

# Charitable Intent



PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

## f FOUNDATION TO BENEFIT FROM TRUST REFORMATION

When Henry McCance created his charitable remainder unitrust in 1994, he intended to include language permitting him and his wife to voluntarily transfer their current and contingent income interests to his private foundation. His attorney was concerned, however, that the availability of a gift tax deduction might be affected, so the language was not included.

Several years later, the IRS issued a favorable private ruling on substantially similar circumstances. McCance proposes to reform the trust to allow an assignment of the income interests to the foundation. The Supreme Judicial Court of Massachusetts noted that it can reform a trust to conform to the settlor's intent. Both McCance and his attorney provided affidavits concerning the intent to retain the power to make voluntary transfers during the couple's lifetimes. The court remanded the matter to the Probate and Family Court to reform the trust.

*McCance v. McCance*, SJC-09917

## m EMORIAL GARDEN LOSES LEASE, FINDS NEW LOCATION

Henry and Martha Kolb entered into an agreement with the city of Storm Lake, Iowa, in 1968, to establish a memorial garden and fountain at a chosen spot in a city park. The couple contributed farm land to a trust to provide funds for maintenance.

In 2003, the city developed a revitalization plan that would necessitate moving the garden and fountain. The Kolbs' son, Norman, sought an injunction to stop the move. When the court refused to issue an injunction, the city proceeded with demolition of the garden and fountain. Norman then claimed that because the purpose of the trust had been defeated by the city's voluntary act, the trust should benefit the Kolbs' successors. The city asked the court to apply the cy pres doctrine to allow the trust to fund the garden and fountain in a new location. The court sided with Norman.

The Supreme Court of Iowa noted on appeal that the terms of the Kolbs' trust did not provide what was to happen if the purpose of the trust failed, adding that state

law establishes "a presumption that cy pres should apply if the trust does not state 'to the contrary.'" Norman argued that the city should not be able to invoke the cy pres doctrine when it caused the impossibility of maintaining the garden in its original location. The court found that the city's actions, while causing the impossibility, were the result of "natural and unavoidable change."

The original location of the garden was certainly important to the Kolbs, noted the court, but the record showed no reason why that spot was unique. The court found that the Kolbs, if alive, would have preferred that the trust continue under cy pres so that the memorial to their grandson could continue. While they might have been disappointed by the relocation, they would be even more disappointed in the complete failure of the trust, ruled the court.

*Kolb v. City of Storm Lake*, No. 63/06-0067

## a TTORNEY NOT TO BLAME FOR NO INSURANCE

Florence Smallegan, on the advice of her financial advisers, planned to transfer \$900,000 of appreciated stock to a charitable remainder unitrust. She intended to purchase life insurance to replace the assets in her estate. Despite rejection by one insurance company, she funded the unitrust anyway. After several other companies denied coverage, Smallegan gave up efforts to obtain life insurance.

Following her death, her son sued the attorney who drafted the documents, seeking to recover the value of the intended insurance proceeds. The trial court, applying the "four corners" rule, found no errors for which the attorney could be liable and granted summary judgment.

The Michigan Court of Appeals agreed, noting that the unitrust clearly indicated Smallegan's intent to distribute assets to charity from her estate. Even if the attorney were guilty of malpractice for advising Smallegan to transfer the stock to the unitrust without first having the insurance, only she would have had a cause of action, not a potential beneficiary, said the court. Although Smallegan knew she had no life insurance, she made no effort in the four years between funding the trust and her death to disavow the trust, rescind it or seek recourse against her advisers, the court pointed out.

*Smallegan v. Kooistra*, No. 272838, LC No. 04-049107-CZ

## t ESTATOR CAN'T AVOID WHAT SHE DIDN'T ANTICIPATE

The codicil to Tillie Zahrobsky's will directed that if her estate exceeded the "applicable estate exemption amount" at her death, any excess value was to be contributed to the local high school scholarship fund or foundation. When the codicil was executed in 2000, the federal estate tax credit sheltered estates up to \$675,000. The state of Wisconsin had no estate tax.

When Zahrobsky died, the federal estate tax exemption was \$1.5 million. Zahrobsky's estate was just over \$1 million. However, in the interim, the state of Wisconsin had enacted an estate tax that applied to estates in excess of \$675,000. Zahrobsky's nephew asked the court to rule that the language in her codicil referred only to the federal exemption. The school, which stood to receive the funds in excess of \$675,000, argued that it referred to any estate tax.

The circuit court, finding the codicil's language ambiguous, allowed extrinsic evidence. Although the attorney who drafted the codicil testified that Zahrobsky wanted to avoid all taxes, an attorney for her family said that she could not have intended to avoid state tax because none existed at the time the codicil was executed. The court, concluding that Zahrobsky was not particularly philanthropic, ruled that the existence of a state estate tax "would have been outside even professionals' contemplation at the time." The Court of Appeals of Wisconsin agreed, finding that because no one anticipated a Wisconsin estate tax when the codicil was drafted, the language could only refer to the federal exemption.

**In re Estate of Zahrobsky, No. 2006AP2527-FT**

## a N OPTION FOR GETTING AROUND SELF-DEALING

A husband and wife each created a revocable trust, naming their private foundation to receive a significant portion of the assets at the death of the survivor. The couple entered into an agreement with their closely held company to grant an option to purchase the company's shares from the trusts at their deaths. The purchase price will be the value as determined for estate tax purposes. The company was also given the right to fund the purchase with a promissory note, payable over no more than 15 years at a 6% interest rate.

Code §4941(a) imposes a tax on self-dealing by private foundations. The sale or exchange of property, the lending of money and the transfer to or for the benefit of a disqualified person is considered self-dealing [Code §§4941(d)(1)(A), (B) and (C)].

There is an exception, however, for a transaction with respect to a private foundation's expectancy held by an estate or trust [Reg. §53.4941(d)-1(b)(3)]. To qualify, the executor or trustee must have the power to sell property or be required to sell under an option, the transaction must be approved by a probate court, the transaction must occur before the estate is terminated for federal income tax purposes, the estate or trust must receive an amount equal to or exceeding fair market value and any payment must be at least as liquid as what the trust or estate gave up.

The IRS ruled that the couple's options would satisfy these requirements, so there will be no self-dealing if the company exercises the option. In addition, if the company chooses to issue a promissory note, neither the foundation's receipt of the promissory note from the estate nor the payment of the annual amounts on the note will be self-dealing.

**Letter Ruling 200722029**

### APPRAISING THE DEDUCTION SITUATION

Rules pertaining to qualified appraisals of charitable gifts were tightened under the Pension Protection Act – a consideration for clients who will be claiming income tax deductions on their 2007 returns. An appraisal for noncash gifts in excess of \$5,000 (\$10,000 for closely held stock) must be obtained no earlier than two months prior to the date of the gift and no later than the due date of the return on which the deduction is claimed (with extension). Numerous court cases have reinforced the fact that, without a qualified appraisal, a donor's deduction may be severely reduced or even disallowed entirely. Special rules relate to gifts of vehicles. The Salvation Army's Planned Giving staff are familiar with the rules and will be happy to help you and your clients work through the requirements to guarantee donors receive the full value of their deductions. Just give us a call.