today permitting what is commonly called “portability,” that is, the transfer of the first spouse’s basic exclusion amount to the estate of the second spouse to die. I.R.C. § 2010(c)(4). This permits the second spouse to leave a total of \$10,000,000 adjusted for inflation on his subsequent death.

149. Jonathan Schwabish & Courtney Griffith, *The U.S. Federal Budget, A Closer Look at Revenues*, CONG. BUDGET OFFICE, Apr. 17, 2012, <http://www.cbo.gov/publication/43153>.

150. For a thoughtful discussion of whether Senator Dirksen actually made his “billion here, billion there” comment, see “*A Billion Here, A Billion There . . .*,”

significant to most of us, though the tax is now focused only on the very wealthy.

If the Giving Pledgers make good on their pledges (as I hope they do), significant revenue will be lost to the federal fisc as a result of the unlimited estate tax charitable deduction. Most Giving Pledgers will pay neither income tax on the unrealized appreciation they accrued while alive nor estate tax on that wealth when they bequeath it to charity. The Giving Pledge constitutes a systematic, albeit inadvertent, threat to the federal estate tax base.

This brings us back to the question whether charitable donations, by Giving Pledgers or by other wealthy donors, represent consumption or sacrifice. The limits of the income tax charitable deduction have proved durable as a compromise reflecting the fact that charitable contributions have elements of both consumption and sacrifice. As a compromise, those limits provide tax incentives for giving while ensuring that an individual who donates her entire income to charity will pay some federal tax.

On the one hand, a donor to charity exercises consumption-style choice when she designates a charitable donee. She may receive significant benefits from her donation including public recognition and the implementation of her personal priorities by the charity receiving her funds. Celebrity-style charity includes much self-promotion.<sup>151</sup>

The argument that charity is consumption is strongest in cases of donations to family-run private foundations. The family members who serve as trustees and officers of such a foundation can receive reasonable compensation for their work on the foundation's affairs with the foundation counting such compensation as part of its charitable outlays for purposes of the Code's five percent minimum distribution rule.<sup>152</sup> In addition, as Professor Miranda Perry Fleischer has observed, control of a private foundation entails economic and political power in terms of determining who will receive the foundation's largesse<sup>153</sup> and where the foundation's endowment will be invested.<sup>154</sup> Moreover, she notes, "control of a charity

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THE DIRKSEN CONG. CTR., last updated Sept. 25, 2012, [http://www.dirksencenter.org/print\\_emd\\_billionhere.htm](http://www.dirksencenter.org/print_emd_billionhere.htm).

151. See, e.g., Max Chafkin, *Sightseers On a Mission*, N.Y. TIMES MAG., Aug. 11, 2013, at MM18; MATTHEW BISHOP & MICHAEL GREEN, PHILANTHROCAPITALISM: HOW GIVING CAN SAVE THE WORLD 9 (2008) ("At least since the Live Aid concert in 1985, celebrities and philanthropy have become ever more entwined. Now, movie and rock star 'celanthropists' are serious partners with the superrich.")

152. I.R.C. § 4942(g)(1)(A) (charitable distributions of private foundations include "reasonable and necessary administrative expenses").

153. Miranda Perry Fleischer, *Charitable Contributions in an Ideal Estate Tax*, 60 TAX L. REV. 263, 286-87 (2007).

154. *Id.* at 287.

can bring with it prominence in a community, and such prominence often brings with it power – much the same way being a business leader often brings with it indirect political power.”<sup>155</sup>

To take one prominent case, Warren Buffett’s children exercise significant political and economic influence by virtue of their father’s contributions<sup>156</sup> to the private foundations they control. Howard Buffett’s charitable efforts come across as sincere and productive.<sup>157</sup> Unlike other well-known instances of high profile charity,<sup>158</sup> Howard Buffett’s charity advances neither his nor his family’s political ambitions and is conducted in an obviously thoughtful way.<sup>159</sup> On the other hand, Mr. Buffett wields substantial economic and political influence as the head of his private foundation. When Howard Buffett travels to Africa for his anti-hunger efforts, he is taken very seriously by government and NGO officials.<sup>160</sup>

One wealthy philanthropist declined to join the Giving Pledge because the Pledge can be satisfied by creating and funding “family-controlled foundations.”<sup>161</sup> Since the Pledge can be fulfilled through such foundations, Robert W. Wilson reportedly told Bill Gates that the Pledge is “practically worthless.”<sup>162</sup> I am not prepared to go this far in light of admirable efforts like Howard Buffett’s. It is, however, hard to deny that some, perhaps many, private foundations serve dynastic and self-promoting agendas.

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155. *Id.* at 290.

156. William Alden, *Buffett Gives \$2 Billion to Gates Foundation*, N.Y. TIMES, July 8, 2013, <http://dealbook.nytimes.com/2013/07/08/buffett-gives-2-billion-to-gates-foundation> (discussing contributions to the Susan and Howard Buffett Foundations).

157. See HOWARD G. BUFFETT, FORTY CHANCES: FINDING HOPE IN A HUNGRY WORLD (2013) [hereinafter BUFFETT, FORTY CHANCES].

158. See, e.g., Andrea Peyser, *It’s Chelsea Clinton’s time*, N.Y. POST, Nov. 4, 2013, <http://nypost.com/2013/11/04/its-chelsea-clinton-time> (discussing the Bill, Hillary & Chelsea Clinton Foundation); Maureen Dowd, *Isn’t It Rich?*, N.Y. TIMES, July 13, 2014, at SR11 (same).

159. Cf. Erin Carlyle, *The Anti-Paris Hilton*, FORBES, Dec. 2, 2013, at 86 (discussing the charity of Liesel Pritzker Simmons).

160. See, e.g., BUFFETT, FORTY CHANCES, *supra* note 157, at 74 (“We made arrangements to meet up with the United Nations World Food Programme (WFP), which was working in the country. A friendly, capable country director named Dom and a driver named Douglas met me at the airport in Lilongwe, Malawi’s main city and capital.”).

161. Eleanor Goldberg, *Major Philanthropist Refuses To Join Gates’ Charity Pledge Because It’s ‘Practically Worthless,’* HUFFINGTON POST IMPACT, last updated Jan. 25, 2014, [http://www.huffingtonpost.com/2014/01/02/robert-wilson-giving-pledge\\_n\\_4531661.html](http://www.huffingtonpost.com/2014/01/02/robert-wilson-giving-pledge_n_4531661.html).

162. *Id.*

Professor Tanya D. Marsh argues that the boundaries established in 1969 between private foundations and public charities have subsequently become both over- and underinclusive.<sup>163</sup> The donor-advised funds operated by community foundations and by commercial investment firms, she argues, are effectively private foundations (though the law does not classify them as such) while institutions like the Ford Foundation, no longer controlled by the founding family, are effectively public entities.

Even if the Code's current distinction between public charity and private foundations is not perfect, it captures an important reality, namely, that family-controlled private foundations often entail financial benefit, as well as political, economic and social power, for the family controlling that foundation. In important respects, bequests to such foundations have consumption and dynastic qualities and represent wealth passed on to the donor's family, even when such family-controlled foundations do admirable work. If, as Professor Marsh suggests, Congress revises for income tax purposes the definition of a private foundation to reflect post-1969 developments, that updated definition can be used for the estate tax as well.

On the other hand, as Professors Andrews, Bittker, and Turnier argue, charity is different from other personal outlays because of the benefits charitable donations confer on others. Even when charitable donations reflect affluent tastes, for example, contributions to art museums and private schools, donors are sharing their wealth with others. Donations to museums and prep schools may have redistributive impact if, for example, such donations enable museums to adopt free admissions policies<sup>164</sup> or allow private schools to expand their scholarship programs for low-income students.

To return to the example of the Buffett family members and their private foundations, the Buffetts are using their money differently and more admirably than are other billionaires who instead engage in what Professor Andrews dubbed "private, preclusive household consumption."<sup>165</sup>

The limits on the income tax charitable deduction as framed in 1969 have been stable because such limits strike a defensible balance among these contending policies. This compromise should be emulated in the federal estate tax by limiting that tax's deduction for charitable bequests,<sup>166</sup> thereby ensuring that all large estates pay some estate tax, even if they devolve entirely to charity.

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163. Tanya D. Marsh, *A Dubious Distinction: Rethinking Tax Treatment of Private Foundations and Public Charities*, 22 VA. TAX REV. 137 (2002).

164. See, for example, the free general admission policy of The Walters Art Museum, last accessed Oct. 1, 2014, <http://thewalters.org>.

165. Andrews, *Personal Deductions*, *supra* note 65.

166. Any limitation to the estate tax charitable deduction should also apply to the gift tax charitable deduction.

Professor Bittker was skeptical of the claim that every taxpayer should pay something.<sup>167</sup> However, that premise is today deeply embedded in the federal income tax charitable deduction and should now be carried over to the estate tax charitable deduction. If so, every large estate will pay some estate tax while the affluent would still have the incentive to bequeath wealth for charitable purposes.

A limit on the estate tax charitable deduction could take any of several forms. The best possibility is the wholesale incorporation of the income tax's charitable deduction limits into the estate tax. Under this approach, bequests to public charities and qualifying (i.e., pass-thru, active, and supporting) private foundations would be deductible up to 50 percent of the estate.<sup>168</sup> Bequests to all other private foundations would be deductible up to thirty percent of the estate. In this way, the estate tax (like the income tax) would, by granting the deduction, encourage charitable donations to maintain a vital charitable sector and would also recognize that charity's public benefits make charitable bequests different from direct bequests to family members.

Simultaneously, limiting the deduction would recognize the competing claims: charitable contributions are, in important respects, consumption-like. Bequests to family foundations have a dynastic quality. Under current law, much wealth of the Giving Pledgers and their billionaire peers will, prior to death, never be taxed or will be taxed at lower capital gain rates. Death is the final opportunity for the federal fisc to obtain compensation from the affluent decedent for the social overhead which helped to create his fortune. Despite its commendable qualities, the Giving Pledge is a systematic, although unintended, threat to the estate tax base.

A limit on the estate tax charitable deduction would reconcile the Buffett-Gates commitment to federal estate taxation (by guaranteeing that all large estates pay some estate tax) with the agenda of Buffett-Gates Giving Pledge (by incenting bequests to charity).

An alternative attempt at such reconciliation might instead argue for estate taxation only for those who don't leave their wealth to charity. Supporting this approach and an unlimited estate tax charitable deduction, Bill and Melinda Gates can plausibly contend that their foundation spends their money for good causes more productively and more efficiently than would the federal government. From this vantage, the estate tax prods the wealthy to give to charity, but should not be levied when wealth in fact devolves to charity.

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167. Bittker, *Matching Grants*, *supra* note 68.

168. The limits would apply to the estate reduced by the marital deduction of section 2056 and debts and administrative expenses deductible under section 2053. *See* I.R.C. §§ 2053, 2056.



However, as Bill Gates, Sr. persuasively asserts,<sup>169</sup> large fortunes and the owners of such fortunes receive important public services from the inefficient federal government. Moreover, most of the Gates and Buffett fortunes consists of appreciated Microsoft and Berkshire-Hathaway stock on which the Gates and Buffett families will pay little or no federal income tax because they will never engage in a taxable sale.<sup>170</sup> If the Gates and Buffett families do not pay federal estate tax on this wealth,<sup>171</sup> they will effectively pay no federal tax at all—despite the public contribution to that wealth eloquently highlighted by Attorney Gates. There is a dynastic quality even to the most commendable of private foundations. And not all private foundations are so commendable.

Consider in this context a widowed<sup>172</sup> Giving Pledger whose estate will consist of one billion dollars and who has paid no federal income tax on the unrealized appreciation of this fortune. Suppose further that this Giving Pledger plans to leave this entire amount to a private foundation controlled by his children. The Giving Pledger will pay no federal income tax on this appreciation while alive. Under current law, the Pledger's estate will subsequently bear no federal estate tax on his death since the entire billion dollars going to charity will be fully deductible for estate tax purposes. If, instead, a 30 percent deduction limit applied to this bequest to his family's private foundation and if the federal estate tax rate remains at 40 percent, this estate will pay federal estate taxes of \$280 million.<sup>173</sup> How might our theoretical Giving Pledger respond to this change of law?

Perhaps not at all. He might still leave his entire estate to the private foundation controlled by his children except that, after the payment of federal estate taxes, this foundation would receive \$720 million rather than the full one billion dollars. This outcome would constitute Professor Dobris's "little bite"<sup>174</sup> since, in this scenario, the Pledger's children would still control a private foundation with formidable resources—though somewhat

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169. GATES SR. & COLLINS, *WEALTH AND OUR COMMONWEALTH*, *supra* note 97, at 110.

170. Federal income tax is only imposed if there is a "sale or other disposition of property." I.R.C. §§ 61(a)(3), 1001(a), (c).

171. Again, in this context, the reference to the estate tax includes the federal gift tax as well.

172. A Giving Pledger who leaves a surviving spouse might prefer to leave her assets to her surviving spouse pursuant to the unlimited estate tax marital deduction and instead have the surviving spouse make the ultimate bequest to charity. I.R.C. § 2056 (estate tax marital deduction).

173. 30 percent of the one billion dollars going to charity will be deductible, leaving a net taxable estate of \$700 million. At the 40 percent bracket, this would produce tax of \$280 million.

174. Dobris, *Possibility of Repeal*, *supra* note 109, at 711.

less resources than if the full donation were deductible for estate tax purposes.

Alternatively, this Giving Pledger, now confronted with an estate tax charitable deduction capped like the income tax charitable deduction, might seek to obtain the 50 percent deduction for his estate, either by switching his bequest to a public charity which qualifies for the higher 50 percent deduction limit or by modifying his family foundation to qualify for that limit. In either case, the federal estate tax would be reduced to \$200 million.<sup>175</sup>

A third possible response is that, confronted with a restricted estate tax charitable deduction, this Giving Pledger will donate to charity only amounts which are deductible and will leave the remainder of his post-tax estate directly to his family. Yet other possible responses include bequeathing to the family foundation the maximum deductible amount of \$300 million, imparting to public charities the additionally deductible amount of \$200 million, and passing to the children the \$300 million remaining after the payment of federal estate taxes of \$200 million.

We cannot predict the response of any particular Giving Pledger (or of any other wealthy individual) to a federal estate charitable deduction limited along the lines of the income tax charitable deduction. We can, however, predict that, as a result of these limits, federal revenues will be greater and the amount received by the charities will be less. In simplest terms, that change would impart to the estate tax the same compromise embodied in the income tax, namely, to incent charitable giving (particularly to public charities and qualifying private foundations) while ensuring that every large estate pays some tax, even if it devolves entirely to charity.

Instead of incorporating into the estate tax the charitable deduction limits of the income tax, a different limit might be fashioned for the estate tax. For example, bequests to public charities could remain estate tax deductible in full while bequests to private foundations would be subject to a deduction cap of 30 percent or 50 percent of the estate. By limiting the deductibility only of bequests to private foundations, such a cap would acknowledge the dynastic qualities of such foundations while more strongly encouraging bequests to public charities through an unlimited deduction.

This approach would have the benefit of neutralizing the political opposition of public charities. Public charities, a formidable interest group, will oppose restrictions on the estate tax deductibility of bequests to them. However, public charities might be indifferent to (or might perhaps even favor) ceilings which only cap the estate tax deductibility of amounts sent to their competitors for donors' dollars (*i.e.*, private foundations.)

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175. Fifty percent of the billion dollars going to charity will be deductible, leaving a net taxable estate of \$500 million. At the 40 percent bracket, this would produce tax of \$200 million.

Limiting the estate tax deduction only for contributions to private foundations would continue to permit large estates to avoid any estate taxation if they devolve entirely to public charities. A second disadvantage of this approach is that it would, via a limited estate tax deduction for bequests to all private foundations, treat the same way both donations to wholly admirable private foundations, like the Gates and Buffett foundations, and donations to less deserving private foundations. While I think most of us know the latter when we see them,<sup>176</sup> I see no administrable way of distinguishing in statutory language “good” private foundations which spend their funds productively and efficiently from their less admirable counterparts. Thus, under this approach, all bequests to all private foundations would be subject to the same estate tax deduction limit.

A third possible version of the estate tax charitable deduction limit would leave unrestricted the deduction for bequests to public charities and to private foundations qualifying for the higher income tax deduction limit, that is, pass-thru, operating, and supporting foundations.<sup>177</sup> The ceiling on estate tax charitable deductions would thus apply only to nonqualifying private foundations currently subject to the lower, 30 percent income tax deduction limit.<sup>178</sup> These are the foundations most prone to dynastic accumulations in the hands of the decedent’s family since these nonqualifying foundations do not pass through their resources, do not conduct active operations, and do not support public charities.

Under this alternative also, federal estate tax would be totally avoidable if an estate were to be bequeathed in its entirety to public charities or to qualifying private foundations. Such an alternative would, however, improve current law by getting more estates to pay some estate tax. Such an approach would also provide the strongest tax incentives for bequests to the public charities and qualifying private foundations for whom the estate tax charitable deduction would remain uncapped.

Like all compromises, none of these alternatives will satisfy those who occupy the polar positions. A libertarian ethically opposed to estate taxation will logically reject any limit on the estate tax charitable deduction as reinforcing the burden of an illegitimate tax. Similarly, no limit on the estate tax charitable deduction will appeal to those who see nothing different between charity and other outlays and who disapprove of the use the estate tax to encourage charitable legacies. However, for those who view the limitations of the income tax charitable deduction as a plausible and durable

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176. Nathaniel Zelinsky, *Fifty Years of “I know it when I see it,”* CONCURRING OPINIONS, June 19, 2014, <http://www.concurringopinions.com/archives/author/nathaniel-zelinsky>.

177. *See supra* notes 47–50 and accompanying text.

178. *See supra* note 149 and accompanying text.

compromise among contending considerations, the same or a similar compromise should be compelling in the context of the estate tax.

If that is not a program which will lead legions to the political barricades, it does reflect a sensible compromise among contending concerns and would align the policy of the income tax (which currently limits charitable deductions) with the policy of the estate tax (which today does not).

## VII. CONCLUSION

The Giving Pledge, an admirable effort to channel wealth to charity, requires us to confront the paradox that the federal estate tax charitable deduction is unlimited while the federal income tax charitable deduction is capped. In light of the commendable success of the Giving Pledge, we should revisit this paradox. If a Giving Pledger makes good on his commitment to leave his wealth to charity, the federal fisc loses significant revenue since the Pledger thereby avoids federal estate taxation as charitable bequests are deductible without limit for federal estate tax purposes. Despite its laudable qualities, the Giving Pledge is a systematic (albeit inadvertent) threat to the estate tax base.

The Giving Pledge requires the amendment of the federal estate tax to restrict an estate's charitable deduction to a percentage of the estate, just as the income tax charitable deduction is limited to a percentage of the taxpayer's income. In this fashion, the sensible compromise embedded in the income tax charitable deduction would be carried over to the federal estate tax to simultaneously encourage charitable giving while ensuring that all large estates pay some federal estate tax.

The Giving Pledge need not be the death knell of the federal estate tax. It should instead be the catalyst to reform the tax by limiting the estate tax charitable deduction.