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THE SALVATION ARMY

# Charitable Intent

PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

## TRUST REFORMED, TO NO AVAIL

A decedent provided pecuniary bequests to two charities in his living trust, which was also the designated beneficiary of his IRA. Non-IRA assets in the trust were insufficient to satisfy the charitable bequests, so the trustee sought and received judicial reformation.

The goal of the reformation was to treat the payments to the charities as direct bequests, rather than having the trust subject to tax on income in respect of a decedent under Code §691. In the alternative, the trustee asked that the trust qualify for a charitable deduction under Code §642(c) for the transfers to charity.

The IRS noted that if a trust or estate satisfies a pecuniary bequest with property, the payment is treated as a sale or exchange of the property [*Kenan v. Commissioner*, 114 F.2d 217]. Because the trust used IRA assets to satisfy pecuniary bequests, the trust must treat the payments as sales or exchanges. Under Code §691(a)(2), the payments are transfers of the rights to receive IRD. To the extent the trust uses the IRA to satisfy the bequests, it must include the value in gross income.

A deduction is allowed under Code §642(c) for amounts paid to charity or considered to be made out of the gross income pursuant to the governing instrument. In general, a modification to a trust is considered to be the governing instrument where the trust is reformed as the result of a bona fide conflict. Because the purpose of the trust reformation was to obtain tax benefits rather than to resolve a conflict, the IRS said it is not required to respect the reformation and no deduction is allowed. **Letter Ruling 201438014**

## GENEROSITY GOES UNREWARDED

Gust and Frances Kalapodis received $75,000 from a life insurance policy at the death of their son. They used the money to fund an irrevocable trust and establish a scholarship fund in his memory in 2006. Income from the trust was to be used exclusively for educational purposes. The trust never applied for or received tax-exempt status.

In 2008, the trust made payments of $2,000 each directly to three high school students. The IRS disallowed the $6,000 charitable deduction that the Kalapodises claimed on their personal income tax return. The Tax Court agreed with the IRS, setting forth three reasons why the couple was not entitled to the deduction.

First, noted the court, the funds to pay the scholarships came from the trust, not the Kalapodises personally. The couple is only entitled to the trust's deduction if they are considered the owners of the trust under Code §671 provisions. There is nothing in the language of the trust that the couple created to indicate they are the owners. In addition, they have not included the trust's income on their returns.

Second, even if the couple were owners of the trust, they would not be entitled to a charitable deduction because the payments do not qualify as charitable contributions. The students, who received the scholarships directly, do not fall into any of the recipient categories under Code §170, said the court.

Finally, the court found, the couple lacked the required contemporaneous written acknowledgment required for contributions in excess of $250. ***Kalapodis v. Commissioner*, T.C. Memo. 2014-205**

## ANONYMOUS AND DEDUCTIBLE DON'T MIX

Peter and Irene Jermihov claimed a charitable deduction of $7,762 in 2009. The bulk of that amount was in cash to purchase candles, make donations to the poor box and for the collection plate at their church. The church's cathedral dean indicated that they were "faithful parishioners." Because the Jermihovs made their contributions anonymously, they lacked any substantiation required under Reg. §1.170A-13(a)(1).

The Tax Court did, however, apply the *Cohan* rule [*Cohan v. Commissioner,* 39 F.2d 540] and allow the couple to deduct $1,000 for their gifts to the church, reasoning that they had made some cash gifts. However, no deductions were allowed for gifts to other charities, since the lack of exact records "is of their own making," according to the court. ***Jermihov v. Commissioner,* T.C. Summ. Op. 2014-75**

## WILL INCONSISTENCIES RESOLVED

Fashion photographer Francesco Scavullo owned photographs, negatives and transparencies from his career at his death in 2004. His will left half of these to fund a charitable trust in his name. After several pre-residuary bequests, he left

the balance "of my tangible personal property" to a friend, Sean Byrnes. Later in the will, he left the other half of the photographs, negatives and transparencies to a trust that was to pay all income to Byrnes for life. (Note: This was not a charitable remainder trust, since Byrnes was entitled to all income.) At Byrnes' death, the corpus was to be added to the charitable trust.

Byrnes argued that he was entitled to half the photos, negatives and transparencies outright, not in trust, as part of Scavullo's personal property. The estate argued that these items passed to the trust, with Byrnes receiving only the income for life.

The Surrogate's Court of New York said that where two provisions in a will are irreconcilable, a canon of construction holds that a prior provision in a will gives way to a later one. The general scope of the will indicates that Scavullo intended to provide for Byrnes partly outright and partly in trust. It was "plausible," said the court, that Scavullo used the phrase "tangible personal property" more broadly at one point and more narrowly at another, since it would be impossible to dispose of the same property twice. ***In re Scavullo,*** **2014 NY Slip Op 31848(U)**

## FOUR WILLS BETWEEN DAUGHTER AND INTESTACY

Philip Mestman's estate was to pass to his wife, if she survived him, or his daughter, at his death in 2013. Because both had predeceased him, Mestman's estate was to pass instead to charity. Another daughter, Cathy Mestman, had been specifically disinherited in her father's will, executed in 2013, as well as in prior wills executed in 2008, 2007 and 1997.

Mestman's executrices sought to sell his residence, claiming that the cost of maintaining the home and paying real estate taxes and insurance was depleting the estate, to the detriment of charity. Cathy opposed the move, arguing that the executrices and attorney for the estate were "duplicitous," that one of the executrices was "a rank dipsomaniac" (alcoholic), and that the parties had engaged in "ingannation" (fraud). She also called New York Surrogate Court personnel "inept and unresponsive."

The court called Cathy's objections "meritless," adding that they were "nothing more than unsubstantiated epithets." Even if Cathy were successful in having the 2013 will declared invalid, there were still three prior wills, all of which disinherited her. The odds of having four wills nullified in the hope of inheriting through intestacy was highly unlikely, said the court. The executrices were allowed to put Mestman's home on the market, but the court said all personal property was to be held to allow Cathy time to provide proof that she owned any of the items. ***In re Probate Proceeding of Will of Mestman,*** **2014 NY Slip Op 51183**

## WHY SUBSTANTIATION MATTERS

The IRS initially disallowed the entire $17,113 charitable deduction claimed by Jeffrey and Ulondra McCarty on their 2007 income tax return. Eventually, however, the IRS conceded that the couple was entitled to a deduction of $9,820. Most of the charitable contributions consisted of tangible personal property, although the McCartys also claimed a deduction for charitable mileage on their personal vehicle.

The Tax Court noted that a contribution of $250 or more must be substantiated with a contemporaneous written acknowledgment from the donee organization [Reg. §1.170A-13(f)(1)]. For noncash gifts in excess of $500, the taxpayer must maintain written records showing the manner and approximate date of acquisition. The court found that the McCartys failed to adequately substantiate their noncash gifts and did not maintain a log of mileage for charitable use. The court did, nevertheless, allow them a deduction of $120 more than the IRS had conceded. ***McCarty v. Commissioner,*** **T.C. Summ. Op. 2014-81**

### CHARITY AND RETIREMENT PLANS – A GOOD COMBINATION

When should retirement plan distributions begin? What are the benefits and drawbacks to naming a particular relative as death beneficiary? How are retirement plan distributions taxed? These are just a few of the questions facing clients approaching age 70½. The right choice on retirement plan distributions and beneficiary designations depends on the client's financial and family needs and the size of the estate. Charity also may have a place in planning for retirement accounts. The tax on income in respect of a decedent is avoided when qualified plan assets pass to charity. The balance in an IRA or 401(k) can be used to fund a charitable remainder trust or a charitable gift annuity that makes payments to family members and then passes to The Salvation Army. Our staff can acquaint you with many ways in which retirement plan assets can be used to make the most cost-effective and satisfying charitable bequests for your clients. Please call our office to learn more.