THE SALVATION ARMY

Charitable Intent

PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

TRUST TERMS SUPERCEDE BENEFICIARY'S NEEDS

Since 1991, at the death of the last income beneficiary, a trust created by Lillian Loucks had been making equal payments of income to a church and a home for the elderly. The document provides that the corpus is to be held in trust "perpetually" with payments from income to be used for any purpose determined by the organizations.

The church, which is generating insufficient funds to meet its operating costs, asked the Orphans' Court to allow the invasion of a portion of the trust principal. The court denied the request. The Superior Court of Pennsylvania agreed, noting that only when the language of a trust is ambiguous or when the settlor's intent cannot be determined from the document can the court alter the terms of a trust. Because the terms of Loucks' trust clearly articulated her intent, it was not necessary to look to any other construction, the court held.

Loucks may have anticipated that one or both of the charities might be in need of funds in excess of the income generated by the trust, but she did not provide for the invasion of principal in that event, said the court. The church's request for principal would eventually result in the termination of its portion of the trust, which is not permitted under the language of the trust. While lauding the church's efforts on behalf of the poor, the court said the church's financial situation is "not a factor" in interpreting the trust's terms. ***In Re: Estate of Loucks*, 2016 PA Super 206**

NO AUTHORITY IN WILL FOR CHARITABLE GIFTS

A testamentary trust was established under the will of Harvey Hubbell at his death in 1957. The trustees were to pay small annuities to several named individuals for their lives. At the death of the last annuitant, the trust was to end. The remainder and any undistributed income was to be paid to charities selected by the trustees.

In the years prior to the death of the surviving annuitant, the trustees made significant distributions to charities. In 2009, trust income was $112,403. In addition to monthly payments totaling $1,500 to the two surviving annuities, the trustees made cash gifts of $26,700 and gifts of appreciated stock valued at $88,631 to charity. The trust claimed a deduction in 2009 for amounts "paid or permanently set aside for charitable purposes from gross income" [Code §642(c)]. The IRS disallowed the deduction, arguing that because the charitable gifts were not made "pursuant to the terms of the governing instrument," no deduction was allowed.

The trustees argued that to the extent Hubbell's will did not clearly authorize charitable gifts prior to the death of the surviving annuitant, it contained a latent ambiguity. The trustees sought to introduce extrinsic evidence of Hubbell's intent that the trust's excess income be used to make charitable distributions.

The Tax Court determined that Hubbell's will was the "governing instrument" for purposes of Code §642(c)(1). The will, however, made no provision for charitable contributions prior to the death of the last annuitant. If Hubbell had intended to give the trustees such authority, "he could easily have done so," said the court, adding that the trustees were not seeking to resolve a latent ambiguity, but rather asking the court "to rewrite the will." The trust is not entitled to the charitable deduction. ***Hubbell Trust v. Commissioner,* T.C. Summ. Op. 2016-67**

ONE BEQUEST LAPSES, ANOTHER SURVIVES

Among the specific bequests in Brian Holman's will were $1 million gifts each to Cabrini Medical Center and St. Rose's Free Home, Servants of Relief for Incurable Cancer. The will provided that if any named organization was not in existence at his death, other than by merger, the bequest lapsed. The residue of Holman's estate was to pass to charities selected by his executor.

At Holman's death in 2013, Cabrini was in the final stages of bankruptcy liquidation, having ceased functioning as a hospital in 2008. The hospital argued that it should receive the bequest because its exempt status had not been revoked. The Surrogate's Court of New York County agreed with the executor that the bequest passed as part of the residue. The court noted that the cessation of benevolent function has been held to defeat a claim to the disposition, "notwithstanding continued corporate existence." Donors of charitable gifts do not intend their bequests to be received by entities that have ceased to function as charities, the court said.

The Servants of Relief for Incurable Cancer operated two facilities – St. Rose's and Rosary Hill Home. Although St. Rose's closed in 2009, its functions are carried on by Rosary Hill. In essence, said the court, St. Rose's merged into Rosary Hill. Therefore, pursuant to the provisions in Holman's will, the bequest does not lapse, but is instead directed for use by Rosary Hill Home. ***In re Duckworth,* 2016 NY Slip Op. 32278(U).**

DISCLOSURE REQUIRED FOR CERTAIN CONSERVATION EASEMENT TRANSACTIONS

The IRS has added a transaction involving gifts of conservation easements to its "listed transactions" under Reg. §1.6011-4(b)(2). The Treasury Department said it has become aware that promoters are "syndicating conservation easement transactions" that purport to give investors the ability to obtain charitable contribution deductions significantly in excess of the amounts invested. Under Code §170(f)(3)(B)(iii), a deduction is allowed for a qualified conservation contribution. This is a gift of a real property interest to a qualified organization, exclusively for conservation purposes, in perpetuity [Code §170(h)(2)(C)].

The IRS is targeting promoters using one or more pass-through entities to acquire real property. Ownership interests in the pass-through entity are then syndicated, with promotional material suggesting that investors may be entitled to a share of a charitable contribution deduction that "equals or exceeds" the investment. An appraisal is obtained that greatly inflates the value of the easement, based on "unreasonable conclusions about the development potential of the real property." The pass-through entity donates a conservation easement, for which investors claim a deduction on their personal returns.

Persons entering into these types of transactions on or after January 1, 2010, must disclose the transactions to the IRS. Failure to do so will subject taxpayers to penalties under Code §6707A. **Notice 2017-10**

EXECUTOR'S NEGLIGENCE WARRANTED SURCHARGE

Five charities were named to share the residue of the estate of Margaret Billmyer, who died in 2009. Among the assets in her estate was a brownstone residence in New York, valued at approximately $1.5 million. The executor of the estate signed a contract to sell the home to an acquaintance for $670,000. One day prior to the closing, the buyer assigned his rights to an LLC. Three days later, the LLC sold the property to an unrelated third party for $1.3 million.

The charities and the New York State Attorney General's office filed an objection to the executor's accounting. They claimed that the sale of the property at below fair market value constituted a breach of fiduciary duty. The executor argued that the property required extensive structural and cosmetic repairs, and that residuary beneficiaries had given written consent. The Surrogate's Court imposed a surcharge on the executor of $630,000, plus interest.

The Supreme Court of the State of New York, Appellate Division, noted that it isn't enough merely to show that the executor did not get the highest price obtainable. There must be a showing of negligence, with an absence of diligence and prudence which an ordinary person would exercise in his or her own affairs. The fact that a third party was willing to pay nearly two times the price paid by the LLC was prima facie evidence that the executor breached his fiduciary duty and acted negligently with respect to the sale. The surcharge was "properly granted," said the court. ***In re Billmyer,* 2016 NY Slip Op. 5994**

REAL POSSIBILITIES WITH REAL ESTATE

For several years, low §7520 rates have meant that income tax deductions for charitable remainder trusts and charitable gift annuities have been depressed. However, there is a silver lining for gifts of remainder interests in a home or farm. Low §7520 rates generally mean higher deductions for these gifts. The low rates, coupled with rising real estate values, offer an opportunity for clients to satisfy philanthropic goals and possibly reduce future capital gains taxes. Vacation homes are not eligible for the Code §121 capital gains tax exclusion available for principal residences ($500,000 for married couples, $250,000 for single taxpayers), but a client can make a gift of the vacation property to charity while continuing to use the home for life. There's also a generous charitable deduction in the year of the gift. To learn more about gifts of remainder interests in homes, farms or ranches, please call The Salvation Army. We can provide valuable information or run illustrations showing how both clients and the Army can benefit.