VOL. XX NO. 2 2012

THE SALVATION ARMY

Charitable Intent

DOING THE MOST GOOD

PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

RELIANCE ON GIFT LETTER UNREASONABLE

Several members of a family formed an LLC – Herring Creek Acquisition Co. (HCAC) – to which they contributed their rights of first refusal over ecologically sensitive land on Martha's Vineyard. The Nature Conservancy (TNC) began negotiations with the landowner, in order to restore the property to its natural state and reintroduce native plant species. HCAC, which supported these efforts, sought to sell its rights of first refusal to TNC.

TNC and HCAC eventually reached an agreement under which HCAC would receive four parcels, leases on several other properties, an option to purchase, a right-of-way relocation and new beach rights. In addition, TNC agreed to indemnify HCAC for income taxes resulting from the arrangement. The parties structured the agreement as a bargain sale. TNC provided a letter indicating that the value of the gift exceeded the value of the benefits received by HCAC by $2,068.245. HCAC claimed that amount as a charitable deduction.

In general, a taxpayer may rely on a contemporaneous written acknowledgment for the fair market value of any goods or services provided to the taxpayer by the charity [Reg. §1.170A-1(h)(4)(i)]. However, the taxpayer may not rely on the valuation if the taxpayer knows, or has reason to know, that the estimate is unreasonable [Reg. §1.170A-1(h)(4)(ii)].

The Tax Court ruled that HCAC was not entitled to rely on TNC's letter, because several items were omitted from the estimate. TNC had an incentive to exclude those items in valuing HCAC's benefit because enhancing the charitable deduction would reduce the amount TNC would have to pay under the tax reimbursement clause. The court found that TNC and HCAC "made a conscious decision to exclude items of consideration received." Because the parties knew of the omission, they could not reasonably rely on the gift letter to calculate their charitable deductions, ruled the court.

Cohan, et al. v. Commissioner, T.C. Memo. 2012-8

SCHOLARSHIP BENEFITS FROM IRA DESIGNATION IN ADDITION TO BEQUEST

In her 2004 will, Caroline Gill bequeathed $100,000 to Clemson University to establish a scholarship fund for academically deserving football players. Approximately one year after executing the will, Gill designated the scholarship as the beneficiary of $100,000 in her IRA.

Following Gill's death in 2008, Clemson claimed that it was entitled to $100,000 from the will and $100,000 from the IRA. Gill's estate argued that naming the scholarship fund as the beneficiary of the IRA was simply the most "tax-efficient method" to fund the endowment created by the will.

The probate court special referee ruled that the will was unambiguous and, therefore, no extrinsic evidence could be admitted to determine Gill's intent. The IRA was ruled to be a non-testamentary asset that passed outside the will.

The Court of Appeals of South Carolina noted that a court may admit extrinsic evidence to determine whether a latent ambiguity exists. The estate argued that the will and IRA agreement should be considered together to determine Gill's intent. The court agreed with Clemson, however, that because the issue of latent ambiguity was not presented to the special referee, it was not preserved for the court to review. The court noted that the IRA beneficiary designation did not indicate that the money was to be deducted from the $100,000 bequest or in satisfaction of the bequest.

Estate of Gill v. Clemson University Foundation, Op. No. 4951

POTENTIAL TERMINATION DOOMS DEDUCTIONS

The IRS disallowed charitable deductions for three taxpayers who contributed conservation easements to Greenlands, a Colorado nonprofit. The deeds included language providing that the easements could be extinguished by judicial proceedings or "by mutual written agreement of both parties." The IRS said the possibility of termination by mutual consent meant the easements were not preserved in perpetuity, as required under Reg. §1.170A-14(g)(6)(i).

If unexpected conditions make it impractical or impossible to continue using contributed property for conservation purposes, the interest will be treated as protected in perpetuity if the restrictions are extinguished by judicial proceedings and all proceeds from a sale or exchange of the property are used by the charity in a manner consistent with the purposes of the original contribution.

The Tax Court found the transfers to be restricted gifts, but rejected the taxpayers' argument that under the doctrine of cy pres, termination of the easements would require a judicial proceeding. For cy pres to apply, the donors would have to demonstrate a general charitable intent. These donors retained all rights over the property not specifically granted to Greenlands, noted the court. If the conservation purposes became impossible to fulfill, the donors showed no intent that the property be put to some other general charitable use. The ability to terminate the easement by mutual consent meant the conservation purposes were not protected in perpetuity, ruled the court.

Carpenter, et al. v. Commissioner, T.C. Memo. 2012-1

DEDUCTION FOR HOME EXTINGUISHED

Theodore Rolfs claimed a charitable deduction of $76,000 for the value of a home contributed to a fire department, to be used for training exercises. Following the destruction of the home, the land was to be returned to Rolfs, who planned to build a larger home on the lakefront property. He had previously obtained an estimate that it would cost $10,000 to demolish the home.

The IRS disallowed the deduction, saying that the value of what Rolfs received in return exceeded the value of the home. The Tax Court agreed *(Rolfs v. Commissioner*, 135 T.C. 471), finding that the only value for the home would be to relocate it to another parcel. However, due to the age of the home and the logistical difficulties, it was unlikely anyone would pay more than a negligible amount for the house.

The U.S. Court of Appeals (7th Cir.) affirmed, noting that the condition placed on the transfer of the home – that it be destroyed – meant that the home "had essentially no value." The court added that no one was disputing that $76,000 of home value was lost in the fire, but by making the destruction of the home a condition of the transfer, the taxpayer became responsible for the decrease in value. The fire department was merely "the mechanism" to accomplish that result, said the court, adding that none of the value of the house, as a house, was actually given away.

Rolfs, et al. v. Commissioner, 2012-1 USTC ¶50,186

ACTUARIAL FACTORS AND THE TERMINALLY ILL

The IRS's actuarial tables – used to value life, remainder, reversionary and annuity interests – are not to be used by the terminally ill. Reg. §§20.7520-3(b)(3), 1.7520-3(b)(3) and 25.7520-3(b)(3) preclude the use of the factors where the measuring life "is known to have an incurable illness or other deteriorating physical condition" where there is at least a 50% probability that death will occur within one year (Rev. Rul. 96-3). In family situations, the retention of a life interest by a terminally ill individual or a transfer in exchange for an annuity payable to someone likely to die within a year requires that more realistic actuarial factors be used. The same rules also apply to charitable transfers, sometimes resulting in larger deductions. A terminally ill donor who transfers assets to a charitable remainder trust, retaining income for life, must use separately computed actuarial factors to value the remainder and income interests. Our office would be happy to provide actuarial factors and run deduction computations for any charitable gifts. We also can provide information on gifts involving terminally ill donors.