

Charitable Intent



PLANNING NEWS AND IDEAS FOR THE PROFESSIONAL ADVISER

LESSON LEARNED THE HARD WAY

Joseph and Shirley Mohamed claimed a charitable deduction in 2003 for the value of several parcels of real property contributed to their charitable remainder unitrust. Although they included a Form 8283 with their return, they did not hire an independent appraiser. Instead, Joseph, a real estate broker and certified appraiser, determined the value of the property and purposely deducted a lower value to avoid the risk of an overvaluation. They made an additional donation of land to the trust in 2004.

The IRS initially challenged the valuation of the properties, but later asserted that the couple was not entitled to any deduction whatsoever because they failed to substantiate the gifts as required under Reg. §1.170A-13.

The Tax Court agreed with the IRS, noting that the couple's Form 8283 lacked certain required information and that Joseph was not a qualified appraiser for these gifts. An appraisal obtained after the IRS audit began was deemed not timely. The court acknowledged that the taxpayers' deductions actually understated the value of the gifts.

The Mohameds called the IRS's actions "arbitrary and capricious," noting that taxpayers who follow the procedures but overvalue their gifts are entitled to keep some of the deductions, while the deduction is disallowed entirely for a taxpayer who accurately values the gift but fails to follow the procedures.

The court said that the verification rules serve a valuable governmental purpose of preventing tax evasion, adding that a qualified appraisal is an "essential requirement" for a deduction. The court admitted the result was "harsh," but concluded that it could not allow "a single sympathetic case" to undermine the substantiation rules.

Mohamed v. Commissioner, T.C. Memo. 2012-152

HANDWRITTEN DELETIONS, ADDITIONS DIDN'T INVALIDATE WILL

Catherine Hoch's 1999 will, which left specific bequests and the residue of her estate to her niece and nephew, included numerous specific bequests to charities. During the years prior to her death in 2008, Hoch crossed out many of the bequests and wrote in new ones. She named a museum as the new residuary beneficiary, eliminating bequests for the niece and nephew.

Hoch's friend and executor, whose own \$5,000 specific bequest was also eliminated, warned her regarding the validity of the changes to the will. She typed a new will incorporating Hoch's handwritten changes, but Hoch died before a notary was available to witness the signing. The executor presented the original will, with markings, for probate.

The court admitted the will, finding "credible, clear and convincing" evidence that it represented Hoch's intent. Handwritten additions were valid alterations to the will, and the deleted sections were a revocation of "only those words physically affected by them," not the entire will. Hoch never intended to revoke the whole will, the court determined.

The Superior Court of New Jersey agreed, noting that although the handwritten additions and deletions were not executed in compliance with state law, it was not fatal to admitting the document into probate, since it was clear that the document was intended as Hoch's will.

In the Matter of the Estate of Hoch, Docket Nos. A-0758-10T2, A-4881-10T2, A-5019-10T2

STAIRSTEP LEAD TRUST PAYMENTS ALLOWED

The trustees of a testamentary ten-year charitable lead annuity trust asked the IRS whether the formula contained in the trust could be construed to permit payments that increased each year. The trustees indicated that it would be difficult to make the payments over the trust term using a straight-line annuity. Instead, they proposed to make each year's payment 120% of the prior year's payment. The charitable income beneficiary would receive more under the variable ascending annuity method than it would as a straight annuity.

The IRS ruled that the trust constituted a guaranteed lead annuity trust interest under Code §2055(e)(2) for which the testator's estate was entitled to a charitable deduction. The formula contained in the trust, which was designed to zero out the noncharitable remainder interest, contained an ambiguity, the IRS found. The variable ascending annuity payments approved by the probate court resolved the ambiguity and will be treated as the settlement of a bona fide will contest. The trust will not violate any of the private foundation rules under Code §§4941 - 4945.

Letter Ruling 201216045

ORDERING RULES RESTRICTED

Final regulations for estates and trusts provide that an ordering provision for payments to charitable beneficiaries will be disregarded unless it has an economic effect independent of income tax consequences. Ordering provisions in charitable lead

trusts could never have economic effect independent of tax consequences, said the IRS, because the amount paid to charity "is not dependent upon the type of income it is allocated."

Income distributions are generally deemed to consist of the same proportion of each class of items of income as the total of each class bears to the total of all classes. To give effect to ordering provisions with no economic effect independent of income taxes would permit taxpayers to deviate from the general pro rata allocation rule, said the IRS.

T.D. 9582

MOTHER DOESN'T KNOW BEST ABOUT DEDUCTIONS

Evelyn Fujishima took care of her son, Dwight, following an injury in 1992, until his death in 2005. She made transfers to charity after his death and claimed a deduction of \$130,000 on his estate tax return.

The IRS disallowed the deduction, saying that transfers must be made during the decedent's lifetime or by will to be deductible [Reg. §20.2055-1(a)]. Dwight did not have a will, but his mother claimed that the deductions were consistent with conversations she had with him prior to his death. The IRS also said that the transfers had not been substantiated by adequate records.

The Tax Court agreed with the IRS, noting that deductions are not permitted when the amounts passing to charity depend on the actions of a personal representative, rather than the decedent. The transfers were not adequately substantiated and therefore were not deductible, ruled the court.

***Estate of Fujishima v. Comm'r*, T.C. Memo 2012-6**

GETTING PERSONAL WITH CHARITABLE GIFTS

Appreciated assets are often considered excellent choices for charitable giving because the donor avoids capital gains taxes and also receives a charitable deduction. But if an asset is tangible personal property (antiques, artwork, collections), special rules apply. The donor's deduction is limited to basis if the asset cannot be put to a use related to the charity's exempt purposes. Despite this restriction, it may sometimes make financial sense to use tangible personal property to fund a charitable remainder trust, particularly when the item is highly appreciated. The payout from the trust is based on the fair market value of the asset, even though the deduction is calculated using the donor's basis. For estate tax purposes, the related use issue is avoided altogether when assets are left to charity at death. If you have questions about whether gift assets can be put to a related use by The Salvation Army, or about the tax benefits from a trust funded with appreciated tangible personal property, please contact our office.