

**GALLOWAY, SPLIT-INTEREST TRUSTS, AND  
UNDIVIDED PORTIONS: DOES DISALLOWING THE  
CHARITABLE CONTRIBUTION DEDUCTION OVERSTEP  
LEGISLATIVE INTENT?**

“*[I]n charity there is no excess.*”—*Sir Francis Bacon*<sup>1</sup>

INTRODUCTION

Private charitable giving has long been “praised as embodying humankind’s noblest instincts—generosity, altruism, [and] benevolent initiative.”<sup>2</sup> In modern-day America, “[t]he spirit of giving . . . [has become] embedded in American ways as part of a growing self-image of Americans as a generous and altruistic people.”<sup>3</sup> America’s culture, religions, and society, generally, ingrain within us the desire, perhaps even the felt obligation, to give for the benefit of others. Many fulfill this desire by making private contributions of wealth or property to charitable institutions. Considering this aspect of American culture, it is a logical conclusion that charitable giving, like other societal goods, should be, and is, purposefully encouraged by our current tax structure.

Congress encourages private charitable giving by allowing deductions for charitable contributions made by individuals<sup>4</sup> and estates.<sup>5</sup> With regard to estates, the “deduction has been allowed almost since the inception of a modern federal estate tax[, and Congress’s] original underlying policy of encouraging charitable giving remains unchanged.”<sup>6</sup> Today, “most studies find that the deduction in the estate tax for charitable contributions generates a significant increase in contributions at death.”<sup>7</sup> This deduction’s impact “can hardly be overstated. For estates filing returns in 1997 the aggregate total of

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<sup>1</sup> FRANCIS BACON, *Of Goodness and Goodness of Nature*, in THE ESSAYS OR COUNSELS CIVIL AND MORAL (1625), reprinted in ESSAYS, ADVANCEMENT OF LEARNING, NEW ATLANTIS, AND OTHER PIECES 35, 35 (Richard Foster Jones ed., Odyssey Press 1937).

<sup>2</sup> COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS, GIVING IN AMERICA: TOWARD A STRONGER VOLUNTARY SECTOR 53 (1975) [hereinafter GIVING IN AMERICA].

<sup>3</sup> *Id.* at 65.

<sup>4</sup> See I.R.C. §§ 170(a), 2522(a) (2000).

<sup>5</sup> See *id.* § 2055(a) (2000); see also *Burdick v. Comm’r*, 979 F.2d 1369, 1372 (9th Cir. 1992) (explaining that Congress’s “purpose [in] allowing charitable deductions is to encourage testators to make charitable bequests”) (quoting *Underwood v. United States*, 407 F.2d 608, 610 (6th Cir. 1969)).

<sup>6</sup> Edward J. Beckwith, *Estate and Gift Tax Charitable Deductions*, 839 TAX MGMT., 2001, at A-3 (footnote omitted). The charitable contribution deduction has existed in some form in the estate tax context since 1918. *Id.* at A-3 n.3.

<sup>7</sup> William G. Gale & Joel Slemrod, *Overview* to RETHINKING ESTATE AND GIFT TAXATION 1, 54 (William G. Gale, James R. Hines, Jr. & Joel Slemrod eds., 2001).

reported *gross* estates was over \$162 billion”;<sup>8</sup> out of this aggregate, claimed charitable deductions totaled just over \$14 billion.<sup>9</sup> When estates make charitable contributions through trusts that give both charitable and non-charitable beneficiaries interests in the same property—commonly termed “split-interest” trusts<sup>10</sup>—a conflict exists between the application of statutory language and legislative intent. The conflict arises over whether a charitable contribution deduction should be allowed and, if so, under which trust structures.

This Note will show why the rulings of the Internal Revenue Service (“IRS”), the United States District Court for the Western District of Pennsylvania, and the United States Court of Appeals for the Third Circuit in *Galloway v. United States*<sup>11</sup> demonstrate the need for revising I.R.C. § 2055(e)(2) and Treasury Regulation § 20.2055-2(e)(2)(i) and why the charitable contribution deduction should be allowed in instances factually similar to *Galloway*.<sup>12</sup>

This Note focuses on circumstances in which the charitable contribution deduction for estates is disallowed under I.R.C. § 2055(e)(2) and Treasury Regulation § 20.2055-2(e). Part I presents an overview of the estate planning advantages available through split-interest trusts and explains the statutory basis for the estate tax charitable contribution deduction and its disallowance in certain split-interest trust situations. Part II explores the legislative intent behind disallowing the deduction as expressed by Congress and as viewed by courts that have applied Section 2055(e)(2) and its corresponding regulations to disallow claimed deductions. Part III analyzes the *Galloway* decisions, which demonstrate that the result of applying the statute and regulation’s “plain language” in certain instances overreaches congressional intent by disallowing the charitable contribution deduction in situations in which Congress intended the deduction to be allowed. Part IV examines what

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<sup>8</sup> Richard Schmalbeck, *Avoiding Federal Wealth Transfer Taxes*, in RETHINKING ESTATE AND GIFT TAXATION, *supra* note 7, at 113, 115–16.

<sup>9</sup> Barry W. Johnson & Jacob M. Mikow, *Federal Estate Tax Returns, 1995-1997*, STAT. OF INCOME BULL., Summer 1999, at 69, 105.

<sup>10</sup> There is some dispute over whether a “split-interest” trust requires a life interest in a non-charitable beneficiary and a remainder interest in a charitable beneficiary in the same property, or vice versa, or whether a trust giving any interests in property to both charitable and non-charitable beneficiaries should be considered “split-interest.” Congress certainly contemplated the former, more limited definition of “split-interest” in its creation of I.R.C. § 2055(e)(2). See *infra* notes 34–36 and accompanying text. The debate over the definition of “split-interest,” though relevant, will not be a topic of discussion in this Note. For the purposes of this Note, “split-interest” will generally be taken to mean trusts in which any interests in the same property are given to both charitable and non-charitable beneficiaries, in accordance with the language of I.R.C. § 2055(e)(2).

<sup>11</sup> No. 05-50, slip op. 2006 WL 1233683 (W.D. Pa. May 9, 2006), *aff’d*, 492 F.3d 219 (3d Cir. 2007).

<sup>12</sup> See discussion *infra* Parts III-IV.

other courts and the IRS have said concerning when the deduction should or should not be allowed. Part IV also offers a model amendment to revise I.R.C. § 2055(e)(2) so that the statute's application may better reflect congressional intent. Finally, Part V returns to the broader picture of tax policy and to the beneficial aspects of charitable giving, both of which justify and reaffirm the need for legislative clarification in the area of estate tax charitable contribution deductions.

I. THE ESTATE PLANNING BENEFITS OF SPLIT-INTEREST TRUSTS  
AND THE RESTRICTIVE STATUTORY PROVISIONS GOVERNING  
THIS AREA OF ESTATE TAX

*A. An Overview of the Advantages Available in Estate Planning  
Through the Use of Split-Interest Trusts*

It is neither uncommon nor unexpected for individuals to desire split-interest giving in their estate planning.<sup>13</sup> “A split-interest trust is often the chosen form of testamentary bequest because ‘[d]ecedents . . . desire to mix private objectives with philanthropy in their testamentary transfers . . . .’”<sup>14</sup> Practitioners may advise clients that testamentary split-interest giving is more advantageous for all parties concerned if done through a trust “instead of making an outright gift to charity when the client seems unwilling to part with an asset entirely, yet wishes to [e]nsure that the item (or cash) ultimately is given to charity.”<sup>15</sup>

The availability of a deduction for these charitable contributions gives the added bonus of achieving “some present tax savings coordinated with . . . intended future generosity.”<sup>16</sup> Split-interest trusts “are primarily important in estate planning to save income, estate, and gift taxes on wealth passing to non-charitable beneficiaries.”<sup>17</sup> The deduction effectually allows charitable contributions to be “subsidized by [the] government, with the size of the subsidy increasing with the donor's tax rate.”<sup>18</sup> Thus, if a split-interest trust is structured in line with the applicable restrictions,

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<sup>13</sup> See *Estate of Hall v. Comm'r*, 941 F.2d 1209, 1991 WL 158697, at \*5 (6th Cir. Aug. 19, 1991) (unpublished table decision).

<sup>14</sup> *Id.* (alteration in original) (quoting *Estate of Boeshore v. Comm'r*, 78 T.C. 523, 525 (1982)).

<sup>15</sup> Melinda J. Harrison & Edward D. Tarlow, *How To Use Trusts and Estates To Maximize Deductions for Charitable Contributions*, 13 EST. PLAN. 66, 69 (1986), available at 1986 WL 84163.

<sup>16</sup> *Id.*; see HAROLD WEINSTOCK & MARTIN A. NEUMANN, *PLANNING AN ESTATE: A GUIDEBOOK OF PRINCIPLES AND TECHNIQUES* § 14:33 (4th ed. 2002).

<sup>17</sup> DAVID WESTFALL & GEORGE P. MAIR, *ESTATE PLANNING LAW AND TAXATION* ¶ 19.05 (4th ed. 2003).

<sup>18</sup> Jerald Schiff, *Tax Policy, Charitable Giving, and the Nonprofit Sector: What Do We Really Know?*, in *PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS* 128, 129

charitable donations may be paid for in significant measure by the government. This is because of the . . . estate tax deduction which a contribution to charity may produce. In some circumstances, . . . the taxpayer may [even] be able to enhance his or her wealth base, or that of the family, by benefiting from the exemption from taxation which may be provided by such a trust.<sup>19</sup>

It is due to these advantages that the split-interest trust has become an “estate planning mainstay.”<sup>20</sup> The latter parts of this Note describe in greater depth how the restrictions set on these trusts by statute and regulation are severe, making it very difficult for a split-interest trust to fall into a category for which the charitable contribution deduction is allowed.<sup>21</sup> It is especially difficult to achieve the desired charitable contribution deduction when preparing a split-interest trust without adept legal counsel. The IRS, acknowledging the severity of these restrictions, has provided several Revenue Procedures detailing various model trust structures which should, but are not guaranteed to, allow for proper claiming of the deduction.<sup>22</sup> These model trusts, however, give little guidance for the dilemma presented by *Galloway* other than to avoid this type of split-interest trust through well-counseled drafting.

#### *B. The Statutory Basis for the Deduction and Its Disallowance*

In an effort to encourage and effectively subsidize charitable contributions made by estates, Congress enacted I.R.C. § 2055(a), which provides: “In general . . . the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers . . . to or for the use of any

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(Richard Magat ed., 1989); see also Charles T. Clotfelter, *Federal Tax Policy and Charitable Giving*, in PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS, *supra*, at 105, 114.

<sup>19</sup> Jonathan G. Blattmachr & Madeline J. Rivlin, *Some Fundamental and Fine Points of Charitable Giving and Associated Tax Planning*, in FINANCIAL PLANNING THOUGHTS 755, 763 (PLI Tax Law and Estate Planning Course Handbook Series No. D0-001N, 1998) available at WL 267 PLI/EST 715. The implications of the charitable contribution deduction and the applicable statutory restrictions for split-interest trusts for income and gift taxes are similar to those for estate taxes, thus the analysis provided in this Note, while pertaining specifically to estate taxes, may also apply to some extent to income and gift taxes. See I.R.C. §§ 170(f) (2000 & Supp. IV 2004), 2522(c) (2000).

<sup>20</sup> Christopher P. Cline, *Planning for the Charitable Deduction: Charitable Remainder Trusts and Charitable Lead Trusts* (A.L.I.-A.B.A. Course of Study, June 19–24, 2005), available at WL SK093 A.L.I.-A.B.A. 1243, 1245.

<sup>21</sup> See discussion *infra* Parts II, IV.A.

<sup>22</sup> See, e.g., Rev. Proc. 2003-53, 2003-2 C.B. 230, 2003-54, 2003-2 C.B. 236, 2003-55, 2003-2 C.B. 242, 2003-56, 2003-2 C.B. 249, 2003-57, 2003-2 C.B. 257, 2003-58, 2003-2 C.B. 262, 2003-59, 2003-2 C.B. 268, 2003-60, 2003-2 C.B. 274. These IRS Revenue Procedures contain annotated model declarations of trust for the creation of charitable remainder annuity trusts.

corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes . . . .”<sup>23</sup>

Subsection 2055(e)(2), which was added to Section 2055 as part of the Tax Reform Act of 1969,<sup>24</sup> disallows Section 2055(a)’s charitable contribution deduction in instances where split-interest trusts are created with only a few specific exceptions:

(2) Where an interest in property (other than an interest described in section 170(f)(3)(B)) passes or has passed from the decedent to a person, or for a use, described in subsection (a), and an interest (other than an interest which is extinguished upon the decedent’s death) in the same property passes or has passed (for less than an adequate and full consideration in money or money’s worth) from the decedent to a person, or for a use, not described in subsection (a), no deduction shall be allowed under this section for the interest which passes or has passed to the person, or for the use, described in subsection (a) unless—

(A) in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664) or a pooled income fund (described in section 642(c)(5)), or

(B) in the case of any other interest, such interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly of the fair market value of the property (to be determined yearly).<sup>25</sup>

The provisions of Section 2055(e)(2) essentially state that the deduction is disallowed when interests in the same property pass to both charitable and non-charitable beneficiaries in a form that is not one of the three exceptions specified in Section 2055(e)(2)(A).<sup>26</sup>

This statutory provision is applied in accordance with Treasury Regulation § 20.2055-2(e)(1)(i), which states:

[W]here an interest in property passes or has passed from the decedent for charitable purposes and an interest (other than an interest which is extinguished upon the decedent’s death) in the same property passes or has passed from the decedent for private purposes[,] . . . no deduction is allowed under section 2055 for the value of the interest which passes or has passed for charitable purposes *unless the interest in property is a deductible interest described in subparagraph (2) of this paragraph.*<sup>27</sup>

Section 20.2055-2(e)(2)(i) defines a “deductible interest” as,

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<sup>23</sup> I.R.C. § 2055(a)(2) (2000).

<sup>24</sup> Pub. L. No. 91-172, § 201(d), 83 Stat. 487, 560–61 (codified as amended at I.R.C. § 2055(e)).

<sup>25</sup> I.R.C. § 2055(e)(2) (2000). In *Estate of Gillespie v. Commissioner*, the United States Tax Court upheld I.R.C. § 2055(e) as “constitutional” and not merely “a senseless restriction on testamentary giving.” 75 T.C. 374, 376, 380 (1980).

<sup>26</sup> See Treas. Reg. § 20.2055-2(e)(1)(i) (2006).

<sup>27</sup> *Id.* (emphasis added).

a charitable [interest in property which] is an *undivided portion, not in trust, of the decedent's entire interest in property*. An undivided portion of a decedent's entire interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the decedent in such property and must extend over the entire term of the decedent's interest in such property and in other property into which such property is converted.<sup>28</sup>

Application of the "plain language" of I.R.C. § 2055(e)(2) and its corresponding regulations results in a charitable deduction being allowed for transfers "immediately payable" to charitable beneficiaries under a will or "held in trust entirely for charitable purposes."<sup>29</sup> When transfers are held in the same trust for both charitable and non-charitable purposes, however, "they will not be separated for tax purposes, even though the interests may be clearly separable."<sup>30</sup> Therefore, even if an undivided portion of the grantor's interest in trust property is passed to charitable beneficiaries "in trust"—so long as that interest is considered to be "in the same property" as the interest passed to non-charitable beneficiaries "in the same trust," which does not take one of the three excepted forms—no deduction will be permitted.<sup>31</sup>

Thus, charitable contribution deductions are essentially only permitted for split-interest trusts which take one of the three forms specified in Section 2055(e)(2)(A), a charitable remainder annuity trust, a charitable remainder unitrust, or a pooled income fund.<sup>32</sup> Those responsible for forming and administering these trusts, however, must be especially careful to adhere to the strict requirements of these trust forms, since, "[e]ven what may appear to be an insignificant departure from [these] requirements may result in the disallowance of an entire charitable deduction."<sup>33</sup> This strict "plain language" interpretation of Section 2055(e)(2) and its corresponding regulations applied by courts today, may not, in every situation, result in the outcomes Congress had in mind when this subsection was enacted.

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<sup>28</sup> *Id.* § 20.2055-2(e)(2)(i) (2006) (emphasis added).

<sup>29</sup> Beckwith, *supra* note 6, at A-17; *see infra* notes 67–73 and accompanying text; *see also* Rev. Rul. 77-97, 1977-1 C.B. 285–86 (noting that if the decedent had established two separate trusts, one for the interest passing to charitable beneficiaries and one for the interest passing to non-charitable beneficiaries, instead of one split-interest trust, a deduction would have been allowed for the undivided portion of the decedent's interest passing to the charitable beneficiaries).

<sup>30</sup> Beckwith, *supra* note 6, at A-17.

<sup>31</sup> *See id.*

<sup>32</sup> I.R.C. § 2055(e)(2)(A) (2000); BRUCE R. HOPKINS, *THE TAX LAW OF CHARITABLE GIVING* 338 (3d ed. 2005).

<sup>33</sup> Beckwith, *supra* note 6, at A-17; *see* Paul N. Frimmer, *Charitable Dispositions* 219, 241 (PLI Tax Law and Estate Planning Course Handbook Series No. D4-5197, 1987), *available at* WL 176 PLI/EST 219.

## II. THE LEGISLATIVE INTENT BEHIND I.R.C. § 2055(E)(2)'S CHARITABLE CONTRIBUTION DEDUCTION DISALLOWANCE PROVISIONS

The House of Representatives Ways and Means Committee laid out in its report on the Tax Reform Act of 1969 the general reasons for the changes in the estate tax charitable contribution deduction and for the inclusion of I.R.C. § 2055(e)(2):

The rules of [the pre-1969 Internal Revenue Code] for determining the amount of a charitable contribution deduction in the case of gifts of remainder interests in trust do not necessarily have any relation to the value of the benefit which the charity receives. This is because the trust assets may be invested in a manner so as to maximize the income interest with the result that there is little relation between the interest assumptions used in calculating present values and the amount received by the charity. For example, the trust corpus can be invested in high-income, high-risk assets. This enhances the value of the income interest but decreases the value of the charity's remainder interest.

....  
[The] committee does not believe that a taxpayer should be allowed to obtain a charitable contribution deduction for a gift of a remainder interest in trust to a charity which is substantially in excess of the amount the charity may ultimately receive.<sup>34</sup>

This is the reasoning behind the “in the same property” requirement of Section 2055(e)(2); some forms of split-interest trusts divide the same trust property into “two bundles of rights, one of which can be administered . . . to increase the value of the other, thus milking the charitable beneficiary[’s interest] for the benefit of the non-charitable beneficiary.”<sup>35</sup> A deduction is disallowed in these situations because any deduction granted would likely reflect an amount greater than the present value of the amount charitable beneficiaries will eventually receive.

The 1969 House Report goes on to imply that the provision specifically disallows the deduction in three cases: first, when charities receive vested remainder interests in trust property; second, when charitable beneficiaries receive a contingent remainder interest which is not likely to vest; and finally, when invasion of a charitable remainder is

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<sup>34</sup> H.R. REP. NO. 91-413, pt. 1, at 58 (1969), *reprinted in* 1969 U.S.C.C.A.N. 1645, 1704; *see* BORIS I. BITTKER & LAWRENCE LOKKEN, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS* ¶ 130.5.1, at 130-17 (2d ed. 1993) (“The restrictions, which also apply for purposes of the income and gift tax charitable deductions, are designed to prevent manipulations in the exercise of powers over investments and discretionary distributions, thereby ensuring that the amount deducted is commensurate with the benefit that will actually be received by the charity.”) (footnote omitted); HOPKINS, *supra* note 32, at 342 (“The purpose of [Section 2055(e)(2)] is to preclude a claimed charitable contribution deduction in an amount greater than the value of the interest contributed.”).

<sup>35</sup> BITTKER & LOKKEN, *supra* note 34, at 130-19.

permitted “for the benefit of a non-charitable intervening interest which is incapable of reasonably certain actuarial valuation.”<sup>36</sup>

The House supported denying a deduction to any split-interest trust not structured as either “an *annuity trust* (under which the income beneficiary is to receive a stated dollar amount annually) or a *unitrust* (under which the income beneficiary is to receive an annual payment based on a fixed percentage of the trust’s assets).”<sup>37</sup> The “annuity format” is a logical choice to curb potential abuse because

irrespective of whether the charity has the annuity or remainder interest[,] the trustee would have no incentive to manipulate trust investments . . . . In all events[,] either income or, to the extent necessary, principal would be used to pay the annuity and sound business judgment would dictate that the trustee invest the property in the most profitable manner possible since neither interest could benefit from a different investment policy. . . . [T]he annuity format provides the greatest assurance that the amount allowed as a charitable deduction would actually go to the charity . . . .<sup>38</sup>

The Senate Finance Committee, while agreeing with the House Ways and Means Committee’s reasons for amendment, found the House’s version of Section 2055(e)(2) to be “unduly restrictive” and responded by adding pooled income funds to the list of trust structures for which a deduction is allowable.<sup>39</sup> A *pooled income fund* is defined as an arrangement “under which a person transfers property to a public charity which then places the property in an investment pool and pays the donor . . . the income attributable to the property for life.”<sup>40</sup>

The Federal Courts of Appeals have conveyed their understanding of the legislative intent behind I.R.C. § 2055(e)(2), pointing out that “abuses in the administration of split-interest trusts proliferated under pre-1969 law.”<sup>41</sup> The Tenth Circuit, citing an earlier opinion of the Eighth Circuit, stated:

Section 2055(e)(2) was enacted . . . to eliminate [this] abuse of the charitable deduction through the split interest bequest. Congress was concerned with situations in which a noncharitable beneficiary retained a substantial interest in the estate, and benefited from a

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<sup>36</sup> H.R. REP. NO. 91-413, pt. 1, at 58, *reprinted in* 1969 U.S.C.C.A.N. 1645, 1705. The Report indicates that disallowing the deduction is due to the Ways and Means Committee’s fear that the deduction would be abused if it was allowed in these instances. *See id.*

<sup>37</sup> S. REP. NO. 91-552, at 87 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2027, 2116 (emphasis added).

<sup>38</sup> BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 82.1.2 at 82-5 (3d ed. 2003).

<sup>39</sup> S. REP. NO. 91-552, at 87, *reprinted in* 1969 U.S.C.C.A.N. 2027, 2117.

<sup>40</sup> *Id.* at 85, *reprinted in* 1969 U.S.C.C.A.N. 2027, 2114 (emphasis added).

<sup>41</sup> Estate of Hall v. Comm’r, 941 F.2d 1209, 1991 WL 158697, at \*6 (6th Cir. 1991) (unpublished table decision).



charitable deduction for a remainder or other interest that was significantly disproportionate to the actual value ultimately received by the charity.<sup>42</sup>

Additionally, the Ninth Circuit acknowledged that the 1969 Section 2055(e) amendment, specifically subsection (e)(2), was designed to impose “more demanding requirements . . . to assure that [an] estate could not get the benefit of the deduction if the will did not provide a sufficiently certain interest for the charitable remainderman.”<sup>43</sup>

The factual scenario Congress viewed as being prone to this abuse is typified, for example, in *Burdick v. Commissioner*.<sup>44</sup> Burdick’s will created a trust which provided an income interest to an individual for life, with the remaining corpus to be divided evenly between an individual and a charity.<sup>45</sup> In a situation such as this, the non-charitable beneficiary with the life interest could have the trust property invested in stocks that would yield higher income in the short-term and result in a depleted trust corpus to be eventually distributed between the non-charitable and the charitable remainder beneficiaries. In a similar case, *Estate of Johnson v. United States*, a trust was created under a will to serve three purposes, to support the decedent’s three sisters for life, to maintain family graves, and to contribute to specified charities.<sup>46</sup>

It is clear that, in scenarios similar to those in *Burdick* and *Johnson*, the potential exists for the abuse Congress aimed to curb by enacting Section 2055(e)(2). These cases have the capacity for creating little correlation between the amount for which a charitable contribution deduction might be claimed and the amount which a charitable beneficiary holding a future interest in the corpus of a trust might eventually receive. Disallowing the deduction in these instances is merited and is effected under the current language of Section 2055(e)(2), regardless of the additional “undivided portion, not in trust” language of Treasury Regulation § 20.2055-2(e)(2)(i). However, I.R.C. § 2055(e)(2), in coordination with its corresponding regulations, also disallows the deduction when undivided portions of the grantor’s entire interest in trust property are passed to charitable beneficiaries. In scenarios involving undivided portions, the potential for abuse identified by

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<sup>42</sup> *Flanagan v. United States*, 810 F.2d 930, 935 (10th Cir. 1987) (citing *First Nat’l Bank of Fayetteville v. United States*, 727 F.2d 741, 747–48 (8th Cir. 1984)).

<sup>43</sup> *Wells Fargo Bank v. United States*, 1 F.3d 830, 832 (9th Cir. 1993).

<sup>44</sup> 979 F.2d 1369 (9th Cir. 1992).

<sup>45</sup> *Id.* at 1370.

<sup>46</sup> 941 F.2d 1318, 1318 (5th Cir. 1991). A different type of situation, also with the potential for abuse, arose in *Estate of Burgess v. Commissioner*, in which a trust was created to provide a life interest with power to invade the corpus for the decedent’s mother and, after payment of other specific bequests, the remainder of the corpus was to pass to two charities. 622 F.2d 700, 702–03 (4th Cir. 1980). The Burgess Estate was disallowed a charitable deduction under § 2055(e)(2). *Id.*

Congress and illustrated in the above cases does not exist; the charitable and non-charitable interests are non-competing. This is the scenario in *Galloway*.<sup>47</sup> In these instances, the application of the statute and its corresponding regulations oversteps legislative intent.

III. THE *GALLOWAY* DILEMMA: WHEN UNDIVIDED PORTIONS ARE  
GIVEN TO CHARITABLE BENEFICIARIES IN SPLIT-INTEREST TRUSTS,  
DOES DISALLOWING A DEDUCTION OVERSTEP  
CONGRESSIONAL INTENT?

In *Galloway v. United States*,<sup>48</sup> the successor trustee of the James D. Galloway Revocable Living Trust brought suit to recover estate taxes assessed by the IRS after the James D. Galloway Estate's claimed charitable contribution deduction was disallowed.<sup>49</sup> The Galloway Trust, written and revised by James D. Galloway, provided for the trust corpus to pass, essentially in fee, 25% each to four beneficiaries, including two charitable entities,<sup>50</sup> and two individuals.<sup>51</sup> Each beneficiary received 50% of its total interest in a distribution made in early 2006; the remaining corpus of the trust is to be distributed on January 1, 2016, at which point the Galloway Trust will terminate.<sup>52</sup>

Thus far, the Galloway Trust is straightforward. The charitable and non-charitable beneficiaries' interests are seemingly separable, although they are in one body of stock that constitutes the trust corpus. Each beneficiary receives the income and principal from its own percentage share of the trust. It was under this reasoning that the Galloway Estate claimed a charitable contribution deduction for the present value, as calculated by the Pennsylvania Department of Revenue, of the 50% of the trust designated, in both present and future interest (an undivided portion), to the charitable beneficiaries.<sup>53</sup>

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<sup>47</sup> See *infra* Part III.

<sup>48</sup> No. 05-50, slip op. 2006 WL 1233683 (W.D. Pa. May 9, 2006), *aff'd*, 492 F.3d 219 (3d Cir. 2007).

<sup>49</sup> *Id.* at \*1.

<sup>50</sup> Plaintiff's Motion for Summary Judgment at 2–3, *Galloway v. United States*, slip op. 2006 WL 1233683 (W.D. Pa. May 9, 2006) (No. 05-50), [hereinafter *Galloway Motion*]. The two charitable entities were the James D. Galloway Scholarship Fund of the Federated Church of East Springfield, Pennsylvania, and the WLD Ranch of the Federated Church of East Springfield, Pennsylvania. *Id.* As a side note, my sister and I have fond memories of attending the WLD Ranch summer camp as children. Begun in 1963 by the Federated Church of East Springfield, Pennsylvania, upon a charitable donation made in memory of Wayne L. Davis, the "WLD Ranch is committed to providing the very best in Christian camping." Welcome to WLD Ranch, <http://www.wldranch.com> (last visited Oct. 8, 2007).

<sup>51</sup> *Galloway*, 2006 WL 1233683 at \*1. The two individuals were James D. Galloway's son and granddaughter. *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> *Galloway Motion*, *supra* note 50, at 3–4.

The Galloway Trust declarations also provide that, in the event a non-charitable beneficiary of the trust “is not living at the time of final distribution, his or her share will be distributed [evenly among] the remaining beneficiaries[;]” thus, if both individual beneficiaries are deceased at the time of the 2016 distribution, 100% of the remaining trust corpus will be distributed to the charitable beneficiaries.<sup>54</sup> While perhaps no charitable deduction may be allowed for any amount that might be distributed to the charities from the interests of the non-charitable beneficiaries, Galloway maintained that a deduction was allowed for the 50% undivided portion of the trust designated to pass entirely to the charitable beneficiaries.<sup>55</sup>

As Galloway argued, “the [50%] charitable and non-charitable interests are not competing in any way that could give rise to any abuse of the estate charitable tax deduction.”<sup>56</sup> Despite the validity of this argument, the IRS, both initially and on appeal, denied the charitable contribution deduction, “determining that the trust constituted a ‘split interest trust’ in that it divided the same property between charitable and non-charitable entities” and did not take one of the three excepted forms listed in I.R.C. § 2055(e)(2)(A).<sup>57</sup> The IRS disallowed the deduction based on the “plain language” of I.R.C. § 2055(e)(2), requiring the Galloway Estate to pay an additional \$160,394.13 in estate taxes.<sup>58</sup>

Galloway also argued that, were the charitable donation not made “in trust,” it would constitute the donation of an “undivided portion . . . of the decedent’s entire interest,” and would, thus, qualify for the charitable contribution deduction as a “deductible interest” under Treasury Regulation § 20.2055-2(e)(2)(i).<sup>59</sup> The donation in *Galloway*, however, was made in trust. Presumably, this is why the district court and the Third Circuit in *Galloway* both affirmed the holding of the IRS without discussing whether the provisions of Section 20.2055-2(e)(2)(i) regarding split-interest trusts are in line with the legislative intent behind I.R.C. § 2055(e)(2).<sup>60</sup>

The issue presented is well-summarized by Galloway: “[S]hould the IRS be permitted to elevate form so far over substance that the charitable intent and effect of the Trust are ignored, to the detriment of both the individual beneficiaries *and* the charitable organizations

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<sup>54</sup> *Galloway*, 2006 WL 1233683 at \*1.

<sup>55</sup> Galloway Motion, *supra* note 50, at 4.

<sup>56</sup> *Id.* at 6.

<sup>57</sup> *Galloway*, 2006 WL 1233683 at \*1.

<sup>58</sup> *Id.*

<sup>59</sup> Galloway Motion, *supra* note 50, at 5 (quoting Treas. Reg. § 20.2055-2(e) (2006)).

<sup>60</sup> *Galloway*, 2006 WL 1233683 at \*6, *aff’d*, 492 F.3d at 225 n.6.

designated by the Trust[?]"<sup>61</sup> Should the fact that the charitable contribution of an undivided portion was made through a split-interest trust instrument, which does not qualify as a charitable remainder annuity trust, a charitable remainder unitrust, or a pooled income fund, result in its exclusion from the undivided portion exception of Treasury Regulation § 20.2055-2(e) and merit the denial of a deduction under I.R.C. § 2055(e)(2)?

[T]he record of the United States Senate makes it clear that the intent behind § 2055(e) was to prevent abuse in "split interest" or "remainder" trusts, where the *corpus* was comprised of a single, undivided, interest in which an individual beneficiary had, for instance, a life-estate interest, with the remainder of the *corpus* conveyed to the charitable beneficiary upon his or her death, the fear being that the private beneficiary, especially if also Trustee, might choose investments designed to maximize income by pursuing riskier investments, decreasing the amount ultimately realized by the charitable beneficiary . . . .<sup>62</sup>

The Galloway Trust was "for all intents and purposes, and in practical effect, two separate Trusts,"<sup>63</sup> one giving 50% to the charitable beneficiaries in fee simple and another giving 50% to the non-charitable beneficiaries in fee simple on executory limitation with an executory interest (not a valid remainder, either vested or contingent) held by the charitable beneficiaries in the 50% interest of the non-charitable beneficiaries. "Had Galloway initially split his assets down the middle and established two (2) separate but identical trusts, in two (2) separate but identical (except for the beneficiaries) documents," the IRS would have seen no reason to disallow the deduction for the charitable contribution of a 50% undivided portion of Galloway's assets;<sup>64</sup> however, the IRS, the district court, and the Third Circuit concluded that, having been established through a single trust document, the Galloway Trust constituted only "one trust," for which the deduction was disallowed.<sup>65</sup>

#### IV. SHOULD THE "PLAIN LANGUAGE" OF I.R.C. § 2055(E)(2) AND TREASURY REGULATION § 20.2055-2(E)(2)(I) BE STRICTLY APPLIED WHEN THE OUTCOME OVERSTEPS LEGISLATIVE INTENT?

The language of Section 2055(e)(2) and its corresponding regulations has been applied by the *Galloway* courts to disallow the

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<sup>61</sup> Plaintiff's Brief in Support of Motion for Summary Judgment at 5, *Galloway v. United States*, slip op. 2006 WL 1233683 (W.D. Pa. May 9, 2006) (No. 05-50) [hereinafter *Galloway Brief*].

<sup>62</sup> *Id.* at 8 (citing S. REP. NO. 91-552 (1969), reprinted in 1969 U.S.C.C.A.N. 2027, 2116).

<sup>63</sup> *Id.* at 5.

<sup>64</sup> *Id.*

<sup>65</sup> *Galloway*, 2006 WL 1233683 at \*6, *aff'd*, 492 F.3d at 224.

charitable contribution deduction in a factual scenario which is not, at least regarding the 50% of the trust designated solely to the charitable beneficiaries, prone to the abuse Congress designed Section 2055(e)(2) to prevent. These decisions perpetuate the rule that disallows the deduction to any estate which involves a trust, including both charitable and non-charitable beneficiaries, not drafted and administered<sup>66</sup> in one of the three excepted forms, regardless of the nature of the interests involved. Continued application of Section 2055(e)(2)'s plain language in factual scenarios similar to *Galloway*, involving undivided portions given to charitable beneficiaries in trust, will produce results inconsistent with the statute's intent and will effectively, through disallowing the deduction, deplete trust resources bound for charitable beneficiaries.

*A. Galloway Compared: When Should the Deduction Be Allowed  
for Charitable Contributions Made in Trust?*

An examination of how other courts have interpreted and applied I.R.C. § 2055(e)(2) will help in analyzing *Galloway* and the statutory and regulatory language in question. Thus, this section details how other courts apply the estate tax charitable contribution deduction in factual scenarios relevant to *Galloway*.

First, it should be noted that a deduction is allowed for an outright distribution to a charitable beneficiary made by an estate in trust. In *Estate of Simpson v. Commissioner*, Simpson's will established a trust, 1% of which was to be distributed to each of five charities upon Simpson's death.<sup>67</sup> After fulfilling a series of other interests, the remaining trust corpus was to be distributed in equal shares among the charitable beneficiaries.<sup>68</sup> The petitioner, the respondent, and the court in *Simpson* all agreed that outright distributions of 1% of the trust to each of five specified charities upon Simpson's death qualified for a charitable deduction under Section 2055, even though the trust did not take one of the statute's specified three forms and the donation was made in trust.<sup>69</sup> The court prohibited the Simpson Estate from taking a deduction for the charitable remainder interest established under the trust, because the court viewed the remainder interest as separable from that distributed to the charities outright.<sup>70</sup>

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<sup>66</sup> See, e.g., *Estate of Atkinson v. Comm'r*, 309 F.3d 1290, 1292 (11th Cir. 2002) (holding that a charitable remainder annuity trust in which the annuity payments to the non-charitable beneficiary were never paid does not qualify as a charitable remainder annuity trust under I.R.C. § 2055(e)(2)(A) and is disallowed any charitable deduction).

<sup>67</sup> 67 T.C.M. (CCH) 3062, 3063 (1994).

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at 3064.

<sup>70</sup> *Id.*

A trust involving a partial income interest for life in the decedent's sister and a remainder interest in a charitable beneficiary was at issue in *Flanagan v. United States*.<sup>71</sup> Following a will contest and settlement, the charitable interest "passed directly" to the charitable beneficiary.<sup>72</sup> The Tenth Circuit held in *Flanagan* that, even though the will contest resulted in the trust's funds being divided between charitable and non-charitable beneficiaries, there was "no split interest transfer to which [Section] 2055(e)(2) [was] applicable;" the charitable contribution deduction was allowed for the funds that passed directly to the charitable beneficiary upon the settlement of the will contest.<sup>73</sup>

The Tenth Circuit explained in *Flanagan* that, "[w]hile the Supreme Court 'has long recognized the primary authority of the IRS and its predecessors in construing the Internal Revenue Code,' this authority must still be reviewed *with regard to congressional intent*."<sup>74</sup> Agreeing with an earlier decision of the Seventh Circuit, the Tenth Circuit—regarding the legislative intent behind the estate tax charitable contribution—stated that

congressional intent to prefer charitable gifts to estate taxes was "a case of absolute priority . . . [While] loopholes should not be permitted to diminish estate tax payments by ostensibly charitable bequests which may never become effective," *we cannot blindly resolve all doubts in favor of the IRS if we are to respect legislative intent to encourage gifts to charity*.<sup>75</sup>

This is an important point to consider in any analysis of the charitable contribution deduction's disallowance, especially in an instance involving an undivided portion passing to a charitable beneficiary as was the case in *Galloway*.

In *Oetting v. United States*, Mrs. Dunmeyer's inter vivos trust and pour-over will provided \$100 a month to each of three relatives for life, with the remainder of the trust corpus to be divided equally between four charitable beneficiaries and one non-charitable beneficiary.<sup>76</sup> By court decree, upon the death of Mrs. Dunmeyer, the trust funds were

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<sup>71</sup> 810 F.2d at 931.

<sup>72</sup> *Id.* at 933.

<sup>73</sup> *Id.* at 935.

<sup>74</sup> *Id.* at 934 (emphasis added) (quoting *Bob Jones Univ. v. United States*, 461 U.S. 574, 596 (1983)). "In enacting the charitable deduction provisions in I.R.C. § 2055 and its predecessors, Congress sought to encourage gifts to charity." *Id.* (citing *Comm'r v. Estate of Sternberger*, 348 U.S. 187, 190 n.3 (1955)).

<sup>75</sup> *Id.* at 935 (alteration in original) (emphasis added) (quoting *Norris v. Comm'r*, 134 F.2d 796, 802 (7th Cir. 1943)).

<sup>76</sup> 712 F.2d 358, 359 (8th Cir. 1983). Thus far, the fact pattern in *Oetting* resembles the typical trust structure prone to the abuse of overvaluing deductions that Congress tried to discourage by enacting I.R.C. § 2055(e)(2). See *supra* notes 44–46 and accompanying text.

divided into three annuities purchased for the three relatives, outright distributions made to the four charitable remainder beneficiaries, and a trust established for the individual remainder beneficiary.<sup>77</sup> The court in *Oetting* cited the 1969 Senate Report, detailing the purpose of Section 2055(e)(2)—to prevent abuse.<sup>78</sup> The Eighth Circuit held that *Oetting* “present[ed] none of the abuses which [Section] 2055(e)[(2)] was designed to prevent” and allowed the deduction claimed for “those amounts that were actually received by the four charities.”<sup>79</sup> Although *Oetting* involves an outright distribution, and not an undivided portion in trust, the Eighth Circuit’s reasoning in *Oetting* reaffirms the principle argued in *Galloway* that, when applying Section 2055(e)(2) to a situation when the charitable and non-charitable interests in a split-interest trust are structured in a way that they are non-competing and in no way prone to deduction valuation abuse, the allowance of a deduction is appropriate.

More recently, *Estate of Jackson v. United States* involved a revocable inter vivos trust which was to pay Jackson income and principal during her life.<sup>80</sup> Upon Jackson’s death, the trust was to pay outright distributions of \$150,000 to each of her four nephews and nieces; these four non-charitable beneficiaries were also each to receive a one-fourth income interest in the trust for life.<sup>81</sup> The remainder interest in the trust assets was to be distributed upon the death of the last non-charitable beneficiary to a named charitable beneficiary.<sup>82</sup> Following Jackson’s death, however, the beneficiaries agreed to terminate the trust and the charitable beneficiary received an outright distribution of the estimated present value of its remainder interest.<sup>83</sup> The district court looked to the intent of Section 2055(e) to allow a deduction in this instance.<sup>84</sup> According to the court in *Jackson*:

To determine whether § 2055(e) applies to a terminated charitable split-interest, courts routinely emphasize the distinct goal

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<sup>77</sup> *Oetting*, 712 F.2d at 360.

<sup>78</sup> *Id.* at 360–61 (citing S. REP. NO. 91-552, at 87 (1969), reprinted in 1969 U.S.C.A.N. 2027, 2116); see *supra* notes 34–40 and accompanying text.

<sup>79</sup> 712 F.2d at 363. In *Estate of Strock v. United States*, 655 F. Supp. 1334, 1335 (W.D. Pa. 1987), decided by the same district court as *Galloway*, a trust was created under Strock’s will that provided life income interests to non-charitable beneficiaries and a remainder interest in the corpus of the trust to charitable beneficiaries. Upon a will contest, the trust assets were distributed directly to all beneficiaries. *Id.* Under this scenario, the court determined that the Strock Estate was entitled to the charitable contribution deduction for the amount that was paid outright to its charitable beneficiaries. *Id.* at 1341.

<sup>80</sup> 408 F. Supp. 2d 209, 210 (N.D. W. Va. 2005).

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Id.* at 211.

<sup>84</sup> *Id.* at 211–13.

of the statute, i.e., to ensure that an estate's charitable deduction corresponds to the value received by the charity. Accordingly, when analyzing this issue, courts have generally focused on four factors:

(1) whether property is directly transferred to the charitable beneficiary; (2) whether a non[-]charitable beneficiary maintains an interest in that property; (3) whether the deduction is sought for the actual benefit received by the charitable entity; and (4) whether the estate is "concerned solely with gaining a charitable deduction by skirting the split-interest rules" of § 2055(e).<sup>85</sup>

This test minimizes the focus on Section 2055(e)(2)'s strict trust structure requirements and seeks to determine when the deduction should be granted based on the intent underlying this statute.

*Estate of Jackson*, like its predecessor cases, made an outright distribution of trust funds to a charitable beneficiary and was deemed to have properly claimed a charitable contribution deduction. The only major distinction between the four cases described above and *Galloway* is that the 50% charitable interest in *Galloway* is to be held in trust for a period of years before it is fully distributed. All of the income and principal of the 50% charitable interest, however, will be distributed to the charitable beneficiaries, and there are no interfering interests to prevent this from occurring. The design of the Galloway Trust, regarding the 50% charitable "undivided portion," does not create a scenario susceptible to the deduction valuation abuse Congress sought to curb in the creation of Section 2055(e)(2). In accordance with the logic of the cases presented in this Note, the Galloway Trust should be allowed a charitable deduction in the amount of the present value of 50% of the trust.

Additionally, Galloway argued that the Galloway Trust was economically and operationally equivalent to two separate trusts, one for the 50% share for the charitable beneficiaries and one for the 50% share for the non-charitable beneficiaries in which the charitable beneficiaries hold a future interest.<sup>86</sup> Both *Galloway* courts disagreed with this argument, finding that no deduction is allowed where a split-interest trust created to be a single trust does not meet the specific requirements of one of the trust structures listed in Section 2055(e)(2)(A).<sup>87</sup>

The Third Circuit recognized the "unfortunate result" that this conclusion causes in the *Galloway* case, but upheld the outcome, stating:

Section 2055(e) was passed to protect against abuses that resulted most frequently from non-charitable beneficiaries exploiting their life interest in an estate and leaving a charitable beneficiary with a

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<sup>85</sup> *Id.* at 212 (citation omitted) (quoting *Burdick v. Comm'r*, 979 F.2d 1369, 1372 (9th Cir. 1992)).

<sup>86</sup> Galloway Brief, *supra* note 61, at 5.

<sup>87</sup> *Galloway*, 2006 WL 1233683, at \*6, *aff'd*, 492 F.3d at 223–25.



shadow of what was bequeathed to it. In *Galloway*, there is little chance that the same sort of abuse would take place. Each beneficiary of the Trust, charitable and non-charitable, shares equally in the risk of loss and the benefit of good investing as each beneficiary receives an equal share in the property. However, the fact that the abuses Congress sought to protect against are not present here does not give us license to circumvent the clear language presented in the statute. In the future, should testators seek to bequeath their estates to both charitable and non-charitable beneficiaries, they must use the tools provided in §§ 2055(e)(2)(A) and (e)(2)(B).<sup>88</sup>

This is in line with the holding of the United States Tax Court in *Estate of Edgar v. Commissioner*, in which the court asserted:

Although this specific [trust structure] may not have been regarded as abusive by Congress when it enacted [Section 2055(e)], . . . permitting economic factors to be considered would directly contradict Congress' intent to establish specific rules in this area. . . . [Charitable interests in split-interest trusts] must in all events conform to the statutory requirements.<sup>89</sup>

Significantly, though, *Edgar* is distinguishable from *Galloway* in that the Edgar Trust contained a charitable remainder interest,<sup>90</sup> not an undivided portion.

In *Zabel v. United States*—the case most closely analogous to *Galloway*—the court disallowed a charitable contribution deduction claimed for a trust which had been created under a will.<sup>91</sup> The trust's charitable and non-charitable beneficiaries were to equally share the income from the trust for 21 years, at which point the entire remaining corpus of the trust would be distributed to the charitable beneficiaries. Zabel argued that the charitable beneficiaries had “practically, although not legally, received half the trust.”<sup>92</sup> The plaintiff claimed the charitable contribution deduction for the present value of this 50% income and remainder interest and not for any value attributable to the remainder interest the charitable beneficiaries held in the non-charitable beneficiaries' 50% income for life share.<sup>93</sup> Zabel argued that under the trusts in both *Galloway* and *Zabel*, “no harm can befall the charities, though the trust[s] do not employ one of the three devices specified in

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<sup>88</sup> *Galloway*, 492 F.3d at 224 (emphasis added).

<sup>89</sup> 74 T.C. 983, 987–88 (1980). The district court in *Galloway* based its decision in part on the holding in *Edgar*. *Galloway*, 2006 WL 1233683, at \*4. Neither the district court in *Galloway* nor the court in *Edgar* took into account the implications of Treasury Regulation § 20.2055-2(e)(2)(i) where an undivided portion is transferred to charity. The Third Circuit in *Galloway* also summarily dismissed Section 20.2055-2(e)(2)(i), considering it “inapplicable” to the case. 492 F.3d at 225 n.6.

<sup>90</sup> *Edgar*, 74 T.C. at 985.

<sup>91</sup> 995 F. Supp. 1036, 1038 (D. Neb. 1998).

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

section 2055(e)(2)(A).<sup>94</sup> There is only potential for the 50% interests of the charities to increase, not decrease, as a result of the charities' interests in the non-charitable beneficiaries' 50% shares.

The court in *Zabel* based its decision on *Oetting*, which it cited as defining Section 2055(e)(2) for the Eighth Circuit as disallowing a deduction for any split-interest bequest made in trust unless the remainder interest is in one of the statute's three excepted forms.<sup>95</sup> The IRS came to the same conclusion under a similar factual scenario in Revenue Ruling 77-97, noting that "if the decedent had established two separate trusts, one for charitable purposes and one for private purposes, instead of one trust for both purposes [with an undivided portion conveyed to the charitable beneficiaries], the charitable deduction would have been allowable."<sup>96</sup> The IRS has stated that this is also the result when the undivided portion passing to charitable beneficiaries consists of a specified number of shares of stock held in the same trust as a specified number of shares of stock designated to a non-charitable beneficiary.<sup>97</sup> This scenario was found to meet both the "in the same property" and "in trust" requirements of I.R.C. § 2055(e)(2) and Treasury Regulation § 20.2055-2(e)(2)(i), respectively.<sup>98</sup> It seems, then, that the courts and the IRS draw their distinction as to when the deduction should be allowed in the instance of an undivided portion passing to charitable beneficiaries in trust by a simple count of the number of documents involved, *one trust document or two*.<sup>99</sup>

Interestingly, though, the IRS did not follow its prior holdings when applying Section 2055(e)(2) in Revenue Ruling 83-20, in which a trust

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<sup>94</sup> See *id.* at 1047.

<sup>95</sup> *Id.* at 1046; *Oetting v. United States*, 712 F.2d 358, 361 (8th Cir. 1983).

<sup>96</sup> Rev. Rul. 77-97, 1977-1 C.B. 285. Additionally, in a factually comparable Private Letter Ruling, the IRS stated:

It might be argued that, for purposes of section 20.2055-2(e)(2)(i) of the regulations, Charity X has at least an undivided fifteen percent interest in the subject trust because of its twenty percent income interest followed by a fifteen percent remainder interest. . . . But section 20.2055-2(e)(2)(i) applies only to undivided interests *not in trust*.

I.R.S. Priv. Ltr. Rul. 93-26-003 (March 23, 1993) (emphasis added); see also *Estate of Brock v. Comm'r*, 71 T.C. 901, 906 & n.9 (1979); I.R.S. Priv. Ltr. Rul. 2002-23-013 (March 11, 2002) (holding that, where a contribution of an undivided portion was made "not in trust," the deductible interest exception in Section 20.2055-2(e)(2)(i) applied and the deduction was allowed).

<sup>97</sup> I.R.S. Tech. Adv. Mem. 77-35-002 (May 23, 1977).

<sup>98</sup> *Id.*

<sup>99</sup> Even where two separate trust documents are drafted, however, if the two trusts combined give both charitable and non-charitable beneficiaries interests "in the same property," the two trusts may be deemed to constitute one total trust, and the deduction may still be disallowed. See I.R.S. Tech. Adv. Mem. 76-10-199590A (October 19, 1976).

was established similar to that in *Galloway* and in *Zabel*.<sup>100</sup> In this instance, a trust was created entirely for charitable purposes, but the surviving spouse of the decedent “petitioned the probate court for an allowance for support that [was] payable during the period of administration of [the decedent’s] estate,” creating an income interest in a percentage of the trust for the surviving spouse.<sup>101</sup> The IRS held that the “portion of the residuary estate certain to be received by charity (or not subject to diversion for a noncharitable purpose) is property in which no noncharitable interest exists and is therefore deductible and not a split interest.”<sup>102</sup> Since the interests in this trust were “capable of being measured and severed,” the charitable contribution deduction was allowed.<sup>103</sup>

The IRS seems to be uncertain regarding when to allow a deduction to estates making charitable donations in split-interest trusts. When donors give undivided portions in trust, the IRS and the courts have, in most instances, overreached congressional intent and disallowed the deduction. Thus, there is an apparent need for clarification, whether by the courts or by Congress, of the “plain language” of I.R.C. § 2055(e)(2) and Treasury Regulation § 20.2055-2(e)(2)(i). Ultimately, congressional amendment of Section 2055(e)(2) may allow this Section to better reflect legislative intent and better resolve this issue.

*B. Revision of I.R.C. § 2055(e)(2) and Treasury Regulation  
§ 20.2055-2(e)(2)(i) Is Needed to Prevent Improper  
Disallowances of the Charitable Contribution Deduction  
for Undivided Portions Given in Trust*

When should the deduction be allowed or disallowed? As evidenced by the foregoing cases, this is not an easy question to answer, even for the IRS.<sup>104</sup> In light of this, it is not surprising that some courts look to legislative intent to divine the meaning of I.R.C. § 2055(e)(2). Discerning and applying legislative intent, however, is a gray area of law itself and should be approached with caution.

1. Applicable Canons of Statutory Construction

The Supreme Court of the United States has addressed the value of legislative intent in various cases that offer guidance for analyzing Section 2055(e)(2). The Supreme Court begins with the presumption that “[the] legislature says in a statute what it means and means in a statute

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<sup>100</sup> Rev. Rul. 83-20, 1983-1 C.B. 231.

<sup>101</sup> *Id.* at 231–32.

<sup>102</sup> *Id.* at 232.

<sup>103</sup> *Id.*

<sup>104</sup> *See supra* Part IV.A.

what it says there.”<sup>105</sup> While recognizing “the potential for harsh results in some cases” under an existing statutory scheme, the Supreme Court maintains that it is “not free to rewrite [a] statute that Congress has enacted. ‘[W]hen the statute’s language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.’”<sup>106</sup> Legislative intent, though, can be a useful analytical tool, especially in the interpretation of ambiguous statutory language. Upon an “extraordinary showing” of contrary congressional intention, a court’s limitation on the “plain meaning” of statutory language can be justified.<sup>107</sup> “In surveying legislative history [the Supreme Court has] repeatedly stated that the authoritative source for finding the Legislature’s intent lies in the Committee Reports on [a] bill, which ‘represen[t] the considered and collective understanding of those Congressmen involved in drafting and studying proposed legislation.’”<sup>108</sup>

The district court in *Zabel* described the rules that courts have applied regarding the construction of Section 2055(e)(2):

(a) In interpreting tax statutes, the literal meaning of the words employed is most important, and such statutes are not to be extended by implication beyond the clear import of the language used. Thus, the Court’s first duty is to read the statute in its ordinary and natural sense.

(b) Where the meaning of the words used in the statute is doubtful, however, it is proper to resort to legislative history as an aid to construction, although such legislative history cannot be used to expand or contract the scope of the statute itself.

(c) Where a tax statute involves the allowance of a deduction or an exemption, it must be strictly construed.<sup>109</sup>

The court in *Zabel* was also of the opinion that

Congress has the right to pick among various competing alternatives when specifying how a taxpayer must structure trusts to qualify for a tax exemption. The fact that the decedent may have

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<sup>105</sup> *Dodd v. United States*, 545 U.S. 353, 357 (2005) (alteration in original) (quoting *Conn. Nat’l Bank v. Germain*, 503 U.S. 249, 253–54 (1992)).

<sup>106</sup> *Id.* at 359 (quoting *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000)).

<sup>107</sup> *Garcia v. United States*, 469 U.S. 70, 75 (citing *Tenn. Valley Auth. v. Hill*, 437 U.S. 153, 187 n.33 (1978)); see *Consumer Prod. Safety Comm’n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980) (“Absent a clearly expressed legislative intention to the contrary, [statutory] language must ordinarily be regarded as conclusive.”). *But see Zedner v. United States*, 126 S. Ct. 1976, 1991 (2006) (Scalia, J., concurring) (“[T]he use of legislative history is illegitimate and ill advised in the interpretation of any statute[,] especially a statute that is clear on its face . . .”).

<sup>108</sup> *Garcia*, 469 U.S. at 76 (quoting *Zuber v. Allen*, 396 U.S. 168, 186 (1969)).

<sup>109</sup> *Zabel v. United States*, 995 F. Supp. 1036, 1045 (D. Neb. 1998) (quoting *Estate of Cassidy v. Comm’r*, No. 26713-83, 49 T.C.M. (CCH) 580, 583 (1985)).

chosen a different method, *which is as good as the method chosen by Congress*, does not mean that the decedent's choice trumps the Congressional choice of another method. Congress, not the taxpayer, defines the boundaries of tax exemptions.<sup>110</sup>

Regarding the authority of treasury regulations, the Supreme Court has provided: "When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question of whether Congress has directly spoken to the precise question at issue."<sup>111</sup> If Congress has spoken unambiguously, then the agency must give effect to that statutory language. "If, however, the court determines Congress has not directly [and unambiguously] addressed the precise question at issue," such as with the present issue of undivided portions given to charitable beneficiaries through split-interest trusts, then "the question for the court is whether the agency's answer is based on a permissible construction of the statute."<sup>112</sup> Deference should be shown to administrative interpretations of statutory schemes;<sup>113</sup> however,

The judiciary is the *final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent*. If a court employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect.<sup>114</sup>

## 2. Revision of the Split-Interest Trust Charitable Contribution Deduction Provisions with Respect to Undivided Portions

Applying the "plain language" of I.R.C. § 2055(e)(2) and Treasury Regulation § 20.2055-2(e) in factual scenarios that contain undivided portions given to charitable beneficiaries by estates in split-interest trusts, such as in *Galloway*, produces results that are contrary to or extend beyond legislative intent. This disallows the charitable contribution deduction in instances which are not prone to deduction valuation abuse. The charitable interests in these trusts are "capable of being measured and severed"<sup>115</sup> and merit allowance of a deduction.

The effect of Treasury Regulation § 20.2055-2(e)(1)(i) is to deny a deduction to split-interest bequests unless the interest designated to charity is a "deductible interest,"<sup>116</sup> the definition of which includes

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<sup>110</sup> *Id.* at 1047 (emphasis added).

<sup>111</sup> *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842 (1984).

<sup>112</sup> *Id.* at 843.

<sup>113</sup> *Id.* at 844.

<sup>114</sup> *Id.* at 843 n.9 (emphasis added) (citations omitted).

<sup>115</sup> Rev. Rul. 83-20, 1983-1 C.B. 231.

<sup>116</sup> Treas. Reg. § 20.2055-2(e)(1)(i) (2006).

“undivided portion[s].”<sup>117</sup> Section 20.2055(2)(e)(2)(i) operates to deny this “undivided portion” exception to transfers made “in trust.”<sup>118</sup> The Treasury Regulations effectively leave I.R.C. § 2055(e)(2) to be the controlling rule in the situation of an undivided portion given in a split-interest trust, refraining from giving any guidance for how courts should deal with these instances, other than to apply the severe trust structure restrictions included in Section 2055(e)(2) (essentially what could be called the “One trust document or two?” rule). This results in disallowing the deduction in situations not susceptible to the abuse which Congress enacted Section 2055(e)(2) to deter. Thus, courts should allow the deduction—recognizing that failure to do so defeats legislative intent.

Because the congressional intent underlying Section 2055(e)(2) is authoritative when the relevant statutory and regulatory provisions operate to contradict this intent, the *Galloway* and *Zabel* courts erred in disallowing the deductions for the undivided portions passing to charitable beneficiaries in trust. Section 2055(e)(2) is ambiguous with respect to undivided portions given to charitable beneficiaries in split-interest bequests. The statutory provision fails to make any mention of an undivided portion exception, which is a concept that the applicable treasury regulations create and apply only to charitable contributions made in non-trust contexts.<sup>119</sup> Accordingly, the *Galloway* and *Zabel* courts should have concluded the following: (1) these trusts contained separable and undivided charitable interests, not in competition with the non-charitable interests in the same trust, and (2) the “not in trust” requirement of Treasury Regulation § 20.2055-2(e)(2)(i) is contrary to and an inappropriate expansion of the congressional intent behind I.R.C. § 2055(e)(2) and should no longer be followed. Together, these conclusions would have resulted in allowance of the charitable contribution deduction in these cases. Additionally, a ruling of this nature would have set a clear precedent for future decisions.<sup>120</sup>

If, however, the plain language of Section 2055(e)(2) is unambiguous, as both *Galloway* courts decided,<sup>121</sup> and if the relevant

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<sup>117</sup> *Id.* § 20.2055-2(e)(2)(i) (2006).

<sup>118</sup> *Id.*

<sup>119</sup> *See id.* § 20.2055-2(e)(1)(i), (2)(i) (2006).

<sup>120</sup> The Third Circuit in *Galloway* based its decision on *Zabel* and held accordingly, affirming the district court’s decision. *Galloway v. United States*, 492 F.3d 219, 224–25 (3d Cir. 2007). This was the first time the Third Circuit ruled on a case involving an undivided portion given to charitable beneficiaries in a split-interest trust. Had *Galloway* been appealed to the Supreme Court of the United States, there would exist the potential for these two proposed conclusions to be found, allowing a deduction for the 50% charitable interest in the trust.

<sup>121</sup> *Galloway*, 2006 WL 1233683, at \*5, *aff’d*, 492 F.3d at 223–24; *see* *Estate of Johnson v. United States*, 941 F.2d 1318, 1321 (1991) (“[T]he pertinent statutory language [of Section 2055(e)(2) is] unambiguous.”). The Third Circuit stated in *Galloway*:

treasury regulations are assumed to be “a permissible construction of the statute,”<sup>122</sup> then the *Galloway* courts made the only decision they could under the existing language. As the district court in *Galloway* noted, “it is the role of Congress” and not the courts “to clarify or amend the plain language of [Section] 2055(e) to prevent” such harsh results.<sup>123</sup> Statutory or regulatory revision is a possible solution to the *Galloway* dilemma. This could be carried out in two ways. First, the Treasury Department could remove the “not in trust” requirement from Treasury Regulation § 20.2055-2(e)(2)(i). This would create a clear exception to the disallowance provisions for all undivided portions passed to charitable beneficiaries in split-interest bequests.

The IRS, though, likely contends that Treasury Regulation § 20.2055-2(e) is not only a permissible construction, but that it is the intended construction of I.R.C. § 2055(e)(2).<sup>124</sup> Therefore, the second and likely the necessary solution to resolve the *Galloway* dilemma is for Congress to amend I.R.C. § 2055(e)(2) to include similar provisions as found in the following model legislation:

(2) Where an interest in property (other than an interest described in Section 170(f)(3)(B)) passes or has passed from the decedent to a person, or for a use, described in subsection (a), and an interest (other than an interest which is extinguished upon the decedent's death) in the same property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to a person, or for a use, not described in subsection (a), no deduction shall be allowed under this section for the interest which passes or has passed to the person, or for the use, described in subsection (a) unless—

(A) in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a

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Therefore, where, as here, the language of the statute is clear and unambiguous, we will not create an ambiguity through the use of legislative history. The language of § 2055(e) does not refer only to trusts creating a remainder interest. It also refers to “any other interest.” We will not use legislative history that focuses on a particular type of trust to narrow the broad language Congress chose to use when enacting the statute.

*Galloway*, 492 F.3d at 224 (citation omitted).

<sup>122</sup> *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984).

<sup>123</sup> *Galloway*, 2006 WL 1233683, at \*6.

<sup>124</sup> The IRS stated, with regard to the charitable contribution deduction provisions for individual taxation, *see* I.R.C. § 170(a) (2000), (f) (2000 & Supp. IV 2004), that the disallowance provisions “extend[] beyond situations in which there is actual or probable manipulation of the non-charitable interest to the detriment of the charitable interest.” Rev. Rul. 2003-28, 2003-1 C.B. 594; *see also* Rev. Rul. 88-37, 1988-1 C.B. 97.

charitable remainder unitrust (described in section 664) or a pooled income fund (described in section 642(c)(5)),

(B) *the interest that passes or has passed to a person, or for a use, described in subsection (a), is an undivided portion of the decedent's entire interest in property, or*

(C) in the case of any other interest, such interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly of the fair market value of the property (to be determined yearly).<sup>125</sup>

## V. THE BROADER PICTURE OF TAX POLICY AND PRIVATE CHARITABLE GIVING

### A. *American Tax Policy Encourages Private Charitable Giving*

When a charitable contribution deduction is denied in an instance where Congress's intended to allow a deduction, Congress' goal of encouraging and effectively subsidizing private charitable giving is subverted. This is especially true when the tax owed as a result of the deduction's disallowance is paid out of the trust corpus, severely depleting any interest in the trust which charities might eventually receive. This is the case in *Galloway*. When charitable contribution deductions are disallowed in instances lacking the potential for deduction valuation abuse, the American private nonprofit sector, on the whole, receives less private charitable funding. Congress and the IRS, as a policy, sought to avoid this result through the creation of the deduction, which was designed to encourage private giving.

[T]here is little question that an important institutional area of American life—the private nonprofit sector—could not exist without [private giving]. Private support is a fundamental underpinning for hundreds of thousands of . . . organizations; it is the ingredient that keeps private nonprofit organizations alive and private, keeps them from withering away or becoming mere adjuncts of government.<sup>126</sup>

The Seventh and Tenth Circuits have stated accurately that “congressional intent to prefer charitable gifts to estate taxes [is] ‘a case

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<sup>125</sup> This model amended legislation is based on both I.R.C. § 2055(e)(2) and Treasury Regulation § 20.2055-2(e)(2)(i). The italicized portion is the proposed amendment to I.R.C. § 2055(e)(2); the unitalicized text is taken directly from the current text of that statute. See I.R.C. § 2055(e)(2) (2000). The term “undivided portion” will also need to be included in the definition section of these statutory provisions as: *A fraction or percentage of each and every substantial interest or right owned by a decedent in such property extending over the entire term of the decedent's interest in such property and in other property into which such property is converted.* This proposed definition is based on the definition of “undivided portion” provided in Treasury Regulation § 20.2055-2(e)(2)(i).

<sup>126</sup> GIVING IN AMERICA, *supra* note 2, at 53.



of absolute priority”<sup>127</sup> The principal that private charitable giving is to be encouraged should overarch all tax policy regarding charitable contribution deductions. This policy is supported in I.R.C. § 2055(a)’s allowance of the deduction in the area of estate taxes, as well as in I.R.C. § 2055(e)(2)’s disallowance of the deduction in instances of deduction valuation abuse. The abuse is discouraged through disallowing the deduction with an overall goal of increasing the chances that the full amount of contributions for which deductions are allowed will eventually reach the charitable beneficiaries for which the contributions are intended.

However, disallowing the deduction in instances not prone to deduction valuation abuse, as demonstrated in *Galloway*, operates in reverse of Congress’s main intent to encourage private charitable giving. Deduction disallowance in these scenarios typically increases estate taxes substantially and deprives both charitable and non-charitable beneficiaries of a percentage of the trust property designated to them. Because of these “draconian” results<sup>128</sup> which are inconsistent with the American tax policy in favor of private charitable giving, the proposed amendment<sup>129</sup> is an appropriate and necessary addition to existing tax law.

#### *B. A Biblical Basis for Private Charitable Giving*

Private charitable giving, in addition to being encouraged by American tax policy and firmly rooted in American ideals, has been long-established in Judeo-Christian religious doctrine. Deuteronomy 15:7–11 states:

If there is a poor man among [you] . . . Give generously to him and do so without a grudging heart; then because of this the LORD your God will bless you in all your work and in everything you put your hand to. There will always be poor people in the land. Therefore I command you to be openhanded toward your brothers and toward the poor and needy in your land.<sup>130</sup>

A reality of American society is that wealth is not evenly distributed. There is a moral imperative to aid those in need, both within the United States and internationally, and allowing a charitable contribution

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<sup>127</sup> *Flanagan v. United States*, 810 F.2d 930, 935 (10th Cir. 1987) (quoting *Norris v. Comm’r*, 134 F.2d 796, 801 (7th Cir. 1943)).

<sup>128</sup> W. LESLIE PEAT & STEPHANIE J. WILLBANKS, *FEDERAL ESTATE AND GIFT TAXATION: AN ANALYSIS AND CRITIQUE* 215 (2d ed. 1995).

<sup>129</sup> See *infra* notes 124–25 and accompanying text.

<sup>130</sup> *Deuteronomy* 15:7, 10–11 (NIV); see also *Psalms* 112:5 (NIV) (“Good will come to him who is generous . . . .”); *Proverbs* 22:9 (NIV) (“A generous man will himself be blessed . . .”).

deduction is an added bonus on top of the fulfillment of this calling to “[g]ive generously” to others.<sup>131</sup>

People should fulfill this calling even without a deduction for private charitable giving. Paul wrote in Romans 12:6–8: “If a man’s gift is . . . contributing to the needs of others, let him give generously . . .”<sup>132</sup> Biblical principles of fairness,<sup>133</sup> though, imply that if a deduction is allowed for the purposes of encouraging and increasing private charitable giving, then this deduction should be allowed for all who deserve it. These Biblical principles are violated when courts disallow a merited deduction because of legislative or regulatory technicalities.

#### CONCLUSION

When individuals make charitable contributions through split-interest trusts, they risk the disallowance of any potential charitable contribution deduction for estate tax purposes. Even where the interest given to the charitable beneficiary represents an undivided portion of the decedent’s interest in trust property—as was the case in *Galloway*—under the prevailing statutory interpretation of I.R.C. § 2055(e)(2) and Treasury Regulation § 20.2055-2(e), the deduction will be disallowed. This draconian application of Section 2055(e)(2) oversteps the legislative intent behind the enactment of that section. Until a better solution to this conflict between statutory language and intent is reached, whether through case precedent or legislative amendment, the “moral” of *Galloway* remains that “the drafter who is unsure of the technical [deduction disallowance] rules would be well-advised to seek” legal counsel before trying to make any contribution to charitable beneficiaries out of his or her estate.<sup>134</sup>

*Valerie H. Kuntz*

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<sup>131</sup> *Deuteronomy* 15:10 (NIV).

<sup>132</sup> *Romans* 12:6–8 (NIV).

<sup>133</sup> See *Deuteronomy* 1:16; *Proverbs* 31:9; *Isaiah* 30:18.

<sup>134</sup> See PEAT & WILLBANKS, *supra* note 128, at 217.