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THE SALVATION ARMY

Charitable Intent

DOING THE MOST GOOD

PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

PLEDGE ENFORCEABLE AGAINST TRUST

In 1995, Robert Sessions made an irrevocable $1.5 million pledge to Rush University Medical Center for the construction of a home for the university president. He reaffirmed the pledge in 1996, indicating that any outstanding amounts would be binding on his estate.

Sessions had made no payments on the pledge when he was diagnosed in 2005 with late-stage lung cancer. He blamed Rush for failing to diagnose the disease earlier. He executed a new will, making no provision for paying the pledge. Rush, which had built the house relying on Sessions' pledge, sued his estate, but found that it contained less than $100,000.

Rush then filed suit against the trustees of a family trust that Sessions had established in 1994. Sessions was the lifetime beneficiary of the trust, which contained a spendthrift provision prohibiting assets from being used to pay creditors of Sessions or his estate. Rush argued that a spendthrift provision in a trust created by the settlor for his own benefit is void as to existing or future creditors.

The trustees argued, and the appellate court agreed, that the common law regarding self-settled trusts was supplanted by the Fraudulent Transfer Act. The Supreme Court of Illinois reversed, finding that the Fraudulent Transfer Act and the common law "operate in different spheres" and are supplementary, not contradictory. The common law looks at interests *retained* by the settlor, not simply the fraudulent *transfer* of assets, said the court, adding that the Fraudulent Transfer Act did not "displace or abrogate the common law trust rule with respect to self-settled trusts."

***Rush University Medical Center v. Sessions,* 2012 IL 112906**

DEDUCTION AVAILABLE FOR AMOUNTS PASSING UNDER SETTLEMENT AGREEMENT

Betty liked her lawyer – so much that she conveyed her home and a brokerage account to herself and the attorney in joint tenancy with right of survivorship. She also created a bequest allowing him to disburse funds, in his "sole discretion" to organizations for the preservation and care of orphan animals. He could retain any remaining amounts "as he sees fit."

Following Betty's death, the attorney sold the home and retained the proceeds. He made distributions to charities in accordance with the will. The state's attorney general filed suit on behalf of the charitable beneficiaries, asking the court to strike the portions of the will appointing the lawyer as executor and making bequests to the lawyer.

To avoid contested probate, the parties reached a proposed settlement under which a fixed amount from the brokerage account and the sales proceeds of the home were returned to the estate residue. A portion was to be distributed outright to three charities. The lawyer was to receive the balance. The estate asked the IRS whether amounts passing to the charities qualified for the charitable deduction under Code §2055.

Under Reg. §20.2056(c)-2(d)(2), amounts passing to a surviving spouse as part of the settlement of a will contest qualify for the marital deduction if the assignment or surrender was a "bona fide recognition of enforceable rights" of the spouse. The regulation is "equally applicable" to the charitable deduction, said the IRS.

The IRS noted that, under state law, attorneys whose clients intend to leave them a bequest "would do well to have the will drawn by some other lawyer." A jury would be justified in finding the lawyer had exercised undue influence over Betty and the court could have invalidated those provisions benefiting the attorney. This would give the charities an enforceable right to the residue. The payments made to the three charities are in recognition of that right, said the IRS, and are therefore deductible under Code §2055.

Letter Ruling 201236022

TIMING IS EVERYTHING, BENEFICIARY LEARNS

Frank McDougal expected to receive $600 to $700 per month as an inheritance from his aunt. After her death in 1992, he learned that his aunt's living trust had been amended, eliminating his bequest. The residue of her estate instead passed to a charitable remainder trust, of which McDougal's mother was the income beneficiary. A private foundation was to administer the trust and divide the remainder among six charities. The aunt's attorney was the trustee. McDougal consulted an attorney, who determined that he had been "properly removed as a beneficiary."

When McDougal's mother died in 2003, he took boxes of documents from her house and stored them in his attic without reviewing the contents. In 2009, McDougal began reviewing the documents in the boxes and took his aunt's estate planning documents to a handwriting expert. The expert confirmed that the aunt's signature on the trust agreement creating the foundation had been forged in 1983. McDougal filed suit against the foundation, alleging that the attorney had exerted undue influence over his aunt, had prepared the forged trust agreement and physically forced her to sign. The attorney's firm received extensive legal fees, which have continued even after the attorney's death.

The trial court identified three potential dates on which McDougal's claim of tortious interference with an expectancy of inheritance arose: 1992, when his aunt died; 2003, when he removed the boxes from his mother's house; or 2009, when he actually reviewed the documents. The court rejected the foundation's argument that the 1992 date applied, saying McDougal had inquired about his disinheritance at that time. The court also rejected McDougal's contention that the cause of action arose in 2009 when he first discovered the fraud. The court granted the foundation's motion for summary judgment, finding that the matter was time-barred by the four-year statute of limitations.

The Court of Appeals of Ohio upheld the summary judgment, finding that although McDougal inquired about the inheritance in 1992, he did not ask to see any of the estate documents, which were in his mother's possession. He alleged no fraud on the foundation's part that prevented him from seeing the documents in either 1992 or 2003. The court found a lack of "reasonable diligence" on McDougal's part by failing to review the estate documents when he took physical possession in 2003.

***McDougal v. Vecchio,* 2012 Ohio 4287**

BENEFICIARY APPOINTS, TRUST DEDUCTS

Alan, the income beneficiary of an irrevocable trust, has a lifetime limited power of appointment allowing him to direct the trustee to distribute all or any portion of the income or principal to any charitable organizations. He plans to exercise this power by having the trustee distribute some or all of the trust's income to charity.

Code §642(c)(1) provides an unlimited deduction in computing taxable income for the year for any amount of gross income distributed to charity pursuant to the terms of the governing instrument. This deduction is in lieu of a charitable deduction under Code §170(a).

The IRS ruled that a distribution to charity made from gross income under Alan's limited power of appointment will be made "pursuant to the terms of the governing instrument" and qualify for the charitable deductions.

Letter Ruling 201225004

DESIGNATING BENEFICIARY NOT CHARITABLE

Making a gift to a church's college scholarship fund can be a tax-deductible gift, but not if the donor makes a recommendation on how the funds should be disbursed, the IRS ruled. In response to an inquiry from a Congressman, the IRS said that earmarking the gift to a designated individual – in this case the daughter of the church's minister – makes the gift a contribution to the designated recipient. A charitable deduction is allowed only if the church has full control of the funds and discretion over the use. **CONEX-147960-11**

PHILANTHROPY AND RETIREMENT: IDEAS FOR THE YOUNGER CROWD

Many people in their 50s worry that Social Security will not "be there" when they reach retirement age, prompting them to look for other methods of securing their financial future. Normally, planned gifts to charity appeal to donors in their 60s, 70s or 80s, but there are ways for 50-somethings to help charity while also saving for retirement. Clients can arrange a series of deferred gift annuities that will begin payments at a future date. The payout rate for a 55-year old who arranges a gift annuity that is to begin payments in 12 years is 7.0%. The donor also receives a current charitable deduction, making the "effective" rate even greater. Clients don't even need to specify the exact date when they want payments to begin, but can instead choose a range of dates, with payments being higher or lower, depending on the exact date selected in the future. For more information on how deferred gift annuities with The Salvation Army can be used to augment retirement savings, please call our office.