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THE SALVATION ARMY

Charitable Intent

PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

TAX ACT ADDRESSES OVERSIGHT IN EARLIER LEGISLATION

The Tax Increase Prevention Act of 2007 may have gotten more attention with its increase in the AMT exemptions, but another piece of legislation – the Tax Technical Corrections Act of 2007 – included several changes affecting charitable giving.

■ When an S corporation contributes appreciated property to charity, the basis limitation no longer applies to deductions, provided the shareholder's pro rata share of the contribution exceeds the pro rata share of the adjusted basis in the property. The Joint Committee on Taxation gave the example of an S corporation with one shareholder. The corporation contributes an asset with a $200 basis and a $500 fair market value. The shareholder's adjusted basis in the stock is $300. The basis limitation does not apply because the $300 adjusted basis of the stock is more than the $200 adjusted basis in the gift property. The shareholder is treated as making a $500 charitable contribution and reduces the basis of the S corporation stock by $200 [Code §1367(a)].

■ Under Code §170(e), a donor's income tax deduction is limited to basis if appreciated tangible personal property is put to a use that is unrelated to the organization's exempt purposes. Upon a disposition, an officer of the charity must certify that the asset was put to a related use. Under the new rules, the use must not only be related, it must be "substantial" [Code §170(e)(7)(D)(i)].

■ For donors who own multiple IRAs and took advantage of the opportunity to make tax-free distributions directly to charity in 2006 and 2007, the distributions will be considered to have been made from all of the donors' IRAs [Code §408(d)].

■ A donor who contributes a fractional interest in artwork won't face gift or estate tax complications for future fractional gifts in the same property. Under the Pension Protection Act, the income tax deduction for a subsequent fractional interest gift is calculated by reference to the original valuation. For example, if a donor gave a 10% interest in a $100,000 painting in 2007 and deducted $10,000, the deduction for a future gift of another 10% interest is limited to $10,000, even if the painting has appreciated to $150,000. The problem: gift and estate tax deductions were also limited. As a result, a later gift might represent a $15,000 transfer, but the gift tax charitable deduction was limited to $10,000. A donor could end up using some gift tax credit or even paying gift tax on a transfer to charity. Code §§2055 and 2522(e) have been amended to allow full gift and estate tax deductions for increased values passing to charity.

ESTATE LEARNS COSTLY REFORMATION LESSON

At Anthony Tamulis's death, his revocable trust was to continue for the longer of ten years or the joint lives of his brother and sister-in-law. In addition to giving the couple a life estate in his property, the trustee was to pay utilities, taxes, repairs and maintenance on his home. The trustee was also to make payments annually to several grandnieces, after which the remainder was to pass to a Catholic diocese.

The estate claimed a charitable deduction of nearly $1.5 million for the "residue following 10 year term certain charitable remainder unitrust at 5% quarterly payments to two grand nieces." Because the noncharitable interest was not a fixed dollar amount or a percentage of the trust's fair market value, it was not qualified under Code §664(d)(2).

A trust may be reformed under Code §2055(e)(3)(B), provided it is a reformable interest – one that would qualify for a charitable deduction under Code §2055(a) but for the requirement of Code §2055(e)(2) that the trust be in the form of a qualified charitable remainder trust or pooled income fund [Code §2055(e)(3)(C)(i)]. A reformable interest is one in which payments to noncharitable beneficiaries are expressed either in specified dollar amounts or as a fixed percentage of the trust's fair market value [Code §2055(e)(3)(C)(ii)]. A trust that does not meet these criteria may still be reformed, provided a judicial proceeding is commenced no later than 90 days after the last date (including extensions) for filing the estate's tax return [Code §2055(e)(3)(C)(iii)(l)].

The trustee never initiated judicial reformation action, although he did operate the trust as if it were a qualified 5% charitable remainder unitrust. The IRS disallowed the estate's charitable deduction and the Tax Court ruled that the trust was not reformable because the time limit had passed.

The estate appealed, claiming that the deduction should be allowed under the doctrine of substantial compliance. The U.S. Court of Appeals (7th Cir.) rejected that argument, noting that the estate was well aware of the substantial deduction that was at stake but failed to initiate the required judicial action to reform the trust. The court said the fact that the trust was operated as a qualified unitrust "depended largely on the good faith of the trustee." The doctrine of substantial compliance seeks to forgive noncompliance for "unimportant and tangential requirements," said the court, adding that the reformation requirement "is not unimportant."

***Estate of Tamulis v. Comm'r.*, No. 06-4141**

COURT DETERMINES STATUS OF UNCASHED CHECK

A check for $33,800, the proceeds from the redemption of a CD, was found in Dona Mae Franklin's home following her death. She left her house and all "corporeal movable contents" to Robert Davis in her will, with the residue of her estate passing to two charities. The district court, asked to rule on whether the check was a corporeal or incorporeal movable, found it was an incorporeal movable and therefore part of the residue. Davis appealed.

Under state (Louisiana) law, corporeals are "things that have a body, whether animate or inanimate, and can be felt or touched" and can normally be moved from place to place. Incorporeals have no body but "are comprehended by the understanding, such as the rights of inheritance." Rights, obligations and actions that apply to a movable thing are incorporeal movables, said the Court of Appeals of Louisiana, giving examples of bonds, annuities and interests.

A check that is not cashed prior to an individual's death is still an incorporeal movable, the court said. It represented the bank's obligation to pay funds to Franklin. The bank had no obligation to pay the funds to Davis, the court found.

***Succession of Dona Mae Franklin*, No. 42,496-CA**

INCORRECT ADVICE NEGATES TRANSFER TO FOUNDATION

Hartford Bealer's son-in-law, a tax attorney, assured Bealer that he could transfer his West Virginia farm to a foundation and not have to make annual payments of 5% of the fair market value to charity. Bealer's intent was to preserve the farm in his family. He made the transfer in 2000, although attorneys in his home state of Florida were skeptical that the son-in-law was correct.

When Bealer discovered that the advice was wrong, and the son-in-law ceased all contact, Bealer removed him as co-trustee and transferred the farm back to himself. He had never claimed a charitable deduction and had paid all expenses of the farm personally. Bealer changed his will, leaving the farm to a granddaughter who intended to preserve it. After Bealer's death, his daughter sought to have the court declare that the farm was still owned by the foundation and that Bealer did not have a legal right to deed it back to himself.

The circuit court granted the daughter's motion for summary judgment. The Supreme Court of Appeals of West Virginia, however, determined that under Florida law, if the execution of a trust is procured by a mistake, it is void. The appeals court found that Bealer was under the mistaken impression that putting his farm into a foundation would enable him to keep it in his family. The foundation document was "so inconsistent" with Bealer's intent that it was never valid, said the court, which rejected the daughter's argument that he simply changed his mind. The transfer of the property to the foundation was void ab initio. It remained in Bealer's estate at his death.

***Parker v. Estate of Bealer*, No. 33339**

THE GIFT ANNUITY ALTERNATIVE TO CDs

Clients who are investors rather than borrowers won't welcome future cuts in interest rates. There is an option, however, for those who are charitably motivated: the charitable gift annuity. With a gift annuity, a client contributes cash or appreciated securities in exchange for annuity payments for life, for one or two annuitants. Annuity rates are generally higher than what's available from CDs or money market funds. Donors may also enjoy payments that are partly tax free or taxed at favorable capital gains rates. Charitable gift annuities also offer two other advantages not provided with conventional investments: an income tax charitable deduction for a portion of the gift and the satisfaction of providing assistance to a good cause. To learn more about The Salvation Army's gift annuities or for a sample calculation showing payout rates and deductions, please call our office.