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THE SALVATION ARMY

Charitable Intent

DOING THE MOST GOOD

PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

FAMILY, CHARITY SHARE IN DECLINE

Warren Fisher's estate was to be divided into two parts. He wanted to benefit a number of charities with the bulk, but the balance was to pass to 12 of his 21 nieces and nephews. At his death, his gross estate was valued at $3,345,305, with $2,455,793 passing to the charities and $675,000 (the amount sheltered from state estate tax) passing to the nieces and nephews. Between his date of death and the date the trustee was ready to disburse the funds, the value of the assets declined to only $2,335,715, leaving insufficient funds to fully fund the charities' share and nothing to fund the family portion. The trustee asked the probate court to allow a distribution of all assets to the charities, leaving the family share unfunded. The probate court applied the doctrine of probable intent and ordered that both parts be funded on a proportional basis. One of the charities appealed.

The Superior Court of New Jersey found that, although there was no ambiguity in the language of Fisher's will, there can be an ambiguity where an unforeseen contingency results in unexpected intestacies. Fisher had specifically named those nieces and nephews with whom he had a relationship, and it is unclear that he would want the court to follow the clear language of the will if it meant completely disinheriting them. Fisher expected both parts of the will to be funded, but an unanticipated decline in asset value frustrated that expectation. Reducing the shares proportionally preserves Fisher's plan to also benefit his nieces and nephews. ***In re Estate of Fisher,*** **Docket No. A-1889-11T1**

MORTGAGE FATAL TO CONSERVATION EASEMENT

Walter Minnick claimed a $941,000 deduction for a conservation easement granted in 2006, over a 74-acre parcel in Idaho. He warranted that there were no outstanding mortgages, although a mortgage had been recorded a year earlier. The IRS initially challenged the valuation of the easement, but later said no deduction was allowable because the mortgage had not been subordinated to the conservation easement. In 2011, at Minnick's request, the lender executed a subordination agreement providing that the easement would remain in effect if the mortgage was foreclosed.

Reg. §1.170A-14(g)(2) provides that no deduction is allowed for a conservation easement over property subject to a mortgage unless the mortgagee subordinates its rights to the charity's rights to enforce the easement. The Tax Court denied Minnick's deduction, saying that any subordination agreement must be in place at the time the conservation easement is granted. Prior to 2011, the lender could have seized the land in the event of a default and would have owned it free of the easement, the court noted. ***Minnick and Lienhart v. Commissioner,*** **T.C. Memo. 2012-345**

LIFETIME GIFTS DIDN'T NEGATE BEQUESTS, COURT SAYS

Charles Walgreen's living trust included bequests of Walgreen stock to numerous charities, but he made several gifts during his lifetime that he characterized as "pre-bequest" donations, "prepayment on my bequest" or "advance payment." He had pledged 10,000 shares of Walgreen stock to Rotary/One Foundation, Inc. and the Rotary Foundation International, both of which were included on a separate beneficiary list. He made outright gifts of 10,000 shares to each foundation in 1999.

At Walgreen's death in 2007, his family claimed that the bequests to the foundations had been adeemed by the lifetime gifts. The foundations argued that, under Illinois law, the doctrine of ademption did not apply to trusts, and that even if it did, there was no evidence Walgreen intended to adeem these bequests with his lifetime gifts. The trial court granted summary judgment for the foundations.

The Appellate Court of Illinois ruled that the doctrine of ademption applies to trusts, noting that courts use the same principles to ascertain a settlor's

intent when interpreting a trust document that they do in determining intent in a will. But the court added that written communications between Walgreen and certain charities "unequivocally" showed that when he wished his lifetime gifts to satisfy bequests, he stated as much. Had Walgreen intended to adeem the foundations' bequests with the lifetime gifts, his family would have been able to present the court with supporting evidence. The court declined to present his intent, which would be "contrary to the plain language of the trust as a whole." ***Koulogeorge v. Campbell,*** **2012 IL App (1st) 112812**

FAILURE TO FILE MEANS NO DEDUCTION

Robert Naylor was "a habitual nonfiler," said the Tax Court. He had failed to file timely income tax returns from 2000 to 2009, although only the 2003 and 2007 tax years were before the court. Using the authority granted under Code §6020(b)(1), the IRS prepared substitute returns for Naylor.

Naylor claimed that he was entitled to a charitable deduction carryover of nearly $90,000 from 2002 on his 2003 tax return. The deduction was for a charitable contribution made by a limited liability company, which flowed through to a family partnership of which he was a partner.

The Tax Court ruled that no deduction was allowed. Naylor had the burden of proving that he was entitled to claim the charitable deduction in 2002, that it could not be fully used and that it could therefore be carried over [Code §170(d)(1)] to 2003. However, because Naylor failed to prove that he filed a return for 2002, he has no charitable deduction to carry over to 2003, ruled the court. ***Naylor v. Commissioner,*** **T.C. Memo. 2013-19**

APPRAISAL FLAWS DEFEAT DEDUCTION

Harvey Evenchik owned 72% of the shares of Chateau Apartments, Inc. The company's only assets were two apartment buildings. In 2004, Evenchik gave all his shares to Family Housing Resources, to create an endowment fund to assist low- to moderate-income individuals and families in obtaining affordable housing.

Evenchik claimed a charitable deduction of $1,045,289, which represented 72% of the value of the apartments, based on two appraisals attached to his return. The IRS audited his 2006 return, on which Evenchik had carried over a portion of the deduction. The IRS disallowed the deduction, saying that he had not provided a qualified appraisal for the gift.

The Tax Court determined that neither appraisal valued the correct asset. Evenchik had given shares of stock, not the underlying assets of the company. In addition, he had given only a fractional interest in the company, but neither appraisal reflected the effect this might have on the value of the shares. Reg. §1.170A-13(c)(3)(ii) requires that the donor provide a description of the gift property sufficient to allow the IRS to determine what was given. Evenchik's appraisals were "woefully short," said the court, noting that the appraisals did not state that they had been prepared for income tax purposes [Reg. §1.170A-13(c)(3)(ii)(G)]. The court rejected Evenchik's argument that he had substantially complied with the regulations, saying that an appraisal of the incorrect assets prevents the IRS from "properly understanding and monitoring the claimed contribution." ***Estate of Evenchik v. Commissioner,*** **T.C. Memo. 2013-34**

CHARITABLE PLANNING WITHOUT THE ESTATE TAX

Now that estates up to $5.25 million are sheltered from estate tax ($10.5 million for couples), will charitable planning be as important for clients? The desire to help worthwhile causes remains the overriding motivation for making charitable bequests or creating lifetime gifts. Charitable bequests may still save taxes where donors leave charities items of income in respect of a decedent (especially retirement accounts) or own property in states with estate or inheritance taxes. Whether or not taxes are a concern, advisers should ask clients if they wish to include charity in their estate plans. Testamentary charitable remainder trusts and gift annuities can assist both charities and family members, and many donors, on reflection, would find satisfaction in having an estate plan that leaves the world a better place. The Salvation Army has a number of planning ideas that offer income, gift and estate tax advantages. To learn more about how these can benefit your clients, please call our Office of Planned Giving.