THE SALVATION ARMY

Charitable Intent

Doing the Most Good

PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

NO EASY WAY OUT OF DEFECTIVE TRUST

At the suggestion of his financial planner and an attorney, a donor established a charitable remainder unitrust. The advisers assured him there would be no gift taxes due upon the creation of the trust because he would retain the right to change successor recipients, making the gifts incomplete. However, because the attorney failed to include language in the trust retaining the right to revoke a beneficiary's interest, the interests were vested at the creation of the trust and gift tax was due.

The trust was to make payments for the shorter of the donor's life or 20 years. If he died within the 20 years, payments were to continue to a successor beneficiary for the balance of the time. Trust assets would then pass to charity. The financial planner promised the trust would generate a particular rate of return if trust assets were invested in annuities and insurance products that the planner was licensed to sell.

In fact, the trust never achieved the promised return without including capital gains. Under state law, capital gains were allocable to principal, not income. Although the trust never generated sufficient income to pay the unitrust amount, the trustees included capital gains to pay the donor the full amount, despite trust language limiting the distributions to the lesser of the stated percentage or the trust's net income.

Relying on the advisers' assurances that the value of the trust would not be included in his gross estate, the donor made additional contributions to the trust in later years in order to reduce his taxable estate. He claimed charitable deductions for the year the trust was created and for the added contributions.

Following the donor's death, the successor beneficiary became the sole trustee. The state's attorney general and the charitable remainderman objected to several petitions filed to judicially reform the trust. The court eventually determined that the trust was either void ab initio, contingent on an IRS ruling that there would be no additional federal income tax consequences, or the court's order would default to a trust termination.

The IRS said that while the trust failed to operate exclusively as a charitable remainder trust and thus maintain its tax exemption, it was nevertheless subject to the split-interest trust rules of Code §4947(a)(2). Because the deductions claimed by the donor were not challenged by the IRS, the deductions were "allowed" for purposes of Code §170 and the trust is therefore treated as a private foundation. If any trust assets are distributed to the income beneficiary prior to termination of the trust's private foundation status, it would be a taxable expenditure under Code §4945(d)(5) and an act of self-dealing [Code §4941(d)(1)(E)]. The trust is also required to file income tax returns and pay any taxes owed, with penalties and interest. **Letter Rulings 201714002, 201714003**

DEDUCTION FOR AIRPLANE GIFT GROUNDED

In 2010, three years after purchasing a used private jet for $42,000, the owners contributed it to the museum of the Houston Aeronautical Heritage Society. From 2007 until the date of the gift, the aircraft had been stored at an airfield in Texas. One of the donors claimed a charitable deduction of $338,080, based on an appraisal of his 50% interest. The IRS disallowed the deduction.

The Tax Court denied the donor's motion for partial summary judgment, finding several disputes of material fact, including whether the donor had attached a contemporaneous written acknowledgment from the charity [Code §170(f)(12)], whether Form 8283 had been properly signed by an officer at the charity and whether the deduction claimed reflected the fair market value of the donor's interest in the jet.

In 2016, the donor filed an amended Form 1040, including an acknowledgment letter dated 2010, a signed Form 8283 and an appraisal dated 2011. The IRS refused to process the amended return and asked the Tax Court for a partial summary judgment on the grounds that the donor did not satisfy the statutory substantiation requirements for a used aircraft. The court agreed.

The substantiation requirements for contributions of used vehicles – including airplanes – with a value exceeding $500 is more stringent than the substantiation requirements of Code §170(f)(8)(B). The donor must obtain a contemporaneous written acknowledgment from the donee organization and include it with the return. If the vehicle has not been sold, the acknowledgment must include additional information, such as a certification that the vehicle will not be transferred, whether the organization has provided any quid pro quo for the gift and the intended use of the vehicle. Form 1098-C, Contributions of Motor Vehicles, Boats and Airplanes, has been designated for this purpose. The court noted that the acknowledgment requirements are strict and cannot be met with "substantial compliance."

The donor did not include Form 1098-C with his original return and the acknowledgment from the charity did not contain the information required under Code §170(f)(12)(B). An acknowledgment for a vehicle is contemporaneous only if the donee provides it within 30 days of the contributions [Code §170(f)(12)(C)(ii)], noted the court, adding that the charity did not file it until several years after the gift. ***Izen v. Commissioner,* 148 T.C. No 5**

▲ Tax Planning Pointer

In general, no qualified appraisal is required where a donated used vehicle is to be sold by the charity. The donor's deduction is limited to the gross proceeds received by charity upon a sale [Code §170(f)(12)(A)(i)]. The charity must report the sale proceeds on Form 1098-C. An appraisal may be required if the charity does not intend to sell the vehicle, but rather put it to a related use.

MARRIAGE, TRUST BOTH SPLIT

A husband created a charitable remainder unitrust, naming himself and his wife as income beneficiaries. Now in the midst of a divorce, they have asked the IRS about the consequences of dividing the unitrust into two new trusts, each with provisions similar to the original trust. Each spouse will receive a portion of the original trust and will be the sole income beneficiary of his or her trust, with the power to name the charitable remainderman.

The IRS determined that each trust will meet the requirements of Code §664(d)(2) and that the division of the original trust into two new trusts will not cause the new trusts to fail. This will not be considered a sale or exchange that would result in any shift in the beneficial interests, so neither spouse will have any gain or loss. The holding period of the assets in the new trusts will be the same as in the original trust.

Because the transfer is incident to a divorce, no gain or loss will be recognized on the husband's transfer to the wife [Code §1041(a)]. Provided that the divorce is final within two years, the IRS said that the husband's transfer will be for full and adequate consideration and will not be subject to gift tax under Code §2501. The value of each spouse's trust will be included in his or her gross estate at death, but each will be entitled to an estate tax charitable deduction for the value of the assets passing to the charitable remainderman. **Letter Ruling 201648007**

CAPITAL GAIN ACCOMPANIES GIFTS

Several subsidiaries of an S corporation proposed to contribute business properties, some of which are subject to mortgages, to charity. The amount of the indebtedness will be treated as an amount realized, even if the charity does not assume or agree to pay the indebtedness [Reg. §1.1011-2(a)(3)]. The IRS determined that the computation of basis will be determined on a property-by-property basis for encumbered property contributed to charity. **Letter Ruling 201709001**

MAKING "OLD" SAVINGS BONDS WORTHWHILE

According to the U.S. Treasury, billions of dollars in matured savings bonds are sitting in safe deposit boxes, desk drawers and filing cabinets. These bonds no longer earn interest and should be redeemed. Unlike direct charitable gifts of appreciated stock, which avoid the capital gains tax, bonds cannot be given directly to charity in order to circumvent tax on the interest. Clients can, however, use the proceeds from the bond redemption to make gifts to charity and offset, fully or in part, the tax that will be owed. Bond owners can contribute the proceeds outright or use the cash to fund a charitable gift annuity, which can provide payments for life at attractive rates. Not only will a portion of the annual gift annuity payments be tax free, but clients will be entitled to a charitable deduction. A charitable remainder trust is another option. For more information on gift annuity rates offered by The Salvation Army or to learn about the other financial benefits of charitable gift annuities, please feel free to call our office.