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THE SALVATION ARMY

Charitable Intent

PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

Actions Speak Louder Than Words

Louise Thomas informed East Carolina University that she wanted to establish an endowed scholarship, using the proceeds from the sale of real property. She met with representatives of the University and had several phone conversations, during which she indicated that she planned to transfer $1,190,000 to fund the scholarship. She also acknowledged that a memo about the discussion was correct.

Thomas sold the property and made an appointment for representatives from the school to come to her home to pick up the check on February 14, 2013. However, on February 9, Thomas was hospitalized after breaking her leg. She died in the hospital on February 17, without having delivered the check. The University filed a claim with Thomas' estate, which the bank trustee denied, saying there was no meeting of the minds to form an enforceable agreement and that the gift was not completed because Thomas had not delivered the check. The trial court agreed, granting the trustee's motion to dismiss the claim.

The North Carolina Court of Appeals agreed with the University that Thomas had manifested an intent to deliver the check. An implied contract arises where the intent of the parties is not expressed, but an agreement, creating an obligation, is implied or presumed from a party's acts, noted the court, adding that an implied contract is as valid and enforceable as an express contract. The court noted that the North Carolina Supreme Court had ruled that the exchange of a pledge and a promise to designate funds as directed constitute sufficient consideration to support a contract [*Rutherford College, Inc. v. Payne*, 209 N.C. 792 (1936)]. Thomas' conduct manifested an intent to deliver the proceeds of the sale to the University. In consideration, the University was designating a scholarship in her name. She would have fulfilled the pledge, but for her death, the University argued.

The court found that the steps taken by both Thomas and the University memorialized the agreement. The trial court erred in dismissing the University's claim. The court remanded the case to the trial court. ***East Carolina University Foundation, Inc. v. First Citizens Bank & Trust Co.*, No. COA14-465**

Reformation Repairs Trust Invasion Problem

The settlor of a trust directed that the trust was to continue after his death, making payments for life to a named beneficiary, with assets passing to charity at the beneficiary's death. However, the trust also provided that the executor of the settlor's estate could request funds from the trustee for the payment of estate, transfer and inheritance taxes, funeral expenses and debts and to satisfy legacies payable under the settlor's will. The will gave the executor the authority to exercise these rights to request payments from the trust.

The trust does not qualify as a charitable remainder trust. Code §664(d)(2) specifically provides that no amounts, other than the unitrust payments, may be paid to or for the use of any noncharitable beneficiary. A trust that does not function exclusively as a charitable remainder trust from its creation does not qualify for a charitable deduction [Reg. §1.664-1(a)(6), Example 3].

The executor and trustee sought a judicial reformation that would be effective as of the settlor's date of death. Under the reformation, two trusts would be created. The first would be a charitable remainder unitrust that would pay a stated percentage in quarterly payments. A specific portion of the unitrust amount will be paid to the noncharitable beneficiary, with the balance paid to charity. The second trust would be an administrative trust, from which taxes, debts, expenses and legacies from the will are to be paid. At the end of the estate administration, assets remaining in the administrative trust will be added to the unitrust.

The IRS ruled that charity's remainder interest was reformable under Code §2055(e)(3)(C)(i) because the actuarial value is presently ascertainable and therefore severable from the noncharitable interest. Although the payments to the beneficiary were not expressed in specified dollar amounts or as a fixed percentage of the fair market value of the property, the judicial reformation proceeding was initiated before the 90th day after the last date for the filing of the settlor's estate tax return. Therefore, ruled the IRS, the settlor's estate will be entitled to a charitable deduction for the value of the remainder interest and the charity's income interest in the trust. **Letter Ruling 201450003**

TIMING RIGHT TO AVOID SELF-DEALING

A charitable trust was bequeathed a parcel of land, as well as a remainder interest in an adjacent parcel, by the grantor of the trust. The grantor's son, who is one of the trustees, received a life estate in the parcel, provided he made it his primary residence.

The trust would like to sell the land to have the funds to carry out its mission, but the market for a remainder interest is limited. The only likely buyer, the son, also owns several contiguous parcels. Under Code §4941(d)(1)(A), the sale of the property by the trust to the son would constitute self-dealing.

There is an exception to the self-dealing rules for transactions that occur during the administration of an estate [Reg. §53.4941(d)-1(b)(3)]. Provided the executor has the power to sell estate property, the transaction is approved by the probate court, the sale occurs before the estate is terminated for federal income tax purposes, the estate or trust receives an amount equal to or greater than the fair market value and the interest received is at least as liquid as the one it gave up, the sale by the estate avoids the self-dealing restrictions. The IRS found that the cash purchase by the son will not constitute self-dealing. **Letter Ruling 201441020**

CORRECTING ERROR NOT SELF-DEALING

A husband and wife established a trust that, at their deaths, was to allocate certain assets between the couple's children and a private foundation that they had created. Several years later they amended the trust to change the allocation, giving more to the children. Only after the death of one of the parents, when the trust was irrevocable, did the parties learn that the allocation clause had been amended in only two of the three spots in which it occurred.

The court was asked to interpret the allocation clauses to make them consistent and to conform with the couple's intent. A direct or indirect transfer of private foundation assets to or for the benefit of a disqualified person constitutes self-dealing [Code §4941(e)(1)(E)]. The requested reformation of the clerical error would result in more assets being received by disqualified persons.

The IRS found, however, that the settlors amended the trust prior to the first spouse's death, when the trust was revocable. The clerical error was not discovered until the trust was irrevocable. Because the court determined that the settlors intended all three clauses to be consistent, and because the parties consented to the reformation, the IRS ruled that no self-dealing occurred. **Letter Ruling 201432025**

SCRIVENER'S ERROR FIXED BY COURT

A couple created a charitable remainder unitrust that was to make payments for their lives and the lives of their two children before assets were distributed to charity. After the parents' deaths, the children discovered that the trust contained a net-income with make up language, rather than the standard charitable remainder unitrust that the parents intended to fund. Since its inception, the trust had been administered as a standard unitrust, and had paid out the stated percentage, even in years when net income was less.

At the request of the trustees, a state court reformed the trust ab initio to a standard unitrust, noting the scrivener's error. The effect of the reformation is to increase the annual amount payable to the children in years when net income is less than the stated percentage. This could be an act of self-dealing under Code §4941(d)(1)(E), as a transfer to use by or for the benefit of disqualified persons of the income or assets of a private foundation.

The IRS ruled, however, that the court was convinced that the trust did not comply with the settlors' intent, due to a scrivener's error. In addition, there was no evidence that the income beneficiaries were using the benefit of hindsight to their benefit in making the trust change. Therefore, said the IRS, the judicial reformation did not constitute self-dealing. **Letter Ruling 201426006**

CHARITABLE RETIREMENT SAVING OPTIONS

Even though they may already have significant amounts held in qualified retirement savings accounts, many clients may be looking for ways to shelter even more for their golden years. The contribution limit for IRAs in 2015 is $5,500, with a $1,000 catch-up for savers ages 50 and older. The 401(k) contribution limit is $18,000, with a $6,000 catch-up. An option for those maxed out on qualified retirement plans may be a charitable remainder unitrust. A flip unitrust allows clients to create a trust that will grow significantly during a donor's working years, make large payments in the early years of retirement and permit the client to receive capital gains, rather than the ordinary income available from IRAs, 401(k)s and other qualified plans. A series of deferred payments charitable gift annuities also offers the ability to defer receipt of income until later years. Charitable remainder unitrusts and gift annuities may be attractive to younger clients with charitable goals. The Salvation Army's planned giving professionals would be happy to answer questions about these charitable vehicles.