

Charitable Intent



PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

e STATE PAYMENT OF ORAL PLEDGE APPROPRIATE

Reinhard Schmidt told his pastor he wished to fund several remodeling projects for the church, although no specific amount was mentioned. Shortly thereafter, Schmidt executed a new will, but did not include a bequest to the church. His great-nephew, Loren Mulligan, headed the committee overseeing the church's remodeling. Mulligan obtained estimates on the projects and told Schmidt the cost would be between \$115,000 and \$150,000.

Later that year, after work had begun on the remodeling, Schmidt died. Mulligan, who was executor of the estate, used \$135,410 of estate funds to pay for the church projects. A beneficiary of Schmidt's will filed an objection to the use of estate funds to satisfy the oral pledge, but the court deemed the payment appropriate.

The Iowa Court of Appeals noted that to have a charitable subscription, there must be a promise to a charity, not merely a statement of intent, and acceptance. Under state law, there is no requirement to show detrimental reliance. The beneficiary argued that Schmidt's promise was too vague to be enforceable. The court found, however, that Schmidt pledged to pay for the improvements and was aware of the costs. The appeals court agreed that the church accepted his offer prior to his death by actually starting work on the projects, which "would not have been undertaken by a small rural congregation without having accepted the generous pledge of one of its members to pay."

In the Matter of Estate of Schmidt, No. 6-644 (Iowa App.)

RULE CHANGE ENCOURAGES BUSINESS INTERESTS IN CHARITABLE REMAINDER TRUSTS

A provision in the Tax Relief and Health Care Act of 2006 amends Code §664(c), enabling owners of business interests to use these to fund charitable remainder trusts. The income generated by a

business between the time it is contributed to a charitable remainder trust and when the business interest is sold is unrelated business taxable income (UBTI). Previously, a charitable remainder trust lost its tax exemption for any year in which it had any UBTI. If that happened to be the year in which the business interest was sold, significant capital gains could be due. Starting in 2007, however, a charitable remainder trust will owe a 100% excise tax on any UBTI, but will retain its tax-exempt status. The owner of a business interest who wishes to sell within a charitable remainder trust can enjoy a charitable deduction, income for life – part of which may be taxed at capital gains rates – and the avoidance of capital gains tax, while also providing future assistance to favorite charities.

REFORMED UNITRUST WON'T QUALIFY

A couple asked a court to reform their net-income with make up charitable remainder unitrust, saying the attorney who drafted the trust did not explain to them the availability and advantages of the straight percentage unitrust. Had they known, they would have opted for the straight unitrust, they said, noting that due to a change in the investment climate, the trust was not providing the annual income stream they expected or needed. The court approved the reformation, subject to the IRS ruling that the change would not cause the trust's disqualification under Code §664.

Under Reg. §1.664-3(a)(4), a charitable remainder trust may not be subject to a power to invade, alter, amend or revoke for the beneficial use of a person other than charity. A modification or reformation made to correct a scrivener's error does not violate Code §664.

The IRS determined, however, that the proposed modification was not the result of a scrivener's error and ruled that the reformed trust would not be qualified under Code §664.

Letter Ruling 200649027

gUIDANCE ON IRA GIFTS FROM IRS

The IRS has answered several questions posed by new Code §408(d)(8), which permits qualified charitable distributions from IRAs through the end of 2007 by donors over age 70½.

- The exclusion from income (up to \$100,000) also applies to distributions from inherited IRAs, provided the beneficiary has reached age 70½ by the date of the distribution.

- Distributions made directly to charity prior to the enactment date of August 17, 2006 – possibly through IRA checking accounts – qualify for the exclusion.

- Owners who have SEP and SIMPLE IRAs through an employer arrangement may make qualifying charitable distributions, provided the owners are no longer receiving employer contributions in the year of the distribution to charity.

- Qualified charitable distributions are not subject to withholding. The IRA owner is deemed to have elected out of withholding under Code §3405(a)(2).

- A check from an IRA made payable to charity and delivered by the IRA owner is considered a direct payment by the IRA trustee for purposes of Code §408(d)(8)(B)(i).

- An amount intended to be a qualified charitable distribution that fails to satisfy Code §408(d)(8) is treated as a distribution to the IRA owner (included in gross income), followed by a contribution to charity that is deductible subject to the limitation rules in Code §170(b).

- The Department of Labor has determined that a distribution made by an IRA trustee to charity is treated as receipt by the IRA owner and will not be a prohibited IRA transaction, even if the donor has an outstanding pledge to the charity.

Notice 2007-7

aSSIGNMENT OF IRA TO CHARITIES IS INCOME TO TRUST

A decedent whose revocable trust was the death beneficiary of her IRA had provided for \$100,000 to be distributed “in cash or in kind” to three charities in varying amounts at her death. The trustee had the power to make distributions at fair market value, without a requirement that each item be distributed or divided ratably. The trustee instructed the IRA custodian to divide the IRA into shares, naming each of the charities the owner and beneficiary of an IRA equal in value to the dollar amount to which they were entitled.

The balance in an IRA at death is income in respect of a decedent (IRD) under Code §691(a)(1). If an estate satisfies a pecuniary bequest with property, the payment is treated as a sale or exchange. The IRS noted that the terms of the trust did not require the payment of the charitable bequests with the IRA. Therefore, the payments are transfers of the right to receive the IRD and the trust must include the value in its gross income.

When informed of the IRS’s position, the estate withdrew that portion of the ruling request, arguing that the partial assignment was not a sale or exchange under Code §691(a)(2) with no allowable charitable deduction under Code §642(c). The IRS responded that the trust received an immediate economic benefit by satisfying the pecuniary obligation to the charities with property on which neither the trust nor the decedent had paid income tax.

TAM 200644020

▲ TAX PLANNING POINTER

The IRS has issued numerous rulings indicating that the use of an IRA or deferred annuity to satisfy a percentage bequest or a residuary bequest would not cause the estate to be subject to the tax on IRD where the executor has the power, under the will or state law, to make non-pro rata distributions of assets (e.g., 200234019, 200452004, 200617020, 200618023).

HELPING YOU GET THE ANSWERS

In addition to the guidance provided on qualified charitable distributions from IRAs (Notice 2007-7, see article above), the IRS has issued other help for donors, their advisers and charities on navigating the provisions of the Pension Protection Act: Notice 2006-51 addresses supporting organizations and donor advised funds; instructions on Form 1040 (lines 15a and 15b, exception 3) explain how to indicate qualified charitable distributions on the tax return; Notice 2006-96 provides interim guidance on satisfying appraisal requirements for non-cash gifts; and Notice 2006-110 gives guidance on substantiating payroll deduction gifts. The Salvation Army’s Planned Giving staff can help you obtain copies of these documents or answer any questions you might have about your clients’ philanthropic gifts. Please feel free to call us.