University of Richmond Law Review

Volume 35 | Issue 1 Article 3

2001

Family Development Deductions - An Alternative to Repealing the Estate Tax

Richard J. Kovach

FAMILY DEVELOPMENT DEDUCTIONS—AN ALTERNATIVE TO REPEALING THE ESTATE TAX

*Richard J. Kovach**

I. INTRODUCTION

Opposing political and social interests have long conducted a vigorous debate on whether gratuitous transfers of wealth should invoke federal excise taxes.[1] Attempts to eliminate wealth transfer taxes reached a peak in the summer of 2000, when the Senate passed repeal legislation overwhelmingly approved by the House of Representatives.[2] Those supporting repeal point out that wealth transfer taxation discourages work and savings while encouraging consumption.[3] They further assert that transfer taxation revenue does not constitute a very significant portion of total federal revenue.[4] The supporters of repeal also emphasize how the complexity of these taxes has created a parasitic service industry that artificially extracts value from the national economy.[5]

Those who favor wealth transfer taxes point out that tax-free

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* McDowell Professor of Law, The University of Akron School of Law. A.B., 1970, Oberlin College; J.D., 1974, Harvard Law School.

1. Inter vivos and testamentary transfers of wealth merge for estate tax computations. I.R.C. § 2001(b) (1994) (unifying the estate tax with the gift tax by means of a single rate table, effectively making death transfers the last of a potential series of wealth dispositions). In order to tax wealth transfers at least once per generation, I.R.C. § 2601 imposes a generation-skipping tax in aid of the estate and gift taxes. I.R.C. § 2601 (1994). Accordingly, the debate over wealth transfer taxation involves three different transfer taxes having a common purpose.

2. Death Tax Elimination Act of 2000, H.R. 8, 106th Cong. (2000) (vetoed by President Clinton in August, 2000).

3. *See, e.g.*, Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 YALE L.J. 283, 364 (1994).

4. Estate and gift taxation accounted for only 1.4% of total federal taxes collected during 1997. I.R.S. DATA BOOK, PUB. 55B 3 (1997).

5. See Henry J. Aaron & Alicia H. Munnell, *Reassessing the Role for Wealth Transfer Taxes*, 45 NAT'L TAX J. 119, 133-38 (1992), for a short review of wealth transfer tax avoidance and its economic costs.

wealth transfers would jeopardize the overall progressivity of the federal tax system.[6] In addition, inordinate wealth transfers can discourage the personal development and economic productivity of recipients, as well as encourage profligate consumption while many citizens suffer economic need that could lessen under a proper redistribution of excessive wealth.[7] Those in favor of wealth transfer taxation tend to view taxation in general as a useful social mechanism to promote fairness and lessen the widening financial gap between the wealthiest and poorest citizens.[8]

To date, the best technical accommodation between these opposing views of wealth transfer taxation remains the deduction for charitable transfers.[9] Charitable transfer deductions have no dollar limitations, allowing even the wealthiest citizens to escape transfer taxation.[10] Charitable transfers, however, do restrict the ability of wealthy persons to benefit their own families.[11] Nevertheless, many wealthy persons like charitable transfers because benevolent donations directly ameliorate social needs without causing government to serve as an intermediary between source and application.[12]

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6. An official speaking for the United States Treasury Department recently supported wealth transfer taxation by stating that "repeal [of the transfer excises] would have 'a negative impact on the overall progressivity of the tax system' and create a 'significant loss' of revenue." *Tax Report*, WALL ST. J., Sept. 29, 1999, at A1.

7. Economist Paul Krugman refers to the revenue raised by wealth transfer taxation in this context: "[I]t is roughly what the federal government spends on the earned-income tax credit, a program that helps millions of poor workers .... and it's more than twice our total spending on foreign aid, and around five times as much as the non-military component of that aid." Paul Krugman, *Death and Taxes*, N.Y. TIMES, June 14, 2000, at A27.

8. *See, e.g.*, Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 YALE L.J. 259, 274-83 (1983).

9. Unlimited deductions for properly made charitable transfers occur under I.R.C. § 2055 which grants a deduction for estate tax purposes and I.R.C. § 2522 which allows for a gift tax deduction. I.R.C. § 2055 (1994 & Supp. 1998); I.R.C. § 2522 (1994). Transfers to charitable organizations escape imposition of the generation-skipping tax. I.R.C. § 2651(e)(3) (Supp. 1998) (assigning charitable organizations to the transferor's generation, thus making a charitable transfer not generation-skipping).

10. In contrast to charitable deductions under wealth transfer taxation, the charitable deduction for income tax purposes imposes precise limitations that generally vary according to a taxpayer's level of adjusted gross income. *See* I.R.C. § 170(b) (Supp. 1998) (establishing various percentage limitations).

11. Because qualifying charitable recipients must have an organizational status, no charitable transfer deduction results from a direct payment by a benefactor to an individual, regardless of the recipient's need. *See, e.g.*, I.R.C. § 2055(a) (1994 & Supp. 1998) (defining qualifying recipients as political entities, corporations, trusts, or other organizations).

12. Taxpayers typically dislike at least some tax expenditures, whether pertaining to

Despite the role of charitable deductions in ostensibly addressing the disparate concerns of both opponents and proponents of wealth transfer taxation, both sides express concerns about the inefficiencies of charitable transfers. Opponents of wealth transfer taxation dislike how charitable transfers conflict with family benefit,[13] while wealth taxation proponents focus on technical features of charitable contribution deductions that address perceived abuses.[14] Neither side appears totally happy with the role of charitable transfer deductions in simultaneously offering tax relief and redistribution of wealth toward social goals.

This article outlines a proposal to create a new transfer tax deduction that would simultaneously reduce pressures to repeal wealth transfer taxes and promote wealth redistribution. This proposed deduction best takes the name "family development deduction" as used throughout this article.[15] Family development

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military spending, welfare programs, or "political pork." Choosing how to use one's money to produce a social good becomes an important consideration for those who make gratuitous transfers. Support for the choices of benefactors in the form of tax relief promotes pluralism, as evidenced by the great number and variety of charitable organizations that exist. Family development deductions would further promote pluralism by addressing social needs while providing personal benefits for a benefactor's descendants.

13. This kind of conflict exists when a benefactor attempts to take a charitable contribution deduction for a large gift to a qualifying private foundation and then involve relatives in the financial affairs of the foundation so as to promote family control and benefit. *See infra* notes 27-28 and accompanying text.

14. *See, e.g.*, George Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 COLUM. L. REV. 161, 204 (1977) (lamenting the use of charitable gifts of conservation easements to generate tax deductions respecting property still subject to a donor's desired personal uses). Qualified conservation easements now must meet technical requirements set forth in I.R.C. § 170(h), incorporated by reference for estate tax purposes in I.R.C. § 2055(f). As a further example of an abuse, transferors to charitable lead trusts (involving a gift of an annuity interest to charity followed by a noncharitable remainder interest) sometimes attempt to inflate gift and estate tax deductions by having the charity's interest last for the life of an unrelated terminally ill person expected to die before the applicable standard life expectancy taken from IRS valuation tables. The Treasury Department recently cracked down on this morbid technique. *See* Prop. Treas. Reg. §§ 1.170A-6(c)(2), (e), 65 Fed. Reg. 17,835 (Apr. 5, 2000); Prop. Treas. Reg. § 20.2055-2(e), 65 Fed. Reg. 17,835 (Apr. 5, 2000); Prop. Treas. Reg. §§ 25.2522(c)-3(c), (e), 65 Fed. Reg. 17,835 (Apr. 5, 2000). Conflicts involving tax allowances, private benefit, and charitable interests have produced various technical accommodations for decades, but manifested broad results in the Tax Reform Act of 1969. Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487, 492 (1969) (codified as amended in scattered sections of 26 U.S.C.) (creating regulatory distinctions between private foundations and public charities and subjecting the former to numerous impositions expressed as penalty taxes in I.R.C. §§ 4940-4948 (1994 & Supp. 1998)).

15. As discussed more fully *infra* at Part IV.B., a "family" need not consist only of beneficiaries who have a blood relationship with the benefactor. Because wealth can best benefit successive generations of beneficiaries if held in trust, this article will frequently

deductions, like charitable transfer deductions, would permit wealth owners to transfer assets without taxation for the benefit of a potentially large class of beneficiaries. Unlike charitable transfer deductions, family development deductions would apply to transfers that directly benefit relatives of the donor (although in a restrained manner).

Recipients of wealth from family development deduction trusts would first have to demonstrate both the personal and social benefit of their distributions. Family development deduction trust distributions would not enable expenditures for extravagant homes and high living, private collections (whether of art, automobiles, or ex-spouses), or other indicia of opulence. By contrast, family development recipients would use their distributions to further their educations, provide adequately for their spouses and children (who are unable to do so for themselves), take sabbaticals from work to perform social service, alleviate economic need pertaining to necessities, capitalize a small business, fund projects to enhance personal spirituality and good mental health, provide for needed medical and elder care, or permit other similar applications that blend personal and social benefits.[16]

II. CHARITABLE CONTRIBUTIONS AND HUMAN DEVELOPMENT IN THE FAMILY CONTEXT

A. *Technical Features of the Charitable Contribution Deduction Require Transfer of Wealth to Outsiders and Discourage Family Involvement in Grant Administration*

From a donor's perspective, charitable giving directly conflicts with family giving. The donor can avoid taxation by selecting, or creating, a charitable recipient that conforms with statutory requirements mandating institutional characteristics for the do-

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refer to "family development deduction trusts."

16. The socially useful personal relief or developmental endeavors a benefactor could fund would potentially reflect at least as worthy and diverse an array of human pursuits as allowed for tax-exempt organizations, which can serve "religious, charitable, scientific, testing for public safety, literary, or educational purposes or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals. . . ." I.R.C. § 501(c)(3) (1994). As used herein, "charitable" refers to organizations that embrace any of the above purposes.

nee.[17] Yet no deduction results if the donor simply transfers money or other property directly to a needy person, even if the needy recipient has only a weak relationship to the donor.[18] The donor must transfer value to an appropriate institution acting as an intermediary that selects proper beneficiaries.[19] Attempts by the donor to secure a charitable contribution deduction while indirectly determining specific recipients tend to fail.[20] If a donor wishes to transfer wealth directly to family members without taxation, the benefactor must rely on other technical devices, like the unified credit, which greatly restrict the potential tax savings available.[21]

The fundamental restriction against letting family members share in charitable transfers comes from statutory language that requires recipients of deductible transfers to be "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.... no part of the net earnings of which inures to the benefit of any private ... individual ...."[22] The

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17. If the donor creates the charitable recipient (establishes a new organization to carry out good works with the donor's endowment), lack of public support will likely result in private foundation status and thus heavier scrutiny, regulation, and exposure to penalty taxation. *See* I.R.C. § 509 (1994 & Supp. 1998) (defining private foundations); *supra* note 14 (referencing private foundations); *infra* note 26 (referencing private foundations).

18. *See supra* note 11.

19. *See supra* note 11.

20. A fund created primarily for the support of a relative manifests private benevolence, not public charity. James Sprunt Benevolent Trust v. Comm'r, 20 B.T.A. 19, 24 (1930). A trust to educate and care for poor members of a family is not a charitable trust. Hardage v. Hardage, 84 S.E.2d 54, 55-56 (Ga. 1954). Similarly, an educational trust to benefit one's descendants does not fulfill the charitable definition. Griffin v. United States, 400 F.2d 612, 615-16 (6th Cir. 1968). A class of relatives does not receive benefits in a public manner simply because it constitutes an entire family tree dating back to 1647. *In re* Beekman's Estate, 134 N.E. 183, 184-85 (N.Y. 1921).

21. The estate tax unified credit and the gift tax unified credit permit tax-free transfers up to $675,000 in 2000 and 2001. I.R.C. § 2010 (1994 & Supp. 1998) (regarding the estate tax unified credit); I.R.C. § 2505 (1994 & Supp. 1998) (regarding the gift tax unified credit). The gift tax exclusion of $10,000 per year per donee (doubled with spousal consent) similarly permits tax-free outright transfers regardless of the donee's use. I.R.C. § 2503(b) (Supp. 1998) (limiting the exclusion to present interest gifts); I.R.C. § 2513 (1994) (treating a gift made by a spouse as made one-half by each spouse). I.R.C. § 2503(e) permits unlimited tax-free gifts for tuition or medical care, but requires direct payment to service providers, thus preventing donee reimbursements. I.R.C. § 2503(e) (1994).

22. I.R.C. § 170(c)(2)(B–C) (1994). The private inurement prohibition appears in I.R.C. § 170(c)(2)(B–C) with respect to income tax deductions for charitable contributions, I.R.C. § 501(c)(3) which allows for an income tax exemption for qualifying recipient organizations, I.R.C. § 2055(a)(2) with respect to estate tax charitable deductions, and I.R.C. § 2522(a)(2) with regard to gift tax charitable deductions. I.R.C. §§ 170(c)(2)(B–C), 501(c)(3), 2055(a)(2), 2522(a)(2) (1994).

public purpose notion behind this language subordinates family interests in favor of dispositions that benefit broader classes of persons largely unknown to the grantor. For example, a transferor cannot secure a deduction when a class of scholarship takers contains only grandnieces and grandnephews.[23] Similarly, no deduction results even if the beneficiary class consists of individuals born with the grantor's surname shared by hundreds of families in the United States.[24] The best a benefactor can do in attempting to allow family members to benefit from a deductible transfer is to make a mere statement of preference, without imposing a requirement that needy family members be included among those considered for relief by the recipient organization.[25]

Not only do family members get squeezed out as potential recipients of charitable donations, but their presence as directors or managers of charitable entities comes under close regulatory scrutiny.[26] In the context of charitable private foundations, members of the family of a substantial contributor assume the status of "disqualified person[s]."[27] Accordingly, those members can trigger substantial penalty taxes against themselves and a private foundation as a result of their transactions and holdings.[28] Because of potential abuses involving large charitable contribution deductions, a donor and the donor's family can only weakly maintain involvement in a charitable organization's ongoing operations. The tax system greatly favors control by outsiders in the

23. Davis v. Comm'r, 55 T.C. 416, 425 (1970).

24. Priv. Ltr. Rul. 96-31-004 (Apr. 30, 1996).

25. *See, e.g.*, Estate of Robinson v. Comm'r, 1 T.C. 19 (1942).

26. The public charity versus private foundation distinction prevents those who make large donations from exerting undue influence over a charitable organization for the benefit of private interests. Accordingly, the private foundation definition stresses public support as a key criterion to avoid private foundation status and additional regulation. I.R.C. § 509(a) (1994). Large amounts of public support help ensure that entity management will not come under private control. Even "supporting organizations," exempted from private foundation status and public support requirements, I.R.C. § 509(a)(3) (1994), must assure revenue officials that their controlling boards receive sufficient input from the charitable organizations they support under a "responsiveness" test that blunts potential private influences. *See* Treas. Reg. § 1.509(a)–4(i)(2) (1972) (providing technical mechanisms to assure an "effective voice" by the beneficiary organization in the management of the supporting organization).

27. I.R.C. § 4946(a)(1), (d) (1994) (defining various family members as disqualified persons for transactional purposes).

28. I.R.C. § 4941 (1994) (imposing penalty taxes on acts of self-dealing between a disqualified person and a charitable private foundation); I.R.C. § 4943(a)(1) (1994) (imposing penalty taxes on charitable private foundations that have "excess business holdings" in enterprises also owned in part by disqualified persons).

governance of entities permitted to enjoy income tax exemption while receiving deductible contributions.[29]

B. *Integrating Family Development Deduction Trusts with Traditional Charitable Giving*

The restrictions against family beneficence and managerial involvement respecting charitable organizations would not apply to family development deduction trusts. Transfer tax deductibility would result from a benefactor's setting up a fund that would deliberately permit family members to receive grants similar to those dispensed to outsiders under charitable arrangements.[30] These grants could include awards for education, research, spiritual and social missions, literary and artistic endeavors, child care, elder care, medical needs, and a variety of other activities.[31] The number of potential grants would multiply as the grantor's family grew, until even a large family development deduction trust would consume its income with distributions—as various foundations now operate under charitable endowment.[32]

Unlike charitable endowments, family development deduction trusts would only avoid wealth transfer taxation—the estate tax, gift tax, and generation-skipping tax.[33] Family development deduction trusts would not involve either income tax exemption for the trust or income tax deductibility for a donor making contributions to the trust.[34] Consequently, the private versus public purpose difference behind traditional charitable entities would not apply entirely to family development deduction trusts, since they need not generate any *income* taxation advantages not already found in the current scheme involving transfers to private trusts.[35]

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29. *See supra* note 26.

30. *See infra* Part IV.B. (discussing how and why the concept of "family" should expansively include persons other than blood descendants of the benefactor).

31. *See supra* note 16 (illustrating that tax-favored organizations can have many purposes other than the mere alleviation of poverty).

32. *See infra* Part IV.A. (discussing possibilities for family development deduction trusts to operate in perpetuity, like charitable trusts).

33. *See supra* note 9.

34. *Cf.* I.R.C. § 501(a), (c) (1994 & Supp. 1998) (exempting charitable organizations from entity income taxation); I.R.C. § 170(a)(1) (1994) (creating an income tax deduction for contributors to charitable organizations).

35. Thus, "Subchapter J," which governs the income taxation consequences to gran-

Yet, family development deduction trusts would result in expansion of the class of family beneficiaries until recipients might exceed, in number and diversity, those qualifying for aid from traditional charitable entities.[36] Family development deduction trusts would have the potential to transform what might look like purely private benefit during the early years of a fund into a form of public benefit as a family, which a grantor could alternatively define broadly at the outset, and gradually expand into a very large group of individuals through procreation, adoption, and in-law assimilation.[37]

If traditional charitable organizations see their purposes partially fulfilled through the grant making processes of family development deduction trusts, they might object less to a putative diversion of dollars.[38] Moreover, family development deduction trusts could actually assist traditional charitable organizations directly in at least two ways. First, family grants could free individuals, at least for temporary periods, from the necessity of earning a living by allowing the equivalent of sabbaticals to engage in charitable works. For instance, a family development deduction trust beneficiary who became a public school teacher could apply for a leave of absence for an academic year to serve as a volunteer under a charitable organization that provides language instruction to the children of impecunious immigrants.[39]

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tors, beneficiaries, and trustees of trusts, would apply to family development deduction trusts. *See* I.R.C. §§ 641-692 (1994 & Supp. 1998). This means that distributions to the beneficiaries of such trusts would cause income recognition to the extent of a trust's distributable net income. *See* I.R.C. § 652(a) (1994). Thus, charitable trusts would still generate tax advantages not shared by family development deduction trusts. The purpose of the latter would relate solely to acceptable ways for benefactors to avoid wealth transfer taxation while benefiting family members.

36. For instance, a charitable transfer today might generate full tax benefits while serving only the artists (and art lovers) in a particular small community. *See* Goldsboro Art League v. Comm'r, 75 T.C. 337, 343-45 (1980). Indeed, benefactors often make tax-favored transfers that only benefit small groups of professors, as evidenced by the many professorship titles held by selected academics (including the author of this article). Family development deduction trust beneficiaries could easily and quickly grow into a class that far exceeds the number of professors at a law school.

37. An enabling statute for family development deductions would thus limit authorities, like those discussed *supra* notes 23-25 and accompanying text (disallowing family benefit), to charitable trust transfers that attempt to invoke the full range of tax benefits, not just wealth transfer taxation relief.

38. Traditional charities would still generate tax advantages that could give them an edge over family development deduction trusts respecting income taxation. *See supra* notes 34-35.

39. Family development grants could encourage volunteerism benefiting a variety of

The grant could cover the applicant's expenses and salary for the year.[40] The teacher might simultaneously avoid career burnout, perform significant charitable work, and continue to fulfill all personal financial obligations. Clearly, the organization receiving the teacher's free and valuable services would also obtain a direct benefit.

Second, family development deduction trusts could make direct distributions to traditional charitable organizations, particularly in earlier years when large endowments would produce trust income substantially in excess of allowable applications for grants.[41] The benefactor could anticipate surpluses of taxable trust income over permissible distributions and add a trust provision to make interim distributions to designated classes of charities. These distributions would permit the fiduciary (not the benefactor) to take income tax deductions against trust income while avoiding accumulations of trust income taxed at rapidly graduated rates. Family development deduction trusts could thus directly benefit traditional charities while taking advantage of post-transfer income tax relief now enjoyed by private express trusts.[42]

Even without directly benefiting from income distributions or volunteer services, traditional charities might concede that family development deduction trusts would present a less threatening competitor for donative dollars than gifts to support family opulence under an outright repeal of wealth transfer taxes. For existing nonprofit organizations, the "lesser evil" between family development deduction trusts and elimination of all wealth transfer taxation surely would reside in the former.

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traditional charitable organizations that rely as much on volunteer services as on cash donations. For example, consider Habitat for Humanity.

40. Perhaps the grant could also cover a potential loss of pension contributions or benefits by allowing for the purchase of a single premium annuity commencing payments to the volunteer in coordination with the distributee's regular pension system.

41. *See infra* Part IV.B. (discussing, by contrast, how a benefactor might address grant demand that greatly exceeds the trusts income by assigning distribution priorities).

42. *See* I.R.C. § 1(e) (1994) (respecting the rapidly graduated income tax rates applicable to trusts). Offsetting relief can occur under I.R.C. § 642(c), which allows a deduction for any amount of trust income paid or permanently set aside for a charitable purpose. I.R.C. § 642(c) (1994).

III. How Family Development Deduction Trusts Could Accommodate a Philosophical Compromise

A. *The Vantage Point of the Propertied Class*

Many persons who create substantial wealth spend inordinate time and energy adjusting to the rigorous demands of an extremely competitive and unforgiving market economy. Their personal identification with economic success can create deep resentment against outsiders, whether competitors or government, who might encroach upon the prerogatives inherent in the formation and retention of substantial wealth.[43] Of course, the builders of wealth fully appreciate their mortality and the ultimate necessity of parting with their material possessions. From a purely personal perspective, the next best thing to taking wealth into an afterlife, as envisioned by the ancient Egyptians, probably consists of transferring it to one's own issue.

Yet, the creators of wealth often exhibit great ambivalence when contemplating the transmission of substantial sums to future generations whose desire to earn a living might thereby dissipate. The process of creating wealth—at times brutish, rife with anxiety, and fraught with risk—nonetheless has an instructional quality that promotes an identity between striving for success and self-esteem, personal development, and quality of life.[44] Consequently, the creators of wealth, wishing only the best for their progeny, often take great pains to avoid "silver spoon in-the-mouth" syndrome as a family affliction.[45] Frequently, wealthy people deliberately attempt to sustain virtues and values that mitigate temptations toward lassitude, ineptitude, self-

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43. Apparently, not all holders of wealth would agree with Andrew Carnegie, who declared in his essay, *The Gospel of Wealth*, that a rich person should, after acquiring wealth, distribute it for the general welfare. ANDREW CARNEGIE, *The Gospel of Wealth*, *in* THE GOSPEL OF WEALTH, AND OTHER TIMELY ESSAYS 14 (Edward C. Kirkland ed., 1965). Between the classical Ebenezer Scrooge (before he repented) and Andrew Carnegie exist many wealth holders who would not mind benefiting both the general welfare and their descendants simultaneously in a way that encourages their descendants to grow in stature.

44. Those who ascribe to this view no doubt find practical ways to implement it within their families, such as requiring their children to work between semesters in high school and college despite having no need for the extra money.

45. *See* Monica Langley, *Trust Me, Baby: The House, the Money—It'll All Be Yours; There's Just One Thing*, WALL ST. J., Nov. 17, 1999, at A1.

centeredness, and other detrimental traits sometimes associated with unearned wealth.[46]

Accordingly, the wealthy often wish to link wealth transmission with observance of designated values personally cherished and deemed indispensable to success itself. Unsurprisingly, the recent explosion of "new economy" wealth has encouraged an enhanced interest in estate planning techniques that emphasize varying degrees of dead-hand control to promote the stated values of benefactors.[47] Just as the explosion of industrial wealth a hundred or so years ago in the "Gilded Age" produced a social awareness among philanthropic giants like Andrew Carnegie, today's proliferation of wealth has also spurred philanthropy, as well as a heightened sense that unearned wealth might cause detriment to a benefactor's descendants.[48]

Perhaps another difference between now and one hundred years ago comes from a stronger current emphasis on how wealth can yield greater opportunities for cultural attainments. At the turn of the nineteenth century, penury among even the working class was quite apparent and encouraged direct applications of private largess to alleviate poverty.[49] Today's post-New Deal so-

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46. The "family incentive trust," described as the "latest fad in estate planning for the affluent," lets successful parents transfer wealth to their children in proportion to each child's conformity with designated behavior standards. *Id.* For instance, star baseball pitcher Tom Glavine, who earns an $8,000,000 annual salary, has expressed a wish to use an incentive trust to match his children's earned income up to $100,000. *Id.* Family development deduction trusts would incorporate incentive elements, but not focus on the benefactor's children as much as on long-term human development in an ever-growing extended family. Additionally, family development deduction trusts could only warrant exemption from wealth transfer taxation through a political compromise that would likely emphasize awarding distributions upon need, social result, and personal benefit, rather than by way of providing incentives or disincentives relating to specific conduct a benefactor might whimsically and arbitrarily define.

47. For a discussion of the problems and opportunities facing practitioners of incentive estate planning, see Howard M. McCue III, *Planning and Drafting to Influence Behavior*, *in* THE THIRTY-FOURTH ANNUAL PHILIP E. HECKERLING INSTITUTE ON ESTATE PLANNING ch. 6 (Tina Hestrom Portuondo ed., 2000).

48. *See* Brigid McMenamin, *Who's Spoiled?*, FORBES, June 12, 2000, at 266 (discussing the view that birth into riches need not doom a child's chances for success and providing advice on "how to raise good kids amid opulence").

49. *See* Gordon M. Fisher, U.S. Census Bureau, From Hunter to Orshansky: An Overview of (Unofficial) Poverty Lines in the United States from 1904 to 1965 (1993), http://www.census.gov/hhes/poverty/povmeas/papers/hstorsp4.html (last modified Dec. 13, 2000). Mr. Fisher demonstrates how efforts to provide measurements of poverty thresholds coincided at the beginning of the twentieth century with efforts to alleviate the acute poverty of the time. *Id.*

cial nets and greater affluence in general help focus charitable dispositions toward human development at higher levels.[50] Consequently, the wealthy now seem to direct their wealth increasingly toward spiritual development, the arts, and specific educational endeavors.[51]

Supporting these endeavors in a way that could also benefit generations of family members would greatly appeal to many members of the propertied class, especially if family values, achievement, and community benefit all coincided. Family development deduction trusts could efficiently accomplish a joining of these interests. As an added bonus, family development deduction trusts might yield inestimable intangible benefits for a grantor.

A grantor could take a place of honor in a long family history as an original benefactor whose largess, linking personal development, need, and good works, extended to persons unborn at the grantor's death but later brought together by more than mere genealogy.[52] The values of the family benefactor, emphasized repeatedly via grants for education, family support, skill enhancement, social improvement, and the like, would serve as a lasting personal memorial to the benefactor. More importantly, the ever-growing family would take on a life of its own shared ultimately by hundreds or even thousands of individuals.[53]

The benefactor's family development scheme might provide that successive generations of family members serve as trust advisors or directors, elected upon merit by all family members eli-

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50. In 1998, the official poverty level for a family of four was an annual income of $16,660. JOSEPH DALAKER, U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS, S. P60-207, POVERTY IN THE UNITED STATES 1998, Table A-1 (1999). Adjusted for inflation to reflect 1998 dollars, in 1949 the annual income for United States' families was $16,589 or less for forty percent of all families. *Id.* Presumably, going back fifty more years would reveal an even larger percentage of American families below current poverty levels, although Census Bureau tables do not reflect data earlier than the 1940s.

51. In 1998, 63.7% of all charitable giving supported religion, education, arts, culture, and humanities. AMERICAN ASS'N OF FUND-RAISING COUNSEL, GIVING USA 1999: THE ANNUAL REPORT ON PHILANTHROPY FOR THE YEAR 1998 20 (Ann E. Kaplan ed., 1999).

52. For administrative suggestions on bringing together the class of beneficiaries who would benefit under a family development deduction trust, see *infra* note 101 and accompanying text.

53. If a family produced children at the rate of just two per member, it would number in the thousands after only a dozen generations. Since nobody can predict the future course of procreation rates, enhancement of a family class through the inclusion of persons having non-blood affinities might interest a benefactor with sufficiently large wealth. *See infra* text accompanying notes 86-96.

gible to apply for grants under a properly conducted voting procedure.[54] Family leadership at each generation would judge grant applications in the manner now reserved for those who govern charitable foundations.[55] Family identity and cohesion would result from the mere necessity of keeping track of eligible grant applicants whose requests would be the subject of periodic meetings to decide how best to dispense trust income.[56] Most persons in the family would eventually know the extent and composition of the group, and a continuing sense of pride and opportunity would attach to the status of being a family member, however large the group might grow.[57] Family unity itself would become a memorial that could easily outlast the razing of a building named for a benefactor under the traditional charitable scheme. Even members of the propertied class who otherwise staunchly resist wealth redistribution might find such a notion highly attractive.

B. *The Vantage Point of Wealth Redistributionists*

Many persons who dislike large concentrations of wealth believe that wealth attainment too frequently occurs by chance or results from manipulated competitive advantages within an imperfectly regulated market economy.[58] Their personal belief in structural economic unfairness fosters concern about abuses of power that can result from large concentrations of wealth in pri-

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54. Procedures frequently used by alumnae to elect college trustees might provide a good model in this context. *See infra* note 101 and accompanying text.

55. Family members need not serve as trustees of family development deduction trusts, but could serve as elected advisors to trustees, which, as discussed *infra* Part IV.C., might best come from the ranks of institutional fiduciaries.

56. The issuance of annual reports outlining fund awards, activities, and investment decisions would also generate significant interest among the growing class of family members.

57. Family discourse can, of course, have a dark side that feeds off rivalries, disparities in talents or status, and clashes of opinion. Perhaps thoughtful benefactors could structure a family development deduction trust in ways that would tend to mitigate such unpleasant side effects. For instance, a clause in the governing instrument could invoke a special trustee's review in the event distributions would tend to concentrate within a particular branch of a family.

58. See, for example, RICHARD HOFSTADTER, SOCIAL DARWINISM IN AMERICAN THOUGHT (Beacon Press 1992) (1944), in which the author offers this conclusory view about the historical effects of business competition in America: "[N]othing is so unstable as 'pure' business competition; nothing is so disastrous to the unlucky or unskilled competitor; nothing . . . is so difficult as to keep the growing number of the 'unfit' reconciled to the operations of such a regime." *Id.* at 201-02.

vate hands.[59] Since wealth can come into private hands at the expense of wage earners, the environment, consumers, and other social interests, redistributionists believe the wealthy should accept their mortality by transferring substantial sums for the common good, especially in view of the unaddressed needs of numerous citizens who find themselves in far less fortunate circumstances.[60] From this vantage point, transferring great wealth to family members encourages plutocratic excesses and contradicts the tenet that earned rewards yield much more social utility than wealth achieved only by the happenstance of birth.

Yet those who would break up large concentrations of wealth often express ambivalence about whether redistribution best occurs under governmental guidance or via pluralistic enterprise in the form of numerous and varied nonprofit organizations.[61] Nonprofit enterprises annually dispense billions of dollars of donated wealth without uniform administration to prioritize social needs, which can range from the fundamental (food for the hungry) to the sublime (support for a regional symphony orchestra).[62] Because private charitable pursuits can supplement governmental action, wealth redistributionists frequently applaud not just charitable giving, but also support, or at least tolerate, related tax benefits.[63] Of all the tax benefits enjoyed by the wealthy, tax

59. *See id.* Mr. Hofstader continues his vitriolic conclusions about economic competition by commenting on what he views as changed attitudes toward the social role of those who gather wealth: "In time the American middle class shrank from the principle it had glorified, turned in flight from the hideous image of rampant competitive brutality, and repudiated the once heroic entrepreneur as a despoiler of the nation's wealth and morals and a monopolist of its opportunities." *Id.* at 202.

60. Not all socially conscious persons assume most personal wealth is ill-gotten, just as not all wealth holders think the best way to dispense wealth is through familial dispositions. *See supra* note 43 and accompanying text. An important aspect of family development deduction trusts would come from their flexibility to accommodate a wide range of views about the disbursement of wealth.

61. *See, e.g.*, Mark L. Ascher, *Curtailing Inherited Wealth*, 89 MICH. L. REV. 69, 135-36 (1990) (arguing for the imposition of a death tax rate of 100%, but conceding that a limited list of exemptions should include at least some allowance for charitable transfers).

62. *See* John W. Gardner, *The Independent Sector, in* AMERICA'S VOLUNTARY SPIRIT ix, xiii-xv (Brian O'Connell ed., 1983) (extolling the virtues of the diverse nonprofit sector of America's economy, in contrast to the rigidity of governmental bureaucracies). Many benefactors, voting with their dollars, apparently believe that food for the soul has every bit the importance of food for the body. *See supra* note 51.

63. Wealth redistributionists for many years have successfully argued for progressive rates for both income taxation, *see* I.R.C. § 1 (1994), and estate taxation, *see* I.R.C. § 2001 (1994). Yet the continuous existence of income and estate tax charitable deductions, I.R.C. § 170 (1994 & Supp. 1998); I.R.C. § 2055 (1994 & Supp. 1998), since World War I indicates that wealth redistributionists have not simultaneously strongly opposed charitable transfer tax benefits.

relief for charitable contributions seems the least offensive, even though charitable dispositions help donors and donee organizations express a quite diverse range of values under a very broad concept of community benefit.[64]

Similarly, wealth redistributionists might not object to tax-favored transmissions of wealth to family members as long as benefit flowed to growing numbers of persons who help fragment wealth in diverse ways that fulfill a general standard of social utility. If wealth deconcentrates among an extended family in a manner that both benefits society and encourages salutary personal development, including social awareness and cultural attainments, wealth redistributionists might accept family development deduction trusts as readily as traditional charitable giving.[65] Redistribution through charitable entities would still occur, but family development deduction trusts would effect redistribution by using generations of the donor's own issue.[66]

Consider distributions to descendants of a wealthy donor to care for a disabled child or ailing elder, fund a trip to help clean up devastated places after a natural disaster, or provide a down payment for a first home when low earnings make home ownership nearly impossible. The list of socially useful redistributions within an ever growing family is limited only by the imagination. For example, distributions might fund retirement benefits for family members who work for employers that do not sponsor qualified retirement arrangements.[67] A grant could permit an

64. The Internal Revenue Service has apparently recognized a religious organization having a membership of witches as worthy of tax beneficence. *See Developments in the Law—Nonprofit Corporations*, 105 HARV. L. REV. 1578, 1578 (1992) (citing Karen Schwartz, *Out of Closet, into Kitchen, Witches Win Nonprofit Tax Status As a Religion*, L.A. TIMES, Aug. 20, 1989, at 4). In addition, tax allowances benefit many mainstream religious organizations that condemn sexual and other personal conduct at odds with views much less than universally accepted. *See id.* at 1581.

65. What could give greater delight to redistributionists than to witness large fortunes used as inducements to make the progeny of the wealthy at once less plutocratic and more socially conscious?

66. Presumably, plutocratic tendencies cannot pass genetically, but even if the human genome project identifies a "plutocracy gene," carriers of that gene would run the risk of mating with socially conscious redistributionists and thereby diluting the propensity among future generations.

67. The prerogative to sponsor a tax-favored retirement arrangement belongs to employers, not employees, in the usual private employment situation. *See* Treas. Reg. § 1.401-1(a)(2) (as amended in 1976) (stating that a tax-qualified retirement plan "is a definite written program and arrangement which is communicated to the employees and

abused spouse, especially one with children, financial freedom to depart from the abuser. A family development deduction trust could support retired grandparents who must raise grandchildren abandoned by their parents.[68] Grants might help parents homeschool their children or permit a school teacher working in an expensive area to afford a house within reasonable commuting distance of work.[69] Trust distributions could take the form of scholarships to promising students whose parents cannot fund college or graduate school at quality institutions. Distributions might also provide educational aid to permit necessary or desirable career changes,[70] or to permit tangible rewards for the outstanding career accomplishments of public service workers.[71]

The list easily continues to include funds to support voluntary charitable works by sabbatical or part-time endeavor,[72] seed capital to permit a beneficiary to pursue a promising business idea that would create new job s and prosperity for a community, health insurance premiums for family members whose employers have no health insurance plan, payments on educational loans taken out by family members who pursue low-paying public service careers, expenses of adopting a child or the cost of raising an orphaned child, funds to celebrate or reward important family

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which is established and maintained by an employer. . . ."). Employees can establish their own individual retirement accounts but cannot contribute more than $2,000 per year. I.R.C. § 408(a)(1) (1994).

68. In such instance, a benefactor might consider making the parents of such hapless children ineligible for distributions from the family development deduction trust even though if the parents had been initially eligible for assistance, they might not have abandoned their children.

69. *See* Jonathan Kaufman, *No R-E-S-P-E-C-T: Silicon Valley Puts Its Teachers Through School of Hard Knocks*, WALL ST. J., June 20, 2000, at A1 (chronicling the discomforting case of an experienced schoolteacher who cannot afford to live in the same community as her students because of inordinately high local real estate values).

70. Law schools would no doubt benefit indirectly from this possibility.

71. Public service workers often feel unappreciated by the taxpayers who indirectly employ them. Family appreciation in the form of a monetary award might encourage public service employment and mitigate the competition between public and private sectors for competent employees.

72. For example, a young plastic surgeon might interrupt a promising practice, with support from a family development deduction trust, in order to join a team of surgeons who voluntarily perform operations on children in impoverished countries who have been horribly disfigured by accident or genetic bad luck. Both the unfortunate children and the caring surgeon would share the good fortune implicit in the surgeon's having a wealthy ancestor whose wealth stayed intact against both wealth transfer taxation *and* the potential waste of earlier progeny.

milestones,[73] and tuition for children or adults that permits artistic, musical, and literary development.

Wealth redistributionists might thus witness the dissipation of fortunes in the name of family cohesiveness and human development over many generations. Wealth so expended would uplift, not debase, its recipients. In time, every member of an extended family would learn about the possibilities for using trust resources to promote both social and personal development.[74] These possibilities would likely appeal to even the staunchest wealth redistributionists who might otherwise have great reservations about allowing large quantities of wealth to pass free of transfer taxes to a benefactor's family.

IV. TECHNICAL POSSIBILITIES FOR FAMILY DEVELOPMENT DEDUCTION TRUSTS

A. *The Problem of the Rule Against Perpetuities*

If the rule against perpetuities required termination before a sufficient number of family beneficiaries accumulated under a generously funded family development deduction trust, the demand for grants might never exceed the trust's income. Consequently, the trust would either accumulate income and potentially pay income tax at rapidly graduated rates or operate

73. If a benefactor wished to promote long-lasting marital bonds as a family value, a family development deduction trust might permit awards to couples in the family who celebrate meaningful wedding anniversaries (e.g., ten, twenty-five, fifty years), perhaps subject to income limitations as applied under the Internal Revenue Code for the phase-out of certain tax benefits. *See, e.g.*, I.R.C. § 219(g) (1994 & Supp. 1998) (setting adjusted gross income limitations for the deductibility of contributions to individual retirement accounts for active participants in other retirement arrangements). If promotion of long marriages seems like an unlikely value to link to wealth transfer taxation avoidance, consider how deductible contributions flow to tax-exempt religious organizations that regularly provide family and marriage counseling and related services for their flocks.

74. Some creators of family development deduction trusts might want to insist on sufficient dead-hand control to ensure total compliance with their personal values. Nevertheless, regulatory restraint against their free reign might keep them from preventing interpretive slippage over time. The lure of substantial tax benefits would likely lessen their objections, just as for charitable contributions. Consider whether Henry Ford today would approve of all the various grants now made by the Ford Foundation. Similarly, benefactors of family development deduction trusts could anticipate that over time, changing social values might result in grant interpretations they cannot ultimately control, even with the most contemplative drafting possible.

primarily to make current charitable dispositions.[75] As a further detriment, at the end of the perpetuities period, the trust's corpus would transfer to a relatively small number of family beneficiaries free from family development restraints.[76]

Just as the rule against perpetuities eventually allowed for the perpetual existence of charitable trusts,[77] the rule need not impair family development deduction trusts. The purposes of the rule—to encourage free alienability of property and discourage dead-hand control over long durations[78]—do not conflict with the family development deduction trust concept. The former purpose could find expression in a technical requirement that the trustees of family development deduction trusts hold a power of sale permitting alienation of the original trust corpus.[79] The dead-hand control objection could result in a requirement to use independent trustees for grant selection upon the advice of elected family boards who exercise discretion under reasonable criteria. By this means, a benefactor could pass some control to the living down through the generations, subject to institutional supervision.[80]

The movement toward complete abolition of the rule against perpetuities has gained sufficient momentum that a number of states now permit private dispositions of property in trust for unlimited durations.[81] Given that a trustor can generally select the state law that governs a trust, the rule against perpetuities need not prevent the use of wealth to encourage and reward family de-

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75. *See supra* note 42.

76. Under the standard expression of the common law rule against perpetuities that "no interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest," family development deduction trusts would unceremoniously end by the time a benefactor's great grandchildren become eligible for distributions. JOHN C. GRAY, THE RULE AGAINST PERPETUITIES § 201 (Roland Gray ed., 4th ed. 1942).

77. *See* 4A AUSTIN WAKEMAN SCOTT, THE LAW OF TRUSTS § 365 (William Franklin Fratcher ed., 4th ed. 1987).

78. THE LAW OF PROPERTY § 3.17 (Roger A. Cunningham et al. eds., 2d ed. 1993).

79. For perpetuities reform statutes that require a power of sale clause, see *infra* note 81.

80. The benefactor would have provided in the trust instrument general criteria for the approval of distributions. Nonetheless, specific requests for distributions would have to undergo scrutiny for need and merit, much as when scholarship or admissions committees at academic institutions review applications.

81. *See, e.g.*, 765 ILL. COMP. STAT. 305/3(a-5) (1998); OHIO REV. CODE ANN. § 2131.09(B)(1) (Anderson 1999).

velopment in perpetuity.[82] Some states abolished the rule against perpetuities in order to accommodate the relatively narrow $1,000,000 generation-skipping tax exemption.[83] This abolishment by some states suggests that many other states would act similarly to accommodate an even more significant transfer tax allowance if a family development deduction proposal reached enactment.

The irony resulting from application of the rule against perpetuities is that, by insisting that wealth not be "tied up" beyond a stated period, the rule actually prevents wealth from being shared among an increasingly larger group of family members. Given the normal suspicions, competitiveness, and other tensions that tend to afflict familial relationships, many families would have difficulty acting in concert toward plutocratic goals as the group expanded, even absent family development restraints as herein proposed.[84] Economic power, rather than remaining concentrated in the hands of a few, as when all property passed to an eldest son, tends to dissipate if an ever-growing pie must serve an ever-increasing number of diners.[85] Adding beneficiaries in perpetuity would certainly dissolve, not concentrate, wealth under a family development deduction scheme.

B. *Technical Features to Enhance the Planning Flexibility of Family Development Deduction Trust Benefactors*

Because large transfers of wealth to a family development deduction trust could initially produce more trust income than aggregate grants, a transferor would want to have wide discretion

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82. *See* 5A SCOTT, *supra* note 77, § 591.

83. *See* Craig F. Frederickson, *The Dynasty Trust Is Here!*, PROB. L.J. OF OHIO, Jan./Feb. 1999, at 41.

84. In any event, stocks and other securities held in large amounts to provide ad hoc distributions to a growing number of recipients under a family development deduction trust would spread wealth and pose no greater threat to alienability than the holding of billions of dollars in pension trusts for indefinite durations.

85. Over time, the pie might even shrink as takers grow in number—as happened for many trust fund beneficiaries during the 1930s. *See* M. & C. Creditors Corp. v. Pratt, 17 N.Y.S.2d 240, 250 (N.Y. App. Div. 1938). *Pratt* involved payment of more than $424,000 to the executors of a deceased partner who died just before the October 1929 stock market crash. *Id.* at 243. Subsequently, the business became bankrupt, causing an unsuccessful attempt by its creditors to recover the payment because of loss of value between the date of death and the date of payment. *Id.* at 243-44, 266.

to permit the trustee to make interim distributions to designated charitable beneficiaries.[86] Simultaneously, the transferor might want to have broad discretion to define "family" in such a way that potential noncharitable beneficiaries immediately constitute a class numerous enough to generate meritorious grant requests equal to a substantial portion of trust income. For example, a benefactor might define a "family" as consisting of all descendants of the benefactor's great-grandparents down to a degree of consanguinity that would permit an immediately broad distribution potential.[87] Similarly, a benefactor might allow for constructive family member status by including, perhaps temporarily, persons not sharing blood with the benefactor.

An obvious extension beyond consanguinity would include inlaws. Beyond marital relationships, however, other beneficiaries could include employees, or classes of employees, of a family enterprise,[88] friends and close acquaintances specifically designated,[89] members of religious organizations with whom the benefactor worshipped,[90] classes of alumni of an educational institution the benefactor enjoyed attending, or any other group of persons with whom the benefactor shared experiences or relationships of a particular definable quality.[91] The concept of "family" could expand to enhance the number and diversity of worthy grantees while bonding the blood and non-blood relationships enjoyed by the benefactor into a cohesive group under one name.

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86. *See supra* note 42 and accompanying text (regarding the income tax implications to the trust of interim charitable distributions).

87. Presumably, no technical objection would result from the benefactor's excluding—for personal reasons—certain "branches" of family members even while adopting a generally broad family definition. Overly specific exclusions, however, would not comport with the family cohesion ideal behind family development deduction trusts.

88. Inclusion of a benefactor's employees would add a new twist on the well-worn legal issue of whether a provider of services takes the status of an employee or an independent contractor. For more information on the federal tax aspects of this issue, see Rev. Rul. 87-41, 1987-1 C.B. 296 (1987).

89. A benefactor should carefully define any class of "friends" and not simply leave the task to another. *See* Clark v. Campbell, 133 A. 166, 170-71 (N.H. 1926) (involving a bequest for the benefit of a testator's "friends" which failed for want of certainty of the beneficiaries).

90. The benefactor might want to refer to an official registry for a house of worship at a specific location, as well as define a time during which membership would count.

91. The benefactor in *Shenandoah Valley Nat'l Bank v. Taylor*, 63 S.E.2d 786 (Va. 1951), left his entire estate to benefit the children of a public school he attended. *Id.* at 788. Unfortunately for the school children, the bequest failed under the rule against perpetuities. *Id.* at 794.

For sufficiently large fortunes, the transferor might expand the non-blood group to cover descendants to a particular degree of relationship.[92] The non-blood group might expand until it encounters a preset limitation, then follow a course of attrition timed with the expansion of the benefactor's own blood line.[93] For example, the non-blood group's expansion might arbitrarily meet a limitation when the blood group reached 100, 1000, or 10,000 members, or when the blood group (perhaps with spouses) contained a designated number of great-grandchildren, or when meritorious grants first exceed distributions to charitable organizations serving as alternate takers of trust income in early years.[94]

In addition to setting a flexible definition of the family class, transferors to family development deduction trusts might want to express some preference for when or how the trust corpus would ultimately reach extinguishment. If the benefactor desired perpetuation of the trust corpus, a volume of worthy grant applications that substantially exceeded the trust income might trigger a clause in the trust instrument that prioritized grants according to the benefactor's wishes.[95] Thus, grants for education or medical needs might take priority over grants for small business or career development. The benefactor should have the power to address both low and extraordinarily high grant demand as the class of beneficiaries waxes and wanes.[96]

Also, permitted grant criteria should express a range of values and concerns that benefactors could adopt or reject in part according to personal preferences. Considering the wide variations of expression now permitted for religious organizations that enjoy

92. If desired, the defined expansion could also include parents and grandparents of the non-blood members primarily designated.

93. With time, both the non-blood and blood groups would contain only persons who never personally knew the benefactor, but the benefactor might assert a preference for blood relatives, in effect using the group of non-blood persons as "filler" beneficiaries pending sufficient growth in the blood group.

94. A benefactor could define contingent groups of non-blood beneficiaries that would take from the fund in the event the blood group might increase initially but later shrink. The birth rates of various groups could obviously fluctuate greatly over many decades.

95. Not every benefactor would necessarily want a family development deduction trust to continue indefinitely. Extinguishment might occur by design once the demand for grants surpassed the trust's income and the trustee was permitted to tap corpus.

96. Default gifts to charities would solve the problem of beneficiary groups that might die out. Escheat to the state presents another solution.

tax benefits, benefactors of family development deduction trusts should have freedom to structure their distribution choices with only minimal governmental intervention or political judgments.[97] For instance, benefactors should have equal power to fund grants to permit stay-at-home parenting as well as to assist working parents in affording childcare expenses, depending on the benefactor's personal attitude toward the respective values of sustained parental contact versus career enabling. The overall criteria for grant allowability should reflect broad standards for salutary human development and sustenance as viewed by the grantor, whose well-expressed intentions would illuminate the trust instrument.[98]

Of course, the benefactor of a family development deduction trust should also have the discretion to draft administrative guidelines for the operation of the trust. These guidelines would have to conform with existing trust law,[99] but one special policy aspect of family development deduction trust administration would have to come to the attention of both trustors and those who make or interpret law—the role of family members serving as advisors to the trustee, setting standards for grant review, and encouraging family cohesiveness as envisioned by the benefactor. As the family grows, it should coalesce, not just on the common ground of eligibility for distributions, but also to celebrate and effectuate the benefactor's respect for personal growth, family unity, duty, largess, and stewardship for family resources.[100] Few administrative paradigms would encourage extended family involvement better than today's model for the governance of educational and other institutions by means of centralized alumni (member) record keeping, open reunions, written communica-

97. Even charitable organizations cannot structure their operations in a manner that violates fundamental public policy and still retain tax benefits. *See* Bob Jones Univ. v. United States, 461 U.S. 574, 605 (1983) (disallowing tax exemption for a university that prohibited interracial dating and marriage).

98. A regulatory standard could prohibit any distributions to support extravagant, ostentatious, or redundant consumption by beneficiaries of a family development deduction trust.

99. Thus, family development deduction trust fiduciaries would have to observe local law restrictions against improper investments, conflicts of interest, loose bookkeeping, and the like. *See generally* 2A, 3, 3A SCOTT, *supra* note 77, at ch. 7.

100. Stewardship for family resources would come forth as family members selected advisors from among themselves to determine grants upon the relative merits of requests. Using these advisors to review investment decisions for the trust fund would also promote family stewardship.

tions, election of properly nominated persons to group leadership, and similar devices that create and sustain a sense of franchise and community among a widely scattered and diverse membership.[101]

C. *Technical Features to Curb Potential Abuses of Family Development Deduction Trusts*

Any arrangement that creates substantial tax benefits invites conflicts between regulatory forces attempting to uphold the arrangement's purposes and individuals wanting to take tax benefits while ignoring the practical execution of policies that motivate those benefits.[102] Accordingly, a set of rules designed to permit family development deductions would have to account for potential abuses. Benefactors and their families would have to use the assets held in trust for the purposes of encouraging beneficial personal development, family cohesiveness, and direct or indirect social consequences that benefit the community at large.[103] Abuses might take the form of self-dealing with trust assets, collusive strategies for the awarding of inappropriate grants, or misapplications of grants into the hands of individuals who might use their distributions for the consumption of goods and services unrelated to the trust's purposes.

Congress protected individual retirement accounts from many potential abuses by requiring institutional trustees.[104] Requiring

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101. Term limitations would help assure that family members elected to advisory positions would turn over often enough to prevent sustained and concentrated influences and permit participation by the greatest number of individuals.

102. The realm of tax-favored retirement arrangements produced such conflicts, causing Congress to enact extensive legislation to address both tax and labor law concerns respecting pensions. *See* Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974) ("ERISA"). Hopefully, proper regulation of family development deduction trusts would not necessitate legislative efforts anywhere near as extensive as ERISA. But even if family development deduction trusts did ultimately cause extensive statutory control, their social benefits would outweigh their regulatory burdens, like tax-favored pension plans.

103. A community could benefit from family development deduction trust distributions in various ways—through lessening burdens on local governments with direct economic assistance to needy beneficiaries, encouraging cultural and educational attainments, and lessening economic tensions that can destroy families.

104. *See* I.R.C. § 408(a)(2) (1994) (requiring that the trustee of an individual retirement account be a bank "or such other person who demonstrates to the satisfaction of the Secretary that the manner in which such other person will administer the trust will be consistent with the requirements of this section").

institutional oversight for family development deduction trusts would lead to commercial fees, investment selection accommodations, or both. Like pension funds and estate planning trusts, however, family development deduction trusts certainly would have ample resources to pay for competent institutional oversight. Since family development deduction trusts might incorporate advisory input from a class of beneficiaries that would change and grow, institutional trustees could serve as a stable power to override grant recommendations that did not comport with both the benefactor's expressed intentions and regulatory requirements.[105]

Institutional trustees could also protect the trust's assets against various prohibited transactions, in parallel fashion to pension trusts and tax-exempt organizations. The law pertaining to prohibited transactions involving these established entities already contains well-developed proscriptions and exemptions.[106] Two-tiered penalty taxes first slap an abuser on the wrist, then inflict a financial punch in the mouth if the abuser persists. Similarly, regulators could use penalty taxes to control transactional problems involving family development deduction trusts.[107]

No matter how well regulators might address potential abuses involving grant discretion or prohibited transactions, the problem of misspent distributions, involving distributees who might even deliberately misrepresent their expenditure plans, would still loom. Because grant administration issues arise for tax-exempt organizations, the existing regulatory response to private charitable foundations in the form of an "expenditure responsibility" concept could also apply to family development deduction trusts.[108] Thus, trustees could administer funds under duties to

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105. As usual for tax-favored arrangements, trustees might resolve close questions involving the application of statutory standards by seeking private letter rulings or determination letters from the Internal Revenue Service. *See* Treas. Reg. § 601.201 (as amended in 1996).

106. *See* I.R.C. § 4975 (1994 & Supp. 1998) (outlining prohibited transactions in the administration of retirement plans); I.R.C. § 4941 (1994) (respecting self-dealing involving charitable private foundations).

107. *Compare* I.R.C. § 4941(a) (1994) (setting a first-tier tax of 5% of the amount involved for self-dealing), *with* I.R.C. § 4941(b) (1994) (imposing a 200% second-tier tax applicable when the self-dealer does not correct the offending transaction in a timely manner).

108. *See* I.R.C. § 4945 (1994); *see also* I.R.C. § 4945(a), (g) (1994) (imposing penalty taxes on certain "taxable expenditures" which include unqualified grants from a private foundation to individuals).

conduct appropriate pre-grant investigations, collect pertinent data, require post-grant reports, and implement follow-up procedures to determine that grants have been spent according to trust guidelines.[109]

In order to enforce appropriate uses of distributions in the hands of grantees, two additional devices could assist regulators. First, a statute or regulation could impose a moratorium on further distributions to an abusing grantee for a period of time corresponding with the severity and repetitiveness of abuses.[110] Second, the abusing distributee could incur a personal tax penalty similar to the imposition against distributees of qualified retirement plans who take pension monies either too early or too late.[111] By such means, distributees would bear grant enforcement responsibility beyond that of the fiduciaries of family development deduction trusts.

Ultimately, an errant family development deduction trust, engaging in flagrant and repeated violations, could trip a "recapture tax" designed to make the Treasury whole upon a disqualification procedure. Again, the regulation of tax-exempt organizations provides a useful parallel—a "termination" procedure permits the Treasury to seize a tax-exempt organization's assets to repay cumulative revenues lost up to the time of a finding that an organization's tax-exempt status cannot continue.[112]

Rules for family development deduction trusts would, of course, develop as a balance of emerging concerns and political considerations.[113] In the realm of political considerations, two issues be-

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109. *See* Treas. Reg. § 53.4945-4(c) (2000) (outlining detailed procedures to assure proper grant-making by charitable private foundations).

110. For instance, a recipient who took a grant to attend college, but withdrew or suffered academic dismissal, might have to wait two years before applying for another grant. A recipient who took a series of grants to care for an ailing parent, but neglected to inform the trustee that the parent had long ago died, might forever remain ineligible for any further grants.

111. *See* I.R.C. § 72(t) (1994 & Supp. 1998) (imposing a ten percent penalty tax on top of any regular income tax owed upon a premature distribution from a qualified retirement plan).

112. *See* I.R.C. § 507 (1994) (imposing a confiscatory "termination tax" that could equal the value of the net assets of a charitable foundation found to have committed "willful repeated acts" in contravention of its tax-exempt status).

113. Sometimes political forces against tax abuses have to build up over a period of years before a regulatory response comes forth. Thus, the "tax shelter" promotions of the 1960s and 1970s, offering write-offs (deductions) as multiples of a taxpayer's investment in certain limited partnerships, did not end until enactment of the passive activity loss

yond the scope of this proposal might also emerge. First, to what extent should existing allowances for the tax-free transmission of wealth remain, expand, or possibly contract in light of a family development deduction trust scheme?[114] Second, to what extent should an overall limitation for family development deductions separate the "super rich" from the "merely rich"?[115]

V. CONCLUSION

Anyone reading this article could have descendants who might become beneficiaries of a family development deduction trust if permitted as herein proposed. Over time, billions of dollars held in thousands of such trusts could inure to the potential benefit of millions of people. The resulting personal and community enrichment would parallel the extent and diversity of benefits now realized under charitable trusts and foundations. Expanding groups of potential beneficiaries would share common interests that demonstrate very tangibly how we all relate to one another within a larger context. Money, instead of producing divisiveness, could serve as a means to bring large numbers of people together for the common purpose of human development. Benefactors would perpetuate their memories and establish positions of honor within their families, not just as originators of wealth, but also as facilitators of enduring values.[116]

Technical features to prevent potential abuses and give benefactors flexibility in setting reasonable distribution priorities

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limitation rules, I.R.C. § 469 (1994), in 1986. Tax Reform Act of 1986, Pub. L. No. 99-514, Tit. V, 100 Stat. 2085, 2233 (1986).

114. In particular, should Congress adjust the wealth transfer taxation unified credit amounts of I.R.C § 2010 and § 2505? *See supra* note 21. Should Congress also adjust the wealth transfer tax rate structure of I.R.C. § 2001(c)?

115. An argument against limitation would emphasize that the larger the fortune left in perpetuity to benefit an expanding beneficiary class, the greater the disbursement of wealth and resulting social benefit. Note also that no dollar limitations restrict charitable deductions for wealth transfers under either the gift tax or estate tax provisions of I.R.C. § 2522 and § 2055, respectively.

116. Some families do a wonderful job of preserving family memories and sensibilities over many generations. *See* Pui-Wing Tam, *A Parchment Unveils a Family's Past*, WALL ST. J., May 17, 2000, at A24 (describing eloquently a sense of family identity that spans thirty-one generations, going back to an ancestor who served as a court official in the Song Dynasty in northern China in 962 A.D.). Family development deduction trusts would have the potential to preserve such a sense of family identity for a very large number of Americans.

could ensure that public and private interests need not clash under a family development deduction scheme. The current system for wealth transfer taxation does not have to disappear and could serve as a backup for benefactors who insist, despite the tax cost, on transferring large concentrations of wealth for the inordinate benefit of their progeny.

A reasonable range of permissible distributions from family development deduction trusts could manifest social benefit on par with traditional charitable giving and include outlays that directly or indirectly benefit existing charitable organizations.[117] Additionally, family development deduction trusts would effectively blend competing political philosophies into one technical mechanism that lets charity begin at home and greatly encourages family values while addressing larger social concerns. Congress might repeal wealth transfer taxes sooner or later, and just as easily reinstate these taxes upon changing its composition. Creation of a family development deduction, however, would effect a much more vital and enduring result than acceding in an all-or-nothing fashion to either the proponents or opponents of wealth transfer taxation.

117. The existing wealth transfer taxation system already gives implicit approval for the tax exemption of certain kinds of transfers which, though benefiting only individuals and not charitable organizations, nonetheless have such intrinsic social benefit that transfer taxation should not impede their flow. Thus, I.R.C. § 2503(e) permits the tax-free transfer of unlimited amounts to pay the tuition or medical expenses of family members or others. *See supra* note 21. Family development deduction trusts would simply extend the concept behind this exemption to a broader range of personal and social benefits for an ever-expanding class of individuals.

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