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THE SALVATION ARMY

Charitable Intent

Doing the Most Good

PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

EARLY END TO UNITRUST COSTS DONORS

A couple who established a net-income with make up charitable remainder unitrust several years ago had become disappointed with the trust's investment returns. They wished to terminate the trust, with the corpus to be distributed to them and charity according to the actuarial values of the income and remainder interests.

The IRS ruled that because the trust paid the lesser of net income or the stated percentage, with make up provisions, a special factor was needed to calculate the actuarial values. To simply use the stated trust percentage – which the trust had not been paying – could result in a greater allocation of assets assigned to the income interest. Instead, said the IRS, the assumed payout was a fixed percentage equal to the lesser of the trust's stated payout percentage or the §7520 rate for the month of the termination. The special factor for the noncharitable interest is 1 minus the special remainder factor.

In this particular case, the §7520 rate was 1.4%, which is less than the trust's stated payout rate (minimum 5%). The donors were ages 70 and 72. The present value of the remainder interest at the 1.4% §7520 rate and those ages is .77971, which is subtracted from $1, giving the couple $0.22029 for each $1 of trust assets. **Letter Ruling 201325018**

▲ Tax Planning Pointer

This method results in a significantly lower income interest than if the stated payout percentage was used to calculate the values. If early termination is a possibility, choosing a standard charitable remainder unitrust would enable the donors to use the stated trust percentage.

PLANE SOARS, APPEAL DOESN'T

Robert Fry and William Smith owned an antique airplane that had been built in Venango County in Pennsylvania. They donated it to the DeBence Museum, located in Venango County, in order to keep it flying and allow people in the county to see the plane.

The Museum maintained the plane for a few years, but then allowed it to deteriorate. Fry and Smith eventually "kidnapped" the plane and gave it to the Golden Age Air Museum, located some distance from Venango County. An aircraft enthusiasts club in Venango County asked to be named the new trustee. They admitted, however, that they could not keep the plane flightworthy. The trial court ruled that Golden Age Air Museum could keep the plane.

The aircraft enthusiasts appealed, asking the court to apply the cy pres doctrine. In most cy pres situations, the settlor is deceased, the court noted. In this case, the settlors were alive and stated that their goal of keeping the plane flying was more important than keeping it in Venango County. An aircraft that is no longer flying was not an airplane, Fry said, "but merely a piece of equipment." The Superior Court of Pennsylvania found no abuse of discretion by the trial court. ***Fry v. Oil Region Music Preservation Museum,*** **J.A2501/13**

GIFT VALUE WILDLY OVERSTATED AND LATE

Ben Alli contributed a 34-unit apartment building to charity in September 2008. Only six of the units were occupied, with the remainder needing significant repairs to be habitable. The charity, which would not accept real estate gifts before finding a prospective purchaser, found only one investor, who was willing to pay just $60,000. Alli claimed a charitable deduction of $499,000.

The IRS disallowed the deduction. Alli produced two appraisals – one conducted in 1999 and the other in April 2008. Reg. §1.170A-13(c)(3)(i) provides that an appraisal may be made no more than 60 days prior to the date of the gift and no later than the due date of the return on which the deduction is claimed. The Tax Court noted that neither appraisal fell within this time period.

In addition, the appraisals lacked much of the required information, including the date of the gift, the condition of the property, a statement that the appraisal was done for income tax purposes, the method used to determine value and the qualifications of the appraisers [Reg. §1.170A-13(c)(3)(ii)]. Donors may use more than one appraisal, but each must comply with the requirements, the court added.

Alli argued that the court should apply the substantial compliance doctrine, but the court said that "strict compliance cannot be excused where a substantive requirement of the qualified appraisal regulations is not satisfied." ***Alli v. Commissioner,*** **T.C. Memo. 2014-15**

DEDUCTION LIMITED FOR BEAUTY PRODUCTS

The deduction for a gift of appreciated property which, if sold, would not give rise to a long-term capital gain is generally limited to the lesser of the fair market value or the donor's basis [Code §170(e)(1)]. There is an enhanced deduction – equal to the donor's basis plus one-half of the unrealized appreciation, not to exceed twice the donor's basis – for "qualified contributions" of inventory [Code §170(e)(3)]. The enhanced deduction applies only to property used by the donee for the care of the ill, needy or infants [Code §170(e)(3)(A)(i)].

A company that contributed wrinkle creams, hair gels, perfumes, hair spray, hair texturizers, curling irons, hair dyes, nail polishes and hair restoration treatments asked the IRS whether it was entitled to the enhanced deduction. The charitable donee distributed the donations to a network of charities in the U.S. and abroad.

The IRS said that none of the donated products helped alleviate or satisfy a "necessity of life," such as food, clothing or shelter. A person who could not afford to buy the donated items might be needy, but the items "do not relate to the specific need that caused the person to be needy." The products are luxury items and do not qualify for the enhanced deduction, the IRS ruled. **Letter Ruling 201414014**

TAX COURT SINKS "FLOATING" EASEMENT

B.V. and Harriet Belk transferred 410 acres of land to a newly formed corporation in order to develop a residential community. The project included a golf course on 185 acres. The company executed a conservation easement over the golf course land, but reserved the right to substitute an area of land contiguous to the conservation easement area for an equal or lesser area of land within the conservation area. The IRS disallowed the charitable deduction and carryover.

The IRS claimed that the use restriction on the property is not in perpetuity, as required in Code §170(h)(2), because the easement agreement permits substitutions. The Belks argued that any substitutions, which would have to be approved by the charitable donee, would not harm the conservation purposes of the easement.

The Tax Court said it was immaterial whether the charity must give permission for the substitutions. The requirement that the easement be in perpetuity applies even if the parties "wish to agree otherwise," said the court. ***Belk v. Commissioner*, 140 T.C. No. 1**

NO DEDUCTION FOR OTHERS' GIFTS

Jose Alonso solicited contributions for several charities from family, friends, colleagues and vendors. While some people would make gifts online directly to the organizations, some would give cash to Alonso. He deposited the cash contributions in his checking account and then wrote checks to the organizations. He claimed deductions of $8,688 in 2009, all of which the IRS disallowed.

Under Reg. §1.170A-13(a)(1), cash gifts up to $250 may be verified by a canceled check. For gifts in excess of $250, the donor must have a written acknowledgment from the charity [Code §170(f)(8)(A)]. Alonso told the Tax Court that he did not make donations on behalf of others. He presented a copy of a computer screen printout of donations. On one day, he wrote six separate checks to the same organization, in amounts ranging from $20 to $563. The following month he wrote five checks on the same day to the same charity, in amounts ranging from $10 to $1,710. When asked about the multiple checks to the same charity on the same day, he explained that he made multiple gifts because he felt he could afford it.

The Tax Court ruled that while Alonso may have participated in fundraising activities and made personal donations, he was not entitled to a charitable deduction because he failed to provide canceled checks or written acknowledgments from the charities. ***Alonso v. Commissioner*, T.C. Summ. Op. 2013-93**

WATCH FOR OPPORTUNITIES

A client's advisers are often the first to know of impending actions by the client that will generate taxes, such as capital gains taxes on the sale of a business, gift taxes on the transfer of substantial assets to family members or estate taxes from transfers at death. At such times, the adviser should take the opportunity to ask the client if there are any charities he or she would like to benefit. Often, taxes can be eliminated or significantly minimized through the use of charitable giving vehicles. For example, by transferring shares in a closely held business to a charitable remainder trust prior to entering into a contract for sale, the client can receive a charitable deduction, plus income based on the stock's fair market value, with no loss to capital gains tax. A transfer to grandchildren using a charitable lead trust may eliminate generation-skipping transfer taxes. Tax-burdened assets such as savings bonds and IRAs can be left at death, free of any tax, to worthwhile causes. The Salvation Army's Office of Planned Giving would be happy to work with you in developing plans that achieve clients' financial and philanthropic goals.