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Interest-Free Loans and *Dickman v. Commissioner*: A Letter to the Supreme Court

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INTEREST-FREE LOANS AND *DICKMAN v. COMMISSIONER:* A LETTER TO THE SUPREME COURT*

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On February 22, 1984, the Supreme Court handed down its decision in Dickman v. Commissioner of Internal Revenue, holding that intrafamily interest-free demand loans give rise to taxable gifts under the Federal Gift Tax. The following letter was sent to the Court on February 27, 1984. On March 5, 1984, the House Ways and Means Committee reported to the Committee of the Whole House the Tax Reform Act of 1984, H.R. 4170, which contains proposed legislation on the subject matter. On March 21, 1984, the Senate Finance Committee approved the Deficit Reduction Act of 1984, S. 2062, which, with minor differences, generally parallels the House bill. A brief discussion of the proposals follows the letter in a postscript.

February 27, 1984

The Honorable Warren E. Burger
Chief Justice
Supreme Court of the United States
One 1st Street, N.E.
Washington, D.C. 20530

Dear Mr. Chief Justice:

We have read, with great interest, the slip opinion in *Dickman et al. v. Commissioner of Internal Revenue*, No. 82-1041, decided February 22, 1984.[1]

We would first like to say that we agree completely with

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Our letter to the Court is reprinted in full. Several footnotes have been added to assist the reader; only footnote 7 appeared in our original letter.

1. 52 U.S.L.W. 4222 (U.S. Feb. 22, 1984).

the Court's conclusion that intrafamily interest-free demand loans involve taxable gifts.

Secondly, we also agree completely with the Court's basic economic rationale that permitting a person to use money interest free involves a transfer of economic value.

Thirdly, we agree completely with that part of the Court's *supporting rationale* that holds that gift taxation of intrafamily interest-free demand loans is necessary to protect against the erosion of the estate tax base.

We are, however, extremely dismayed by the following three sentences in the opinion:

> A substantial no-interest loan from parent to child creates significant tax benefits for the lender quite apart from the economic advantages to the borrower. This is especially so when an individual in a high income tax bracket transfers income-producing property to an individual in a lower income tax bracket, *thereby reducing the taxable income of the high-bracket taxpayer* at the expense, ultimately, of all other taxpayers and the government. Subjecting interest-free loans to gift taxation minimizes the potential loss to the federal fisc generated by the use of such loans as an income tax avoidance mechanism for the transferor. (emphasis added).[2]

The reason for our dismay is that these statements assume that it is the law that a parent-lender can avoid (shift) *income tax* liability by an interest-free demand loan. We would make several points about this assumption which could make *Dickman* a disaster rather than a victory for the Government.

1. First, neither this Court, nor any other court, has ever held that the lender can shift the income tax on income from a gratuitous intrafamily interest-free demand loan. The issue has not been litigated.

2. Second, there is no Revenue Ruling or Regulation (let alone statutory provision) which states anything upon which the Court's assumption could be based.

3. Third, this Court, over half a century ago, established a principle opposite to that assumption, namely that a person who transfers money by way of a revocable gift remains taxable on the income from that money even if it is paid to another. In *Corliss v. Bowers*, 281 U.S. 376 (1930) which involved the income taxation of the grantor of a revocable

2. *Id.* at 4224.

family trust (economically indistinguishable from a gratuitous interest-free demand loan), the question was the constitutionality of section 219(g) of the 1924 Revenue Act (the predecessor of section 676 of the Code) which considered the grantor of a revocable trust as the owner of the trust corpus, and thus taxable on the trust income. Justice Holmes, writing for a unanimous Court, went straight to the heart of the matter, in language particularly relevant to demand loans:

> [T]axation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid. If a man directed his bank to pay over income as received to a servant or friend, until further orders, no one would doubt that he could be taxed upon the amounts so paid. It is answered that in that case he would have a title, whereas here he did not. But from the point of view of taxation there would be no difference. The title would merely mean a right to stop the payment before it took place. The same right existed here although it is not called a title but is called a power. The acquisition by the wife of the income became complete only when the plaintiff failed to exercise the power that he reserved. . . . Still speaking with reference to taxation, if a man disposes of a fund in such a way that another is allowed to enjoy the income which it is the power of the first to appropriate it does not matter whether the permission is given by assent or by failure to express dissent. The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not.

281 U.S. at 378.

Although *Corliss* involved the constitutionality of section 219(g) [presently section 676a] of the 1924 Revenue Act, that statutory provision was not a new statement of tax policy by the Congress; rather, it was a clarification of what was implicit in the development of the assignment of income principles under the predecessor of section 61. That was the precise holding of *McCauley v. Commissioner*, 44 F.2d 919 (5th Cir. 1930), which, although decided after *Corliss*, involved a tax year prior to the effective date of section 219(g) of the 1924 Revenue Act. In holding that the grantor of a revocable trust must include the trust income in his gross income under the predecessor of section 61, the court relied directly on *Corliss*, and stated:

> It is true that the decision is under the Revenue Act of 1924 . . . which provided in terms that the grantor of a trust who reserved the power to

> revest in himself title to any part of the corpus of the trust should be liable for the tax. But that Revenue Act, as it appears to us from its history, was merely declaratory of existing law.

44 F.2d at 920.

4. Fourth, the Court's assumption completely undermines the grantor-trust provisions of the Code. If the Court's assumption were correct, section 676, for example, is really a dead letter since the assignment of income prevented by that section could be accomplished by an interest-free demand loan [either directly to a child, or to an otherwise irrevocable trust for a child (a so-called "Crown Trust")].

Nor would the owner of income-producing property have any need to worry about section 673 which requires that the right to use property be given up for more than ten years (or the life of the beneficiary) in order to shift income tax liability. An interest-free demand loan would do the trick.

The Government's Brief has misled the Court on this point. It states:

> In addition, a holding that the instant loans do not result in taxable gifts would substantially undercut the grantor trust income tax provisions. If the settlor of a trust retains significant rights in or powers over the corpus of the trust, the 1954 Code treats him as the owner of the trust and he is taxable on any income earned by the trust. See 26 U.S.C. 671. See also Helvering v. Clifford, 309 U.S. 331 (1940). In order to avoid taxability on a trust's income, the settlor must create a trust of at least 10 years' duration (26 U.S.C. 673), and must comply with the other safeguards against retained powers or interests contained in 26 U.S.C. 674-677. *These safeguards would be unavailing if a taxpayer could, without gift tax liability, avoid the trust requirements merely by making a demand loan to the desired beneficiary. The taxpayer could then call the loan at any time, while the beneficiary could meanwhile invest the funds in income-producing assets, on which income he, not the lender, would be taxed.* (emphasis added).[3]

To say as the Government does that imposing a gift tax on an interest-free demand loan would safeguard a grantor trust provision such as section 676 suggests the following proposition: with the gift tax, the policy of section 676 would be preserved for the interest-free demand loan, thus safeguarding section 676 while, without the gift tax, the policy of section 676 would be thwarted by the use of such a loan.

3. Brief for Respondent at 21-22, *Dickman*, 52 U.S.L.W. at 4222.

The error of this proposition is that *even with gift tax liability*, the use of an interest-free loan would thwart the policy of section 676 unless the theory of that section is applied to tax the lender of an interest-free demand loan under the *income tax*.

Once again the fundamental error of the Government, which is reiterated by this Court, as noted above, is the assumption, restated in the last sentence of the above quote that in an interest-free demand loan, "the beneficiary could . . . invest the funds in income-producing assets, on which he, not the lender, would be taxed." Such a result clearly violates the principle of section 676 and *Corliss v. Bowers* and the presence of a gift tax would not prevent such a violation. This fact will not be lost on tax practitioners and financial advisors.

In the same vein, the Court's assumption undermines its own previous holding in the assignment of income area, i.e., *Helvering v. Horst*, 311 U.S. 112 (1940); *Harrison v. Schaffner*, 312 U.S. 579 (1941). If, as *Harrison v. Schaffner* holds, a parent cannot successfully shift income from rental property, even by an irrevocable assignment to a child of the right to one year's rent while retaining the reversion, how could it be that a parent could successfully shift income by an interest-free demand loan which can be terminated at any time?

5. Fifth, and finally, the Court states that in order to make a taxable gift, a transferor "must relinquish dominion and control over the transferred property," and that in a demand loan, the gift is not made upon the making of the loan because of the power to demand it back.[4] Thus the gift of use value is made only "as time passes without a demand for repayment."[5] We agree! Indeed, this is exactly the rule adopted by the Court in *Burnet v. Guggenheim*, 288 U.S. 280, 283 (1933) in imposing the gift tax upon the grantor of a revocable trust. Such an analysis for the gift tax, however, requires an identical analysis for the income tax, to wit: the power to demand is the power to revoke and, therefore, an income tax is imposed on the lender as the borrower earns interest upon the loan. Such a result is required by I.R.C. section 676(a) when

4. *Dickman*, 52 U.S.L.W. at 4224 n.7.
5. *Id.*

the loan is to a trust, as it was in *Crown v. Commissioner*, 585 F.2d 234 (7th Cir. 1978). And even when the loan is not to a trust, this result is required under the theory of section 676(a) expounded in *Corliss v. Bowers*, 281 U.S. 376 (1930). *Corliss* upheld the predecessor of section 676(a) on the ground that the grantor of a revocable gift is the owner of the income due to his "unfettered command" over the enjoyment thereof. *Corliss* at 378.

Thus, the reason for imposing a gift tax, i.e., the transfer of the use value during the period of non-demand, also requires imposition of an income tax. Indeed, in upholding the gift tax, *Guggenheim* specifically referred to and relied on its decision and reasoning in *Corliss v. Bowers*. See *Guggenheim*, 288 U.S. at 283. And this very Court, in note 5 of *Dickman*, reconstructs the transaction to illustrate the economics of it: it's the same as a loan at interest with the lender receiving the interest and then making a gift of it to the borrower.[6] There is a gift tax *transfer*; there is also a *receipt* taxable under the income tax because these facts also illustrate the theory of section 676.

In light of the above, it was a mystery to us how this Court came upon the assumption that a parent can shift income tax liability by an interest-free demand loan. Incredibly, it turns out that this was the position taken in the *Government's* Brief to this Court in this case.[7]

> . . . Paul and Esther C. Dickman shifted to Lyle and Artesian the income that would be generated by the money lent them, thereby reducing their own income taxes and ultimately the amounts of their taxable estates.
>
> The concern here is that people will use gifts of income producing property to split up an income taxable in a high bracket into smaller incomes taxable in lower brackets. *No-interest loans do just that.* Moreover, where the loans are payable on demand, the maker of the loans is able to achieve this result without the inconvenience of losing access to the principal should the need arise.[8]

6. *Id.* at 4223 n.5.

7. Martin Ginsberg, in a recent article, *Making Tax Law Through the Judicial Process*, 70 A.B.A.J. 74, 77 (1984), sees "a government that more than occasionally litigates tax cases with eyes firmly shut to broader implications . . . ."

8. This paragraph was part of the Government's footnote 25, and is a direct quote from *Crown v. Commissioner*, 585 F.2d 234, 236 (1978). In footnote 25, the Government says:

> If interest-free demand loans are not subject to gift taxes, the potential loss of tax revenues may be quite substantial in light of the fact that tax practitioners and financial advisors have recognized and widely advocated the use of such loans as a device to split incomes and reduce estate taxes. (emphasis added).[9]

If this is the source of the assumption, the fact is that, whether by design or neglect, the Government has misled the Court about the law concerning the income taxation of interest-free demand loans. If it was by design, it is a sad commentary that in order to win a gift tax case, the Government felt compelled to foist on this Court an assumption which is not only erroneous but which it really cannot live with on the income tax side—indeed, an assumption totally unnecessary to the Court's decision which can stand on its own economic reasoning without the need of such a crutch.

The evidence, however, indicates that the Government's position in its Brief in this case is more probably due to neglect rather than design. Specifically we are referring to the fact that the Government did not even cite *Burnet v. Guggenheim*, 288 U.S. 280 (1933) which had basically already determined the issue before the Court in the present case. Indeed, the essence of Treas. Reg. section 25-2511-2(b), which this Court has adopted in its present opinion, was once a part of the statute (Revenue Act of 1932, section 501(c)). After *Guggenheim*, however, the regulation was removed from the statute by Congress (Revenue Act of 1934, section 511) since, as the House Report stated, "the principle expressed [in the

> As the Seventh Circuit in *Crown* acknowledged (585 F.2d at 236; footnote omitted):

and then follows the paragraph from *Crown*. Brief for Respondent at 19 n.25, *Dickman*, No. 82-1041 (U.S. 1984). The "footnote omitted" is footnote 3 of the *Crown* opinion which states:

> We do not mean to express any view with regard to the Commissioner's contention, not part of this appeal, that the loans in this case gave rise to constructive income to the Areljay partners taxable under the income tax.

Crown, 585 F.2d at 236 n. 3. In other words, in footnote 25 of its Brief, the Government quoted the *Crown* text to support its argument that there was no income tax in the lender of a gratuitous demand loan, but omitted, intentionally, the footnote which disavowed the expression of any such view.

This footnote, our note 8, has been added in the interest of completeness and clarification. It changes nothing with respect to the merits of our arguments received by the Court.

9. Brief for Respondent at 19-20, *Dickman*, 52 U.S.L.W. at 4222.

Regulation] is now a fundamental part of the law by virtue of the Supreme Court's decision in the Guggenheim case." H.R. Rep. No. 704, 73rd Cong., 2d Sess. 40 (1934).

Although the Government's Brief may have been the source of the Court's assumption, it may also be that at a more fundamental level the assumption about the income tax treatment of interest-free demand loans may be the result of a misconception about the *manner* in which the gift tax protects the income tax. To illustrate, it is clear that if a high bracket parent gives a low bracket child a no-strings-attached, outright gift of $100,000, the parent has successfully shifted the income from the $100,000 to Child. Because the Parent is permitted to shift the income by such an outright irrevocable gift, subjecting this transaction to a gift tax minimizes the Government's loss on the income tax side.

On the other hand, it is equally clear that the gift tax is unnecessary to protect the income tax where the income tax protects itself, i.e., where statutory provisions and judicially developed principles *prevent* assignment of income. If, e.g., Parent establishes a revocable trust for Child, the gift tax applies to the income payments to the Child. Nevertheless, *and this is the point*, Parent *still* must include in his or her income the payments made to Child (section 676). The Child excludes the payment under section 102. The same results would obtain under this Court's assignment of income principles.

If Parent assigns personal service income to Child (*Lucas v. Earl*) or assigns interest (*Horst*) or rent (*Schaffner*) while retaining the income-producing property, the assignment constitutes a gift for gift tax purposes but the salary, interest or rent is still included as *income* by the Parent and excluded from income by Child under section 102.

If in all of these situations, the income tax is not in need of protection because the assignment of income provisions or principles prevent income shifting to lower bracket taxpayers, why are these transactions subject to gift tax? The reason is that *after* the assigned payment from a revocable trust, or salary, interest or rent, have been received by Child, the *future* income *from these amounts* will be income to Child, not Parent. In other words, in the case, e.g., of a revocable trust, sec-

tion 676 prevents the *income from the trust corpus* from being shifted to Child. However, the *future income earned by the payments made to Child* is permitted to be shifted. The gift tax exacts a price for the successful shifting of the future income *from* the trust income distributions. The gift tax is not a price paid for shifting the income from the trust corpus since that shifting is prohibited by section 676.

The same analysis is true for interest-free demand loans. If Parent loans Child $100,000 interest free on demand and the Child earns (or could have reasonably earned) $10,000, the gift tax on the $10,000, which this Court has now upheld, is exacted as a price for the successful shifting of the future income *from* the $10,000. The income *of* $10,000, i.e., the income *from* the $100,000, does not need gift tax protection since under *Corliss v. Bowers* and this Court's other assignment of income cases, the income *from the $100,000* should be taxed to Parent.

It is, indeed, ironic that the Court's assumption about the income tax treatment of interest-free loans is made in the context of expressed concern for minimizing "the potential loss to the federal fisc."[10] Given the liberalized annual exclusion and unified credit, both of which can effectively be doubled because of the split gift provisions, and the unlimited marital deduction, the real loss to the federal fisc will be the income tax loss which will occur if the Court's *assumption* about the income tax treatment of interest-free loans is relied upon as a statement of the Court's view of what the law is, or should be. If that were to occur, the Court's present decision would indeed be a Pyrrhic victory for the fisc, "at the expense," as the Court has put it in *Dickman*, "ultimately, of all other taxpayers and the government."[11]

A further irony is the de facto repeal of the grantor trust provisions of the Code, sections 671-678, as noted above. Some of these provisions (sections 673-675 and 678) were enacted as the culmination, in 1954, of years of litigation in the courts of the assignment of income cases (such as *Horst*, *Schaffner*, and *Clifford*) and after the promulgation in 1945 of

10. *Dickman*, 52 U.S.L.W. at 4224.
11. *Id.*

the Clifford Regulations. Section 676, on the other hand, was enacted as far back as 1924 to prevent assignment of income through the revocable trust device. The product of all this time and effort will become so much deadwood unless *Dickman* is clarified on the income tax side to preserve the efficacy of the grantor trust provisions.

In light of the above, we would urge the Court to remove from the *Dickman* opinion, before it is published in the U.S. Reports, the statements referred to at the outset of this letter. At the least, we would urge that the Court make it clear, by footnote or otherwise, that the assumption made in those statements is not an indication that this Court is of the view that the lower bracket child rather than the higher bracket parent is taxed under the income tax on the income earned on an interest-free demand loan.

We have tried to keep this letter as short as possible. An elaboration of our views can be found on pp. 489-501 of Joyce & Del Cotto, "Interest-Free Loans: The Odyssey of a Misnomer," 35 Tax L. Rev. 459 (1980).

With highest regards,

Sincerely yours,

Louis A. Del Cotto

Louis A. Del Cotto
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POSTSCRIPT

Legislation has recently been reported to the House of Representatives by the Committee on Ways and Means to deal, *inter alia*, with the *income tax* consequences of intrafamily interest-free loans.[12]

12. Tax Reform Act of 1984, H.R. 4170, 98th Cong., 2d Sess. § 162, *reprinted in*

In its discussion of the "Present Law" in this area, the Report of the Committee on Ways and Means takes note of the gift tax holding of the Supreme Court in *Dickman* but does not advert to the Court's statements regarding the income tax. Rather, the Committee states:

> It is unclear whether, under present law, interest-free or below-market interest rate loans from one family member to another have any Federal income tax consequences. To date, courts have addressed only the gift tax consequences of such transactions.[13]

In contrast to the above is the Committee's rather blunt discussion when dealing with "Reasons for Change":

> Family loans are being used to avoid the assignment of income rules and the grantor trust rules. An interest-free or below-market interest rate family loan involves a gratuitous transfer of the right to use the proceeds of the borrowing until repayment is demanded (in the case of a demand loan) or until the end of the term of the loan (in the case of a term loan). If the lender had assigned the income from the property to the borrower, the assignment of income doctrine would tax the lender on the income. If the lender had transferred the principal amount to a trust established for the benefit of the borrower that was revocable at will (in the case of a demand loan), or that would terminate at the end of a period of not more than 10 years (in the case of a term loan), the income earned on trust assets would be taxed to the lender under the grantor trust provisions set forth in Code secs. 671-679.[14]

The bill in the main reflects the same views with respect to interest-free loans as are held by the authors.[15]

For demand loans the borrower is treated as paying the interest and receiving it back in a manner conforming to the substance

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71 FED. TAX REP. (CCH) (March 9, 1984); *see* H.R. REP. No. 432 pt. 2, 98th Cong., 2d Sess. 1370-79 (discussing § 162 of Tax Reform Act and new § 7872 of the Internal Revenue Code.)

13. H.R. REP. No. 432, *supra* note 12, at 1371. In Private Letter Ruling 8309002, the position was taken that the assignment of income doctrine would not be applied to make a corporation taxable on imputed interest where the corporation had made interest-free demand loans apparently to shareholders. 313 IRS LTR. RUL. REP. (CCH) 8309002 (Nov. 2, 1982). On October 4, 1983, Private Letter Ruling 8309002 was officially withdrawn by Private Letter Ruling 8403012, which stated: "Subsequent to the issuance of LTR 8309002, the National Office decided that it was not appropriate at this time to take any position regarding the application of the assignment of income doctrine to the lender of interest-free loans." 360 IRS LTR. RUL. REP. (CCH) 8403012 (Oct. 4, 1983).

14. *Id.* at 1373-74.

15. An elaboration of our views with respect to interest-free loans can be found at Joyce & DelCotto, *Interest-Free Loans: The Odyssey of a Misnomer*, 35 TAX L. REV. 459 (1980).

of the transaction, e.g., as a gift, dividend, or compensation. For term loans, the excess of the amount loaned over the present value of the borrower's repayment obligation is an outright transfer to the borrower as a gift, dividend, or compensation, etc. This excess is then treated as original issue discount and interest is viewed as received by the lender and paid by the borrower at a constant rate over the term of the loan.[16]

The amount of interest, the "Applicable Federal Rate,"[17] will be, generally, the average yield in comparable United States obligations. However, in the case of family loans (loans where the foregone interest is a gift), the amount taxed to the lender is limited to the borrower's income attributable to the loan. Thus, for family loans made to finance "consumption items, such as higher education, personal residences, etc. . . ,"[18] the lender's income is considered to be zero.[19]

This latter provision, in effect, introduces a tracing requirement in order to measure the income attributable to the loan. This technique brings taxation of the lender of a demand loan closer to that for revocable trusts. However, it creates problems in measuring or tracing the actual income attributable to the loan, problems which are avoidable.[20] Moreover, it goes only half-way because it only applies if the actual income is less than that produced by the statutory rate.

There is a further exception for non-tax motivated transactions involving small loans for short periods of time which do not involve significant distortions of income.

For income tax purposes the bill treats all loans which involve

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16. The borrower and lender are thus placed in the accrual method of accounting and the loan is treated similar to a discount bond. *See* I.R.C. § 1232A (discount bonds; recodified by proposed Tax Reform Act of 1984 at § 1272); Tax Reform Act of 1984 § 162(a) (proposing I.R.C. § 7872(a) & (b)). However, where the excess is a gift, the bill treats term loans as demands loans.

17. Tax Reform Act of 1984 § 41 (proposing I.R.C. § 1274(d)).

18. H.R. REP. No. 432, *supra* note 12, at 1375.

19. This is a questionable result for loans spent for education since that expenditure should be viewed as a cost of acquiring education, a long-time asset that normally produces future income, and not as "consumption." Compare H.R. REP. No. 432, *supra* note 12, at 1378-79, where the Committee indicates its desire for regulations dealing with loans that produce future income, such as purchase of a deferred annuity, to require that the future income be treated as attributable to the loan.

20. On this point, see Joyce & DelCotto, *supra* note 15, at 491-95. *Cf. id.* at 506 n.7 and accompanying text.

gifts (i.e., "family loans") in the same manner as it treats demand loans even if the loans are term loans. This can lead to some anomalous results. Suppose, for example, that G has $100 and the applicable interest rate is 10%. If G invests the $100 for two years at compound interest, he will have $121 ($10 interest in year one; $11 interest in year two). If G retains and invests only $83 of the $100 and transfers $17 of the $100 to B outright as a gift, then at the end of two years G will have $100.43 ($8.3 interest in year one and $9.13 interest in year two). B will have $20.57 ($1.7 interest in year one and $1.87 interest in year two). By his outright gift to B of $17, G will have successfully shifted $3.57 of interest income to B.

Now, however, suppose G engages in the economic equivalent of this last example by way of a two year interest-free term loan to B of $100.[21] Under the bill, G must report $10 of interest income both in year one and year two.[22] By treating the loan as a demand loan, the bill prevents income shifting that is clearly permissible and which can be accomplished by a bifurcated transaction, i.e., a term loan at market interest and an outright transfer with no requirement of repayment.[23]

Moreover, under the bill, family term loans are treated in the same way as demand loans, *no matter how long the term.* If, e.g., G makes an interest-free loan of $100 for ten years and a day to B, under the bill G continues to report interest income yearly with no shifting of income to B even though, if G had engaged in the economically equivalent transaction of putting the $100 in trust for B, retaining a reversion after ten years and a day, G would have successfully shifted *all the income* to B over the trust term, under

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21. The present value of $100 to be received in two years, given a 10% interest rate, is approximately $83: $100 ÷ $(1.1)^2$.

22. It is not clear whether under the bill G would be required to include $10 or $11 as foregone interest for year two. It seems more likely that the amount would be $10 since the bill basically treats all family loans as demand loans. If the amount reportable by G for year two is $10, then G would have been prevented from shifting only $2.57, not $3.57, of interest income. The fact remains, however, that there exists no good reason for preventing the shifting of any of the $3.57 interest income where the loan is a term loan rather than a demand loan.

23. This result is especially ironic in light of the Committee's statement that

> [t]he committee believes that an interest-free or below-market interest rate loan is the economic equivalent of a loan with a market rate of interest required to be paid by the borrower, and a payment by the lender to the borrower, to fund the borrower's payment of interest.

H.R. REP. No. 432, *supra* note 12, at 1373.

section 673.

Finally, the bill is not clear as to the treatment of an interest-free term loan or an interest-free demand loan, made to a trust whose income is otherwise taxable to the grantor under section 673 or section 676.

Despite its various infirmities, if and when the proposed legislation becomes law, it will go a long way towards neutralizing the potential mischief for the income taxation of interest-free loans created by *Dickman*. If it is not enacted into law, hopefully such fact will not prevent substantially the same results from being achieved under existing principles of law, despite the statements in *Dickman*.

Whatever happens legislatively, the above letter is perhaps more important as a comment on the judicial process than it is as a statement of tax principles.