

income situations arising under sections 1245 and 1250, the Treasury Department recommends that the rule proposed for section 306 stock be applied to this area also. Under this recommendation, the income tax deduction accorded for the gift of any asset to a private foundation would be diminished by the amount of the ordinary income which the donor would have realized if he had sold the asset for fair market value at the time of the contribution.

C. CORRECTION OF COMPUTATION OF ESTATE TAX MARITAL DEDUCTION

When a donor makes an unrestricted contribution of property to a private foundation whose selection of charitable beneficiaries he has power to influence, he secures a current income tax deduction for the full value of the property. The existence of his power over the foundation confers an additional benefit upon him: under existing estate tax law, the value of the asset remains in the base upon which his marital deduction is computed.⁷ Its presence in that base increases, by a sum equal to one-half the asset's value, the amount which the donor can bequeath to his wife free of estate tax—even while the asset itself escapes estate tax through the operation of the charitable deduction. On the other hand, the donor who contributes to a foundation over which he has no power receives no such enlargement of his marital deduction: the property which he has contributed does not bear upon his estate tax computations, and the tax advantage of his contribution is limited to the deduction provided by the income tax law.

This differentiation in the estate tax law between charitable donors who possess power to influence the foundations to which they contribute and donors who do not is quite inadvertent: it arises from the application, to the situation of the donor-influenced foundation, of principles designed to deal with entirely different problems. More significantly, it creates a preference which there is no reason for the tax laws to create. It establishes, through the mechanism of the estate tax, an artificial inducement, which has no necessary relationship to charitable inclinations or interests, for the retention of donor influence over private foundations.

Certain other sections of the estate tax law give rise to analogous incongruities. Under them, transfers which produce current charitable income tax deductions can be arranged to maintain sufficient donor involvement with the contributed property to increase the donor's marital deduction. The section dealing with life insurance has, in particular, been the subject of considerable manipulation designed to produce such double tax benefits.⁸ The provisions governing retained life estates and transfers in contemplation of death may occasion similar problems.⁹ In all of these situations, lifetime chari-

⁷ Secs. 2036 and 2038 of the present Internal Revenue Code require that property transferred *inter vivos* be included in the transferor's gross estate if he retains for life the power to designate the beneficiaries of its income or corpus. Both sections apply whether the transferor may exercise his power alone or in conjunction with other parties, and whether he possesses the power in a fiduciary capacity or not. Hence, in the usual situation, where at the time of his death a donor has a power to control or influence the decisions which a private foundation makes about the amounts and recipients of its distributions, all property which he has contributed to the foundation during his life would be required to be included in his gross estate. The so-called "adjusted gross estate"—which provides the base for the computation of the marital deduction—is determined from the gross estate without subtraction of the charitable deduction. As a consequence, the marital deduction base would include the value of the property contributed to the foundation. (The discussion here assumes that the contributed assets are not community property.)

⁸ The effectiveness of the various life insurance devices has not yet been tested by litigation.

⁹ The recommendation of Part III-A would postpone the income tax deduction for the gift of a remainder interest to a private foundation until the interest becomes possessory and productive or is disposed of by the foundation. By doing so, that proposal would, in the private foundation area, eliminate most possibilities for using retained life interests to achieve the described double tax benefits.