

# Charitable Intent



PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

## CHARITABLE PROVISIONS NOW PERMANENT

Several provisions benefitting charities and donors were made permanent under the Protecting Americans from Tax Hikes Act of 2015.

■ IRA owners ages 70½ and older can make qualified charitable distributions (QCDs) from their accounts – up to \$100,000 annually – and owe no income tax. No charitable deduction is allowed for the gift, but a QCD can satisfy required minimum distributions, thereby saving taxes, even for clients who don't itemize their deductions. QCDs must come directly to the charity from the IRA custodian, not from the IRA owner. QCDs cannot be used to fund life-income gifts such as charitable remainder trusts or charitable gift annuities, but can be used to satisfy a client's outstanding charitable pledge. Only public charities – not donor advised funds – can receive QCDs.

■ The deduction for contributions of appreciated real property for conservation purposes is subject to the 50%-of-AGI limit, not the usual 30%. If the land is agricultural, the property is deductible up to 100%, with a 15-year carryover.

■ An enhanced deduction is available for charitable contributions of apparently wholesome food inventory by non-corporate business taxpayers. The deduction limit is increased from 10% of AGI to 15%, beginning in 2016.

■ An S corporation shareholder's basis in the shares is reduced by the pro rata portion of the adjusted basis – not fair market value – of property contributed by the S corporation for charitable purposes [Code §1367(a)(2)].

## TRUST'S DEDUCTION NOT LIMITED TO BASIS

The David and Barbara Green 1993 Dynasty Trust was established to make distributions to charity from gross income. The Trust was a 99% limited partner of Hob-Lob, a limited partnership that owned or operated many Hobby Lobby stores.

In 2002 and 2003, the Green Trust purchased various parcels of real property in Virginia, Oklahoma

and Texas. The funds to purchase the property came from distributions from Hob-Lob to the Trust. In 2004, the parcels were donated, in whole or in part, to charities. The Green Trust claimed charitable deductions that year totaling more than \$20.5 million. An amended return was filed in 2008, increasing the deduction to more than \$29.6 million. The IRS disallowed the requested refund, saying the Trust's deduction for the real property was limited to basis, not the fair market value of the land.

The IRS argued that Code §642(c)(1) limits a trust's deduction to the amount of gross income contributed to charity, and that gross income does not include unrealized appreciation. The Trust claimed that because the real property was purchased out of gross income, the deduction should be based on fair market value, since no different valuation standard is set forth in Code §642(c)(1).

The U.S. District Court (W.D. OK) pointed to the “notable distinction” between Code §§642 and 170. Code §642, said the court, specifically provides for a deduction “without limitation,” while Code §170 has limiting language. The IRS, the court noted, “seeks to impose limitations where Congress clearly declined to do so.”

The IRS argued that, although the parcels were purchased with funds that were gross income in the year received, the donated parcels had become part of the Trust's principal. The court agreed with the Trust that the IRS conflated the federal tax concept of “gross income” with state law fiduciary accounting concepts of “income” and “principal.” The trustee was acting pursuant to the trust instrument when the parcels were contributed to charity, the court held. Code §642(c)(1) authorizes deductions “without limitation,” and fair market value is the “appropriate valuation standard,” ruled the court. *M. Green v. U.S.*, 2015-2 USTC ¶50,549

## GOOD FOR BUSINESS AND CHARITY

A company providing goods and services to its customers has long advertised its program of contributing a portion of its receipts to charities. It has done so in the belief that the philanthropy would enhance and increase its business.

The customers do not have a right to a share of the amount contributed and can't direct where the funds will go. Therefore, ruled the IRS, the company is not considered merely a conduit for the gifts on behalf of the customers.

Because the company has a "reasonable expectation" of a financial return based on its charitable program, the payments are deductible under Code §162(a) as ordinary and necessary business expenses, not as charitable contributions under Code §170. **Letter Ruling 201543013**

## **e** XECUTOR HAD NO DISCRETION OVER CHARITABLE BEQUESTS

Michael McShane's will left "up to" \$800,000 from his mutual funds, checking accounts, stocks, bonds and cash to his first wife, pursuant to a divorce settlement. He also left gifts "up to" a total of \$500,000 to four charities, to be paid from the mutual funds, stocks, bonds and cash. The residue of his estate passed to Gwendolyn, his second wife, who was also executor of his estate.

Gwendolyn claimed that McShane's intentions were uncertain because of the use of "up to" language, which she suggested was precatory in nature. Gwendolyn proposed to distribute \$800,000 to McShane's first wife, \$45,000 to satisfy specific bequests to two cousins, nothing to the charities and the balance of McShane's \$8 million estate to her. The charities argued that by naming them in the will, McShane intended that they receive the amounts listed.

The probate court agreed with the charities that the "up to" language was not precatory and that nothing in the will conferred discretion for Gwendolyn to withhold the bequests. The court determined that the use of "up to" was in the event the value of the securities mentioned had declined and was insufficient to pay all the named beneficiaries.

The Court of Appeals of California noted that under Gwendolyn's construction, the provisions concerning the charities would be "effectively inoperative," violating state law that gives effect to all words of an instrument.

The will did not contain precatory language and did not give Gwendolyn discretion to withhold bequests. The appeals court upheld the probate court, noting that state policy "favors construction of a will to uphold a charitable bequest." ***Estate of McShane v. University of Wisconsin School of Business et al*, B261360**

## **S** UBORDINATION MUST PRECEDE EASEMENT

The U.S. Court of Appeals (9th Cir.) agreed with the Tax Court that a couple was not entitled to a charitable deduction for a conservation easement where a mortgage on the encumbered property was not subordinated at the time of the gift. The donors claimed a \$389,517 deduction on their 2006 return, carrying over the excess to 2007 and 2008.

The couple took out a mortgage on the vacant property in 2005. The mortgage was increased in 2006, shortly before the donors deeded the easement to the Land Trust of Treasure Valley.

In 2011, prior to a Tax Court hearing on the IRS's denial of the deduction, the bank entered into an agreement, subordinating its rights to the rights of the charity to enforce the conservation purposes in perpetuity. Code §170(h)(5)(A) allows a deduction only if the "conservation purpose is protected in perpetuity." An easement on property subject to a mortgage could be extinguished upon foreclosure. Reg. §1.170A-14(g)(2) provides that no deduction is permitted unless the mortgagee subordinates its rights. The subordination must be in place "at the time of the gift," the court found. ***Minnick and Lienhart v. Commissioner*, 2015-2 USTC ¶50,430**

### GETTING MORE FOR CLIENTS' MONEY

Many older clients are looking for safe investments that offer a better return than the paltry amount offered by CDs and money market accounts, and without the volatility of the stock market. If the client is philanthropic, it might be time to consider arranging a charitable gift annuity with The Salvation Army. A gift annuity is an irrevocable gift to help Army programs, but provides donors with payout rates up to 9% for single annuitants. The exact rate depends on the donor's age and whether the annuity is payable for the life of one or two individuals. In addition to the favorable returns, donors also receive an income tax deduction, potential reduction of capital gains taxes, partially tax-free income and the satisfaction of assisting our programs. To learn more about charitable gift annuities and how they may help solve clients' financial concerns while also benefitting the Army, please call our office.