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THE SALVATION ARMY

Charitable Intent

DOING THE MOST GOOD

PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

TARDY WILL CHALLENGE BENEFITS CHARITIES

Jose Marbaix's 2006 holographic will was admitted to probate on October 14, 2011. Marbaix had left a significant portion of her estate to ten named charities. Any challenge to the probate had to be filed by February 11, 2012 – 120 days after the will's admission.

On June 12, 2012, Vincent Bagby, who was not named in the will, filed an objection. He produced a copy of a 2009 will in which Marbaix revoked the earlier will and left most of her estate to Bagby. The trial court ruled that Bagby's objection was barred by the statute of limitations and that the 2006 will governed the distribution of Marbaix's estate.

Bagby appealed, arguing that he was unable to challenge the will within the 120-day period because he did not learn of Marbaix's death until he returned from a tour of duty in Iraq in November 2011. California law provides an exception to the 120-day rule in cases of extrinsic fraud. Extrinsic fraud occurs when a party, other than from his own negligence, is deprived of the opportunity to present his claim or is kept ignorant or fraudulently prevented from participating in the proceedings. Fraud is *intrinsic* and not grounds for extending the statute of limitations where a party has been given the opportunity to present his case but has unreasonably neglected to do so.

The Court of Appeals of California found that proper notice had been given of the probate proceedings and that Bagby had returned from Iraq within the limitations period. His failure to file an objection for more than five months after the statute of limitations had expired was not due to extrinsic fraud, ruled the court in upholding the trial court. ***Bagby v. American Lung Association of California, et al.,* B244137**

SUBSTANTIATION LETTER TOO LITTLE, TOO LATE

David and Veronda Durden claimed charitable deductions of $25,171 on their 2007 tax return. Most of the contributions to their church were made by check – all but five of which were for amounts in excess of $250.

When challenged by the IRS, the couple produced their cancelled checks and a 2007 acknowledgment letter from the church. The IRS said the substantiation letter failed to comply with Code §170(f)(8)(B), which requires that, for gifts of $250 or more, the letter had to state either that no goods or services were received in return for the gift, or give a good faith estimate of the value of any goods or services provided to the donors.

The Durdens obtained a second letter from their church with the required language, but the IRS also rejected this one, saying that it was not "contemporaneous." Under Code §170(f)(8)(C), a substantiation letter is contemporaneous if it is received by the earlier of the date the taxpayer files the tax return on which the charitable deduction is claimed or the due date (with extensions) for filing the return. The 2009 letter fell outside that period.

The Tax Court agreed with the IRS, noting that the purpose of the contemporaneous written acknowledgment is to help taxpayers determine the deductible amount of their charitable contributions. It's impossible to determine from the first letter whether the payments were for meals or other goods or services provided by the church, said the court. The lack of any mention of goods or services is not sufficient to indicate that none were provided, said the court, noting that the express terms of Code §170 requires an affirmative statement. ***Durden v. Commissioner*, T.C. Memo. 2012-140**

CHARITY'S BAIT-AND-SWITCH EFFORT REJECTED

Bernard and Jeanne Adler had given consistent but modest gifts for years to SAVE, a no-kill animal shelter. In 2002, the couple made the first of several larger gifts toward a pledge that would allow them to name rooms in a new facility that SAVE was planning to build. For their $50,000, the Adlers were told they could name two rooms in the structure, to house larger dogs and older cats that aren't readily adopted – a shelter population that was of particular interest to the couple.

In 2006, two years after the Adlers satisfied their pledge, SAVE announced that it was merging with another charity and would build a significantly smaller facility in a different location. Because the proposed building would not include the rooms the Adlers wanted, they asked that their gifts be returned. They filed suit when SAVE refused to refund the contributions. The trial court ordered a return of the gifts, saying it was clear the Adlers "were only making donations for these reasons."

SAVE appealed to the Superior Court of New Jersey, arguing that public policy "demands" that the result be reversed as detrimental to charities throughout the state.

The appeals court found that SAVE had made a unilateral decision not to honor the donors' wishes and instead put the funds to an unrelated use. The Adlers had clearly expressed their conditions for the gifts at the time they were made, the court said. "Basic fairness dictates that the gift must be returned to the donor," the court said, adding that this was a "mild sanction" where SAVE had breached its fiduciary duty.

The court also rejected SAVE's argument that it should be allowed to keep the funds on charitable cy pres grounds, saying it would be "a perversion of these equitable principles" to allow SAVE to actively solicit funds, accept them under an expressed condition and then disregard those conditions without even attempting to determine what other purpose would be acceptable to the donors. The court added that "responsible charities" should welcome this decision because it assures potential donors that the expressed conditions of their gifts will be legally enforceable. ***Adler v. SAVE***, **Docket No. A-0643-10T3**

ATTEMPT TO REACH TRUST'S BOUNTY REJECTED

Mary Latimer placed $5,000 in a trust in 1924, directing that the income be used for the perpetual care of two vaults and monuments in the Wilmington and Brandywine Cemetery. Excess income could be accumulated to be used to defend against any condemnation attempt or to move the bodies to another location.

Although the cemetery operates at a deficit, its endowment currently is sufficient to cover any shortfall. However, the board of directors foresees financial problems in the near future. The board asked the Delaware Chancery Court to apply the cy pres doctrine to modify the terms of Latimer's trust to allow 3% of the net asset value to be distributed annually for the general maintenance of the cemetery. The board claimed that the trust corpus, which has grown to $500,000, was far in excess of what was needed to maintain the two lots.

The court noted that common law cy pres can be applied only to charitable trusts. Under state law, burial trusts are considered noncharitable. Statutory cy pres can apply to both charitable and noncharitable trusts, but burial lot trusts do not fall within the class of trusts that may be modified. Even if they did, the court added, there must be a showing that the trust's purpose has become unlawful or no longer serves any purpose. If that condition is met, the court may modify the trust only if the trust instrument does not address the contingency, the court noted. Latimer's trust allows the trustee to use excess funds to move the bodies, if needed, in the event the cemetery falls into disrepair.

The fact that the trust is amply funded does not provide a basis for modification. The cemetery's "real beef," said the court, is that the trust does not serve the purpose the board would like, which is to provide for maintenance of 22,000 burial lots, not just two. The court also found that the doctrine of deviation does not apply, since compliance with the terms of the trust are not impossible or illegal. ***In re Latimer Trust***, **C.M. No. 17254-N-VCL**

SECOND GIFT EQUALLY SWEET

A husband and wife created two charitable remainder unitrusts several years ago, retaining the right to change the remainder beneficiary [Reg. §§1.664-2(a)(4) and 1.664-3(a)(4)]. Income from the trusts is to be paid to the couple for their joint lives. The trustee has the power to make distributions of trust assets to charity.

The couple wish to terminate the trusts, contributing their income interests to charity. They have entered into an agreement with a charity to relinquish their right to change the remainder beneficiary and will irrevocably name the charity to receive the trust assets.

The IRS ruled that the couple will be entitled to a gift tax charitable deduction [Code §2522] for the remainder value of the trust and for the assignment of their income interest. They will also be entitled to an income tax charitable deduction for the value of their unitrust interest. Because the couple did not create the trusts initially in order to circumvent the partial interest rules [Code §170(f)(2)(A)], their income tax deduction will not be disallowed. **Letter Ruling 201321012**

▲ Tax Planning Pointer

The fair market value of the income interest will be determined using §7520 rates, which are currently near record lows. In general, the lower the §7520 rate, the higher the value of the income interest. This creates an opportunity for donors who funded charitable remainder trusts when rates were higher to make additional gifts of all or a portion of their income interest. If the value of the income interest is more than $5,000, a qualified appraisal is needed.

GIVING OPPORTUNITIES FOR MODERATE-INCOME CLIENTS

Not all clients who wish to make life-income charitable gifts have the financial wherewithal to fund charitable remainder trusts. The Salvation Army has another option that offers many of the same advantages – an immediate income tax charitable deduction, income for life, capital gains tax savings, the satisfaction of making a thoughtful gift – in lower gift amounts. The Army's charitable gift annuity program also offers the added benefit of partially tax-free income. Gift annuities are available for one or two lives. Minimum contributions for gift annuities are set at levels much lower than what would be practical for a trust.