

**CURRENT DEVELOPMENTS
IN
CHARITABLE GIVING
AND PLANNING**

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Introduction – Below is a list of recent judicial, legislative, regulatory and administrative developments released or pending at the end of 2004 through April 21, 2006 which relate to charitable planning. Some of this information was gathered from the Planned Giving Design Center (PGDC) (see www.pgdc.com to subscribe), and from Tax Analysts (see www.taxanalysts.org to subscribe).

1) PLR 200444030-Charity's Operation of Health Center Will Not Result in UBIT

The Internal Revenue Service ("IRS") ruled that a charitable organization's operation of a health center will not be an unrelated trade or business under section 513(a) of the Internal Revenue Code ("Code"). The income from the health center will not be subject to the unrelated business income tax ("UBIT") under section 511(a) of the Code. The IRS said that an exempt organization ("EO") operating a fitness center may be a charitable organization because it promotes health. In order to be exempt from UBIT under section 511 of the Code, the EO must make the fitness center available to a significant segment of the population. Rev. Rul. 69-545 provided that the charitable purpose of promoting the health of a community is a basis for tax-exempt status under section 501(c)(3) of the Code. Also, as long as recreational facilities are available to a broad segment of the community, providing such facilities to the general public can be an exempt purpose under section 501(c)(3) of the Code.

2) PLR 200444036- Set-Aside May Be Treated As Qualifying Distribution

The IRS permitted a private foundation's proposed set-aside of funds because of the vast size and complexity of the funded project. The foundation's by-laws provide that its primary purposes are: (a) to support the conservation and scholarly study of materials of historic and cultural significance; (b) to foster a wider public interest in the history and culture (including literature, music, art, and cinema) of the past; (c) to support education (especially of young people, in reading, history, cultural and scientific literacy); (d) to support and encourage charitable and educational activities in countries making the transition from communist and other non-democratic regimes to open democratic societies; and (e) to support research and dissemination of information on individual intellectual, economic, and political freedom around the world.

The foundation is participating in the design and construction of preservation and housing center which will be used by an agency of the federal government to store its motion picture, audio-visual, and recorded sound collections. The foundation intends to provide funds for the design and construction of the facility, subject to reimbursement of a portion of the cost. Once completed, the foundation will transfer title to the property to the U.S., and the government is authorized to transfer cash to the foundation within 90 days of the U.S.'s acquisition of the property.

The IRS directed the private foundation's attention to section 53.4942(a)-3(b)(8) of the Regulations, entitled "Evidence of set-aside." That section states that a set-aside approved by the IRS shall be evidenced by the entry of a dollar amount on the books and records of a private foundation as a pledge or obligation to be paid at a future date(s). Further, any amount which is set aside shall be taken into account for purposes of determining the foundation's minimum investment return, and any income attributable to such set-aside shall be taken into account in computing adjusted net income (see sections 53.4942(a)-2(d) and 53.4942(a)-2(c)(1) respectively).

3) PLR 200444037, PLR 200444038, and PLR 200444039-Expenditures for Scholarship Grants are not Taxable

The IRS ruled that a section 501(c)(3) organization's grants as part of a scholarship program for the children of a company's employees will not be taxable expenditures under section 4945(d)(3). As such the grants are eligible for the exclusion from income under section 117(a).

4) PLR 200444041-Private Foundation That Was a Hospital Can Make Set-Aside

The Service ruled that a private foundation that ceased to be a hospital can make a contingent set-aside of its assets. The private foundation remained subject to significant contingent liabilities that arose before the asset sale that ended its hospital function.

5) PLR 200444042- IRS Rules on Private Foundation's Business Holdings

The Service has ruled that whether a private foundation has excess business holdings will be determined by reference to its proportionate share of any interests in a business in which a holding company that the foundation's trustees hold stock in holds a direct or indirect interest.

6) PLR 200444044-Charity's Formation of For-Profit to Market Software Will Not Affect Exemption

In a reissuance of a previous letter ruling, the IRS ruled that a public charity's formation of a for-profit subsidiary and the charity's marketing of its software through the subsidiary will not adversely affect the charity's tax-exempt status and will not result in UBIT.

7) PLR 200445023 and PLR 200445024- Donor Permitted to Manage Contributed Funds

In two rulings, the Service has approved a plan whereby a donor who made an outright gift to a university can retain limited investment control of the contributed funds for ten years.

The irrevocable and unconditional contribution (of cash and securities in this case) is placed by the university in a brokerage account for its sole benefit. An agreement was established between the university and the donor whereby the donor or donor's investment advisor are permitted to manage the funds, subject to a limited power of attorney. The agreement lists the types of investments in which the donor can invest. The donor is prohibited from voting any stock or securities held in the account, and can not otherwise use the investments personally. The university can withdraw any or all of the funds at any time without limitation or terminate the agreement without cause. The agreement also automatically terminates in the event of "severe loss" (defined in the agreement).

The Ruling addressed whether the arrangement would violate the partial interest rule. §170(f)(3) of the Code denies a deduction when the contribution is less than the donor's entire interest. The retention of "substantial rights" by a donor violates the rule. In Rev. Rul. 81-282, the Service ruled that a donor who contributed stock could not retaining voting control of the stock. Such a right is an inherent right of ownership and would therefore violate the partial interest rule. In light of this, voting rights were excluded from the agreement in the Ruling.

Based on the limitations of the agreement, the Service said that the gift would be a completed gift, qualifying for income and gift tax charitable deductions.

8) Form 1023- Revised Application for Tax-Exempt Status

The IRS has updated its Form 1023 to accelerate the application process and obtain information about potentially abusive transactions. To get more information up front and lessen the IRS's need for follow-up correspondence with applicants, the new form and its schedules contain more specific questions and information requests. Applicants only have to fill out schedules that apply to their particular circumstances, and they may cross-reference information contained in another part of the application. Many questions also can be answered "no," which will allow an applicant to go to the next question or skip subsequent questions.

To uncover possible tax avoidance transactions such as excessive compensation, the new form asks for information about payments to third parties who help create the organization. The form also asks for detailed information about compensation and other financial arrangements with officers, directors, trustees, employees, and independent contractors. Applicants must list the name, title, mailing address, and total compensation for officers, directors, trustees, employees who earn more than \$50,000 a year, and independent contractors receiving more than \$50,000 annually. The form requests information about family and business relationships and arrangements that might point to impermissible private benefit. It asks about

conflict of interest policies or practices and instructs applicants to reveal how an organization determines that its compensation arrangements are reasonable.

Also, the new form asks organizations to describe the benefits provided to their members, their membership requirements, and the relationship between individuals receiving benefits and key individuals within the organizations. The form also requires an applicant to provide actual or projected financial information for three or four years (depending on how long the organization has existed) as well as a balance sheet for the organization's most recently completed tax year. In addition, several forms and schedules that applicants have had to file with Form 1023 have been incorporated into the new form. They include Form 8718, *User Fee for Exempt Organization Determination Letter Request*.

The Service is no longer accepting the old (September 1998) version of Form 1023. The revised Form 1023 and accompanying revised instructions has been available for download from the IRS Web site since November 2, 2004. Revised printed Package 1023 are available by calling 1-800-829-3676.

9) IR-2004-14-IRS Clarifies Section 501(c)(3) Prohibition Against Political Activity By Exempt Organizations.

Tax-exempt organizations described in section 501(c)(3) of the Internal Revenue Code are prohibited from participating or intervening in any political campaign on behalf of, or in opposition to, any candidate for public office. Charities, educational institutions and religious organizations, including churches, are among those that are covered under this code section. These organizations cannot endorse any candidates, make donations to their campaigns, engage in fund raising, distribute statements, or become involved in any other activities that may be beneficial or detrimental to any particular candidate. Activities that encourage people to vote for or against a particular candidate on the basis of nonpartisan criteria violate the political campaign prohibition of section 501(c)(3).

Throughout 2004, the IRS reviewed information alleging improper political intervention by more than 100 charities, churches and other tax-exempt groups. Political intervention by a tax-exempt organization carries a variety of possible consequences. It can even result in the organization losing its tax-exempt status or paying a tax. With less serious cases, the IRS can require corrective actions from the violating group.

10) EO Implementing Guidelines-Emphasis on Enforcement

The number one priority for the IRS EO Division in fiscal year 2005 is enforcement, Division Director Martha Sullivan said November 8, 2004. Sullivan said the EO Division's enforcement efforts will focus on four areas: antiterrorism, abusive tax avoidance transactions, credit counseling, and excessive compensation. The examination resources devoted to those four areas will rise

from 5 percent in fiscal year 2004 to 31 or 32 percent in fiscal year 2005. The IRS will also be looking closely at donor-advised funds, particularly those that appear to be established and operated to generate questionable charitable deductions, provide impermissible economic benefits to donors and their families, and provide management fees to promoters. Abuses involving section 509(a)(3) supporting organizations, such as organizations that do not own or control their assets or that have made large loans to the founder or supported organization trustees, will be examined as well.

Officials also discussed the non-enforcement programs the EO Division will work on in fiscal 2005. Earlier in 2004 the IRS made electronic filing available for Forms 990; 990-EZ; 1120-POL; and 8868 (“Application for Extension of Time to File an Exempt Organization Return”). Electronic filing of Form 990-PF started in January 2005. Form 990-T is scheduled to go online in 2007.

11) PLR 200445045-Grants for Scholarship Program Not Taxable Expenditures

The Service has ruled that grants made as part of a scholarship program for high school students comply with the requirements of section 4945(g)(1) and will not be taxable expenditures within the meaning of section 4945(d)(3).

Aside from an employment preference, the public charity operates its private foundation sponsored scholarship program substantially similarly to its nationwide college scholarship program. No application is required. Individuals must achieve finalist status in their respective competitions. Recipients are chosen by selection committees totally independent of the private foundation or the employer involved. No limitations are placed on the recipients’ choice of course of study after the grant is awarded. The number of actual grants made may not exceed the number of employees’ children who qualify as finalists. Under the facts and circumstances stated, there is an insignificant probability that any particular employee’s child will be selected. Thus, the grant’s primary purpose was not considered one of providing extra compensation or other employment incentive.

Based upon the information presented, and assuming the scholarship program would be conducted with a view to providing objectivity and non-discrimination in the awarding of scholarship grants, the private foundation’s grants to the public charity for the awarding of scholarship grants to children of employees of Company X complied with the requirements of section 4945(g)(1) of the Code. Expenditures made in accordance with those procedures will not constitute taxable expenditures within the meaning of section 4945(d)(3) of the Code.

12) United States v. Guess, No. 04 CV 2184 W (S.D. Cal. Oct. 29, 2004)-California Court and U.S. Justice Department Cracking Down on Tax Shelters

A California District Court has issued a temporary restraining order to freeze more than \$500 million in bank and investment accounts of Xélan Inc., a firm allegedly running fraudulent insurance and charity schemes mainly for clients in the medical profession.

The Justice Department has filed a complaint in U.S. district court against Xélan Inc., in which it alleges that Xélan and others allegedly sold abusive tax shelters to thousands of medical professionals. In one alleged fraudulent scheme, the defendants operate the Xélan Foundation as a donor-directed fund. The Foundation purportedly allows doctors to make tax-deductible donations, and then direct those donations to pay for the college tuition of the doctors' children (either as an outright payment to the college or university, or as a purported loan to the donor's child), or to pay the doctors for doing charitable, "pro bono," work.

13) *Lapham Foundation Inc. v. Commissioner*; No. 03-1229 (US Ct. of Appeals 6th Cir., Nov. 18, 2004)-Foundation Doesn't Qualify as Supporting Organization

The Sixth Circuit has upheld a Tax Court decision that the Lapham Foundation, Inc. ("the Foundation") was a private foundation rather than a supporting organization because it failed the integral-part test of Reg. 1.509(a)-4(i)(3).

The Foundation filed Form 1023 seeking recognition as a tax-exempt organization under § 501(c)(3) and as a supporting organization under § 509(a)(3). The application indicated that the Foundation would operate exclusively for the benefit of the American Endowment Fund ("AEF"), and would support AEF by receiving and administering funds for the benefit of AEF. On a financial disclosure form, the Foundation noted that it had received \$1,554,244 in 1998 (a promissory note) and that it expected to receive \$5,000 a year in contributions in 1999 and 2000. The form also noted that the entity anticipated receipt of \$120,454 in gross investment income in 1999 and in 2000, and that it had a gift annuity obligation of \$116,568 per year. The Foundation thus expected an excess of revenue over expenses of \$8,886 per year for 1999 and 2000. Because it intended to give at least 85 percent of its income to the supported organization, the application estimated a donation of \$7,600 annually to AEF. The Tax Court determined that, in 1998, AEF received total contributions in the amount of \$7,350,000 but had income of only \$650,000.

The Foundation received an adverse ruling as to its request for a supporting organization classification under § 509(a)(3). The IRS explained that the Foundation had failed to meet the attentiveness test under the integral-part test found in section 1.509(a)-4(i)(3)(iii) of the Regulations, and that it had also failed to meet the test for control by disqualified persons set forth in section 1.509(a)-4(j)(1) of the Regulations. The Foundation filed in Tax Court.

The Tax Court found that the Foundation did not meet the integral-part test and, because that decision was fatal to the claim that the Foundation was a supporting

organization, did not reach the issue of whether the Foundation was controlled by disqualified persons. The Foundation appealed the Tax Court's determination.

On Appeal, the Foundation claimed that it is operated in connection with AEF and therefore fulfills the relationship required of Type III Supporting Organizations. However, the Regulations elaborate that an organization will only be considered to be operated "in connection with" a publicly supported organization if it meets the responsiveness and integral-part tests (Regulation § 1.509(a)-4(i)(1)). The Tax Court found that the Foundation's structure satisfied the responsiveness test. This issue was not raised in the appeal. Regarding the integral-part test, the Foundation could fulfill the test: by meeting either the attentiveness test under 26 C.F.R. 1.509(a)-4(i)(3)(iii) or the "but for" test in 26 C.F.R. 1.509(a)-4(i)(3)(ii).

The Court of Appeals found that the Foundation did not satisfy the first alternative of the attentiveness test because the Foundation anticipated giving only \$7,600 per year to AEF in the near future and concluded that such a small contribution was insufficient to ensure AEF's attentiveness. The Foundation failed to satisfy the second alternative of the attentiveness test because the alleged program that it supported (supporting charitable organizations in Michigan) was not a substantial part of AEF's work. The Court noted that the program or activity to which the Foundation has earmarked its funds must be important enough to the supported organization that the fear of its loss will cause the supported organization to be properly attentive to the supporting organization. Of the \$1,300,000 AEF distributed to organizations in 1998, it distributed only \$5,500 (.42%) in Michigan. The Court also said that the Foundation's contributions are not earmarked for a specific program or activity when the Foundation simply named a geographic area in which it wants the funds to be spent. Third, because of the lack of specific evidence about communications between the Foundation and AEF, it failed to demonstrate AEF's actual attentiveness.

Similarly, the Court found that the Foundation did not satisfy the "but for" test. because it was unclear that the Foundation engaged in any activity "for or on behalf" of AEF. The Court said that the Foundation's only activity was contributing money to AEF, and even if donating money to AEF was considered an activity "for" AEF, it is not an activity AEF itself would be doing but for the Foundation. The Foundation also failed the "but for" test if its activity was viewed as giving grants to charitable organizations, as "such grant-making activities cannot properly be characterized as something in which AEF *would be engaged but for* petitioner's support. Rather, distributing grant monies is something in which AEF *is* and will continue to be engaged *regardless* of support from petitioner."

14) PLR 200447033- IRS Rules that Judicial Reformation does not Violate IRC §664

A donor created and funded a trust with the intention that it qualify as a CRUT. When the donor created the CRUT he intended that the trust document include a provision that would allow him to change the charitable beneficiaries and their percentage interests. The attorney who drafted the CRUT did not include such a provision. When the error was discovered, the trustee asked a state court to reform the trust from the beginning to provide that the donor retained the right to add and remove qualified charities and to change their percentage allocations. The state court so reformed the trust and the Service ruled that the trust's judicial reformation did not violate §664, and that assuming the terms of the trust are otherwise valid under §664, the reformed trust will be treated as a valid CRUT from the beginning.

15) David C. Roark et al. v. Commissioner; T.C. Memo. 2004-271; No. 9231-02; No. 5105-03 (Nov. 29, 2004)- Couple Denied Deductions for Charitable Split Dollar Life Insurance Agreement

As in *Addis v. Commissioner*, 118 T.C. 528 (2002), and in *Weiner v. Commissioner*, T.C. Memo. 2002-153, the Tax Court has held that David and Irene Roark may not claim 1998-1999 charitable deductions for amounts given to a section 501(c)(3) charitable organization and subsequently used to pay the premiums on an insurance policy on David's life that was owned by a trust benefiting the Roark family.

In 1998, David Roark gave \$160,000 to the National Community Foundation ("NCF"). NCF sent him letters in return saying that "no goods or services have been provided in connection with this gift," and he took his contributions as a deduction. NCF used the money to pay the premiums on a \$2.2 million insurance policy on Roark's life that was owned by a trust benefiting the Roark family. Both the trust and NCF were entitled to portions of the policy's death benefit, the trust entitled to by far the larger share.

As in *Addis* and in *Weiner*, the Court ruled that deductions in charitable split-dollar life insurance agreements failed due to section 170(f)(8). Section 170(f)(8) of the Code requires substantiation of a charitable contribution with a written acknowledgment by the charity stating whether the donor received "any goods or services in consideration, in whole or in part," for his donation. IRC § 170(f)(8)(B)(ii). In both *Addis* and *Weiner*, the court held that letters from a charity stating that no consideration was received were inadequate substantiation if the charity was paying premiums for life insurance benefiting the donor or his family.

Both *Addis* and *Weiner* have now been affirmed on appeal. *Addis*, 374 F. 3d 881 (9th Cir. 2004); *Weiner*, 102 Fed. Appx. 631 (9th Cir. 2004). In this case, the Court followed those rulings and again upheld the Commissioner's disallowance of the claimed deduction. In addition, on February 22, 2005 the Supreme Court denied review of both *Addis* and *Weiner*.

16) PLR 200449033- IRS Approved Flexible Starting Date Gift Annuity

The Service approved a flexible start date gift annuity in which the donor's annuity agreement allowed him to choose when annuity payments were to begin within a specified eight year period in the future. The charity will not have UBIT for providing the flexible start date charitable gift annuity to the donor.

17) Circular 230- IRS Releases Final Regulations on Circular 230 Standards of Practice (“Circular 230”)

In an effort to limit abusive tax avoidance transactions and tax shelters, the IRS published final regulations that amplify ethical standards for tax professionals who provide advice on federal tax issues or submissions to the IRS. Circular 230 applies to written tax advice.

Circular 230 requires “covered opinions” to (1) recite the factual matters in the case, relate the law to the facts, and evaluate significant Federal tax issues or (2) to have a disclaimer, prominently displaying a statement that the written advice is not intended to be used, and cannot be used, for the purpose of avoiding IRS penalties or recommending to another party any transaction or matter addressed in the advice.

18) TAM 200452037- First-Tier Excise Taxes Imposed on Private Foundation Should Be Abated

In technical advice, the Service has stated that section 4945 first-tier excise tax imposed on a private foundation for failure to include required expenditure responsibility reports on its Form 990-PF information return should be abated as provided in section 4962(a).

19) Marie S. Bien-Aime v. Commissioner; T.C. Summ. Op. 2004-175; No. 3456-04S (Dec. 27, 2004)- Individual Liable for Accuracy-Related Penalties

The Tax Court, in an unpublished summary opinion, has held that Marie Bien-Aime was liable for accuracy-related penalties for 2000 and 2001 because she failed to properly substantiate the itemized deductions claimed on her returns and neglected to review forms filed by her preparer before signing them.

20) PLR 200452004- Assignment of IRAs, Annuities to Charity Not Taxable

The IRS ruled that the assignment of IRAs and annuity contracts that named a decedent's estate as beneficiary to a 501(c)(3) charity will not cause the estate or any of its beneficiaries to have taxable income or cause the estate to include any amount in its distributable net income.

21) PLR200453010 and PLR200453011- Service Rules on GSTT Consequences of Merger of Trusts

The IRS ruled that two trusts are currently exempt from the generation-skipping transfer tax and that a proposed merger of the trusts will not affect their grandfathered status, result in taxable gifts, or result in the recognition of gain or loss by the trusts' beneficiaries.

22) PLR 200502037- Proposed CRUT Division Will Not Affect CRUT Status

The Service has ruled that the proposed division of a charitable remainder unitrust (CRUT) into two separate trusts, in connection with the divorce of the trust's income recipients, will not cause any of the trusts to fail to qualify as CRUTs under section 664.

23) Prop. Reg. 155608-02; 69 F.R. 76422-76423- IRS Corrects Proposed Regs. on Retirement Annuity Contracts

The IRS has corrected proposed regulations that provide updated guidance on the section 403(b) retirement annuity contracts of public schools and tax-exempt organizations described in section 501(c)(3).

24) PLR 200502002- Reimbursements From Charity Not Includable in Recipients' Gross Incomes

The Service has ruled that stipends, vouchers, or reimbursements for transportation or respite care made by a section 501(c)(3) organization that helps developmentally disabled persons are not includable in the beneficiaries' gross incomes and the organization is not required to file informational returns for the payments.

25) PLR 200502044-Informal Church Not a Qualified Donee under 170(b)(a)(A)(i)

The IRS ruled that an organization that functioned as a church in some respects (it conducted religious services on Sundays and offered Bible study) but that lacked ecclesiastical government, did not perform "life cycle rituals" like weddings and baptisms, had no code or doctrine or literature, and whose pastor was not formally ordained and had no formal training did not qualify for exemption as a church.

26) ILM 200504031- IRS Lays Out Standards for International Grantmaking by Charities

In a legal memorandum, the IRS set out standards, similar to those governing domestic grant-making, that dictate how United States charities must conduct their international grantmaking activities.

Special standards for international charitable activities apply only in specific areas. For example, while supporting a foreign government does not qualify as a charitable activity, a deduction may be taken for a transfer of property to a foreign government if the transfer is used for exclusively charitable purposes. In the case of grants by private foundations to foreign entities, the recipient will be treated as if it were a 501(c)(3) organization if the foundation manager reasonably believes the grantee is organized and operated as such and the grantor foundation, in good faith, determines that the foreign grantee fits the section 509 definition of private foundation.

27) CARE Bill- Santorum Reintroduces 2005 Version of the CARE Bill

Senator Santorum reintroduced the CARE Bill (a version of which was passed by the Senate in 2003). Some of the charitable incentives included in the CARE Bill are: (1) deductions for a portion of charitable contributions for taxpayers who do not itemize, (2) tax-free distributions from IRAs for charitable purposes, (3) increased charitable deductions for contributions of food and book inventories, (4) increased charitable deductions for scientific property used for research and computer technology used for educational purposes, (5) modifications to encourage contributions for conservation purposes, (6) adjustment to basis of S Corporation stock for contributions, (7) enhanced deduction for charitable contributions of literary, musical, artistic, and scholarly compositions, (8) mileage reimbursements to volunteers excluded from income, (9) 10-year divestiture period for certain excess business holdings of private foundations.

28) Notice 2005-23; 2005-11 IRB 1- Tsunami Deemed 'Qualified Disaster' for Tax Purposes

The IRS has designated the December 26, 2004, Indian Ocean tsunami as a qualified disaster, which will allow for the exclusion of qualified disaster relief payments from recipients' gross income and for employer-sponsored private foundations to provide disaster relief to employee victims.

29) PLR 200512027- Nonprofit Organized Exclusively to Facilitate Boat Donations to Third Party Charities Will Be Denied Exempt Status

The IRS denied an organization's claim for tax-exempt status on the basis that its activities are not charitable. The organization proposed to facilitate contributions of boats, and other tangible property, to the charity of the donor's choice. Donors would transfer title to the organization by outright gift or bargain sale. The organization would then sell the property and transfer a percentage of the net proceeds to charity. The organization had no prior written agreements with recipient charities and did not represent to carry on any other programs or activities. The Service ruled the organization was serving as agent for donors and as such was performing commercial services on their behalves. These are not charitable activities.

30) Final Treas. Regs. Under 664- New Regs. Regarding CRT Distributions

The IRS issued Final Regulations on the four-tier ordering system for CRTs. (The Regs. were proposed in late 2003.) Distributions to a CRT beneficiary are taxed under a four-tier system where, in the past, the income taxed at the highest rate is paid out first. The Final Regulations under 664 confirm prior rulings that within the second tier of capital gains, the highest-taxed gains must be paid out before lower taxed gains. They further create two classes of income in the first tier. With these new Regs., dividend income will be paid out before capital gain income even when it is taxed at lower rate.

31) Rev. Proc. 2005-24- Charitable Remainder Trusts, Safe Harbor to Disregard Right of Election

The Service released Rev. Proc. 2005-24 to provide a safe harbor procedure that, if followed, would cause the right of election to be disregarded for purposes of determining whether a CRAT or CRUT that is within the scope of the Rev. Proc. meets the requirements of §664(d) continuously from the date the trust is created. For CRTs created on or after June 28, 2005, the Rev. Proc. generally requires that the spouse of the donor irrevocably waive the right of election with regard to the assets of the CRAT or CRUT to ensure that no part of the trust will be used to satisfy their spousal elective share. For CRTs created before June 28, 2005, the IRS will disregard a spouse's right of election and a waiver does not need to be obtained for the trust to avoid disqualification. (However, if the spouse exercises the right of election, the CRT is disqualified from the date of creation.)

Rev. Proc. 2005-24 has received much criticism from the tax and charitable community as the waiver of spousal election requirement seems like a severe "solution" to a not so prevalent problem.

32) PLR 200518080-Grants by Private Foundation for Scholarship Program Not Taxable Expenditures

The Service has ruled that grants a private foundation plans to make as part of a scholarship program to help low-income students afford college comply with the requirements of sections 4945(g)(1) and 4945(g)(3) and that expenditures made in accordance with the program will not constitute taxable expenditures.

33) PLR 200518012- Disclaimers Deemed Valid, Entitling Estate to Charitable Deduction

The IRS ruled that beneficiaries' proposed disclaimers of their interests under a revocable living trust to a donor advised fund ("DAF") maintained by a public foundation will be deemed valid under section 2518. The IRS ruled that as a result of the disclaimers, the grantor's estate will be entitled to a charitable deduction under section 2055(a).

34) PLR 200519042- Disclaimer Deemed Qualified, Entitling Estate to Charitable Deduction

The Service ruled that an individual's disclaimer of her interest under a will is deemed qualified under section 2518 of the Code and that property passing to a foundation as a result of the disclaimer will qualify for an estate tax charitable deduction under section 2055.

35) Notice 2005-41; T.D. 9206- IRS Issues Temporary Regulations and Guidance on Qualified Intellectual Property Contributions

The IRS issued temporary regulations providing guidance to recipients of qualified intellectual property contributions on filing information returns. Effective May 23, 2005, the Regs. affect donees receiving net income from qualified intellectual property contributions made after June 3, 2004. The text of the temporary regulations also serves as the text of the simultaneously released proposed Regs. (REG-158138-04).

The IRS also issued related guidance (Notice 2005-41), including notification requirements, on additional deductions for contributions of qualified intellectual property. The deductions result from the addition of sections 170(e)(1)(B)(iii) and 170(m) by the American Jobs Creation Act of 2004.

36) Circular 230-IRS Revises Circular 230 Regulations

On May 19, 2005, final regulations revising the regulations governing practice before the IRS were released. The purpose of the revised regulations was to clarify the standards for “covered opinions” and was most likely in response to the volumes of feedback the IRS received from affected professionals and organizations in response to the final regulations issued in December 2004.

Some tax practitioners appreciated and praised this guidance (which excepted certain communications from the definition of “covered opinion”). Others felt that the revision was not very helpful. Overall, most feel more guidance will still be needed from the Service to clarify the definitions of certain terms used in the Circular 230 Regulations.

37) Charles F. Glass et ux. v. Commissioner; 124 T.C. No. 16; No. 17878-99 (May 25, 2005) Court Rules Easement Donations Were Qualified Conservation Contributions

The Tax Court has held that a couple’s contributions of conservation easements to a nonprofit nature conservancy were qualified conservation contributions under section 170(h)(1).

38) PLR 200521028- For-Profit's Redemption of Private Foundation's Stock Not Self-Dealing

The Service ruled that a for-profit corporation's redemption of a private foundation's shares of stock in the corporation will not constitute an act of self-dealing under section 4941. Section 53.4941(d)-3(d) of the regulations provides that a stock redemption between a private foundation and a corporation which is a disqualified person will not be an act of self-dealing if such transaction is engaged in pursuant to a redemption, recapitalization, or other corporate adjustment, so long as all the securities of the same class as that held (prior to such transaction) by the private foundation are subject to the same terms, and such terms provide for receipt by the foundation of no less than fair market value.

39) PLR 200521029-Amending Lease Agreement Between Public Charity and Trade Association Would Not Affect Charities 501(c)(3) Status

The Service has ruled that the amendment of a leasing agreement between a public charity and a trade association that leases property from the charity, pursuant to the expansion of the property, will not adversely affect the charity's status as a charitable organization described under section 501(c)(3).

40) Notice 2005-44; 2005-25 IRB 1- IRS Explains New Rules for Charitable Donations of Vehicles

The IRS has issued interim guidance (effective until Regulations are issued) on the deductibility of vehicle contributions under section 170(f)(12). The guidance explains requirements for donee acknowledgement letters and penalties for providing a false acknowledgment of a vehicle contribution or for failing to furnish the acknowledgment. The guidance varies depending upon the value of donated vehicles (under \$500, over \$500, and over \$5,000).

41) PLR 200524030- Foundation Allowed More Time to Dispose of Excess Business Holdings

A private foundation that owns excess business holdings is allowed five years to dispose of such holdings under section 4943 of the Code. In this case, involving complicated business structures, several sales attempts fell through and litigation ensued. Following presentation of these facts and a new plan of disposal, the Service has extended the disposal period.

42) PLRs 200524013 and 200524014- Trust Division Won't Prevent Resulting Trusts From Qualifying as Charitable Remainder Trusts

A married couple created a charitable remainder trust naming themselves as the sole joint and survivor income recipients. For a variety of reasons (not including their divorce) the couple wanted to divide their trust into two identical trusts with

each spouse being the sole income recipient of their respective trust. The Service has ruled that the proposed division of one trust into separate trusts will not cause either of the resulting trusts to fail to qualify as charitable remainder trusts under section 664 or cause gain or loss to be recognized by the husband and wife who set up the original trust under section 1001.

43) PLR 200525014-Early Termination of net-income-with-no-makeup CRUT (“NI-CRUT”)

The Service has ruled that the proposed early termination and division of a trust will not amount to self-dealing under §4941(a)(1) by the trustee or either donor with respect to the trust or a private foundation, nor participation in a self-dealing transaction under section 4941(a)(2) by any foundation manager. The Ruling does not address the NI-CRUT’s qualification under §664.

44) Panel on the Nonprofit Sector Final Report to Congress and the Nonprofit Sector- Panel on the Nonprofit Sector Releases Final Report on Governance of Charities

On June 22, 2005, the Panel on the Nonprofit Sector convened by the Independent Sector (“Panel”) issued its Final Report to Congress and the Nonprofit Sector (“Report”) regarding the possible ways of improving transparency and governance of charities. The Report was in response to the Senate Finance Committee (“SFC”) Discussion Draft on Reform for EOs (“White Paper”) which it issued on June 21, 2004.

The White Paper indicated that the SFC was discussing (in part and in summary): (1) requiring a five year review of tax exempt status by the IRS, (2) DAF Reform, (3) eliminating Type III Supporting Organizations, (4) revising exempt standards for credit counseling organizations, (5) revoking charitable status for accommodations to tax shelters, (6) applying private foundation (“PF”) self-dealing rules to public charities and modifying intermediate sanction compensation rules, (7) expanding the definition of disqualified person, (8) increasing taxes for self-dealing, jeopardizing investments, and taxable expenditures, (9) capping or prohibiting compensation of non-operating private foundation trustees, (10) capping compensation of disqualified persons who are employees of non-operating private foundations, (11) making reforms to private foundation grant requirements and administrative and travel and expense reporting, (12) changing Form 990 and financial statement requirements, (13) encouraging strong governance of EOs, and (14) allowing only a basis deduction for non-cash contributions (excluding marketable securities). Since the White Paper was released, members of the tax and charitable communities have been urging lawmakers not to overreact to perceived abuses.

The Panel’s Report made sixteen recommendations. The two items in the Panel’s list of recommendations that the Executive Director of the Independent Sector,

Diana Aviv, said were the most significant were: (1) increasing transparency, and (2) mandating electronic filing. Aviv also emphasized that Form 990 and 990PF should be simplified and revised to provide more transparency to the public and the IRS. The Senate Finance Committee (“Committee”) chair, Senator Grassley, thanked the Panel for the Report and indicated that the Report will be useful to the Committee in drafting legislation (which it plans to issue within the year).

45) Marcus v. Booker et ux. v. Commissioner; T.C. Summ. Op. 2005-90; No. 14036-03S (July 18, 2005)- Claimed Deductions and Exemption Denied for Lack of Substantiation

The Tax Court, in a summary opinion, has disallowed for lack of substantiation a couple’s claimed dependency exemption for a parent, charitable contribution, and business expense deductions. Additionally, it upheld both accuracy-related penalties and an addition to tax for failure to timely file.

46) PLR 200527019- Supporting Organization Not Required to File Information Return

The Service ruled that a supporting organization satisfied the requirements of being an affiliate of a governmental unit. Therefore, it is not required to file Form 990.

47) PLR 200528030- Charity's Exempt Status Not Jeopardized by Transfer of Assets

The Service has ruled that a publicly supported organization's section 501(c)(3) classification will not be adversely affected by a proposed transfer of endowments and real estate to its supporting organization and that the transaction will not result in unrelated business taxable income to the supporting organization.

48) Albert Strangi et al. v. Commissioner, 96 AFTR 2d 2005-5230, Aug. 8, 2005-Fifth Circuit affirms “Strangi II” Holds Individual Retained Enjoyment of Assets Transferred to Family Partnership

The Fifth Circuit affirmed a Tax Court decision, Estate of Albert Strangi, et al. v. Commissioner, T.C. Memo 2003-145 (commonly referred to as *Strangi II*). The Fifth Circuit maintained that the value of assets an individual transferred to a family limited partnership are includable in his estate under §2036(a) because he retained enjoyment of the transferred assets and there was no bona fide sale. Section 2036(a) provides that transferred assets of which the decedent retained de facto possession or control prior to death are included in the taxable estate. The Tax Court held that Albert Strangi retained enjoyment of the assets in question, and thus, that the transferred assets were properly included in the estate.

49) PLR 200529004- Grant to Foreign Nonprofit Not Subject to Withholding

The IRS ruled that a private foundation's proposed grant to a foreign nonprofit, nongovernmental, membership organization will be treated as an excludable gift under section 102 and will not be subject to withholding under sections 1441 and 1442.

50) PLR 200530007- No Self-Dealing Found on Pledge of Corporate Stock Options to Foundation

Superseding an earlier private letter ruling, the IRS ruled that a for-profit corporation's pledge of stock options to a related charitable foundation described in sections 501(c)(3) and 509(a) will not be an act of self-dealing under section 4941.

51) PLR 200530016- Contributions to Cultural Preservation Organization Are Deductible

The Service ruled that an organization is an instrumentality of a state and that contributions to the organization are deductible under section 170. Donors may even request specific uses for their donations if the organization provides no more than assurances that it will attempt in good faith to honor the requests.

52) PLR 200530029- Tax Consequence of Charitable Trust's Proposed Property Divisions Addressed

The Service has ruled that a perpetual charitable trust's procurement of engineering plans and the division of land into parcels won't cause the land to be held primarily for sale to customers in the ordinary course of a trade or business under section 512(b)(5). The sale or lease of undeveloped parcels for further development will not result in gain taxable as unrelated business taxable income under section 511.

53) PLR 200531020 - Trade Group's Exempt Status Not Threatened by Contract With For-Profit

The Service has ruled that a trade association's contract with a for-profit corporation to sponsor a trade show will not violate the terms of its status as a tax-exempt organization described under section 501(c)(6).

54) PLR 200532022- Judicially Reformed Trust Instrument Did Not Invalidate CRUT Status

The Service ruled that a court-authorized amendment to a trust specifying that realized post-contribution capital gains will be included in the trust's income does not prevent the trust from qualifying as a net income charitable remainder unitrust under section 664(d).

55) PLR 200532052- Transaction Will Not Adversely Affect Charity's Exemption

The Service has ruled that a transaction involving a section 501(c)(7) fraternity and a section 501(c)(3) charity and the construction of a building on land purchased by the fraternity's grantor trust will not adversely affect the charity's tax-exempt status.

56) PLR 200532053 and PLR 200532054- Sale of Property Will Not Result in Self-Dealing

The IRS ruled that a trust's sale of property to a grandchild of the trust's founder will not constitute self-dealing as to that grandchild under section 4941(d), and that grandchild will not be subject to taxes under section 4941.

57) PLR 200532055- Contributions to School Districts Not Self-Dealing

The Service ruled that charitable contributions to school districts participating in a program run by a company that helps at-risk or underserved minority students learn technology skills will not be self-dealing.

58) PLR 200532057- Sale of Land to Raise Money for Improvements Will Not Affect Exemption

The Service ruled that a religious organization's sale of property to finance repairs and improvements will not adversely affect its tax-exempt status. The sale of parcels to individuals or developers with limited improvements will not be unrelated business taxable income under sections 511 and 512. This PLR was similar to PLR 200530029 in which the IRS also ruled that the sale of land would not be UBI to the charity. In PLR 200530029 the charity went so far as to subdivide the land before selling two of the lots.

59) PLR 200532058- Foundation's Exemption Not Jeopardized by Ice Arena Development

The Service ruled that the development of an ice arena through a limited liability company ("LLC") will not jeopardize a foundation's exemption. In this case, a private non-operating foundation was the sole member of the LLC. The Service also ruled that income the foundation gets from the arena will not be subject to tax under section 511.

60) Rev. Proc. 2005-52 through Rev. Proc. 2005-59- IRS Releases Eight Sample Declarations of Trust for CRUTs

The IRS released eight new annotated sample declarations of trust and alternate provisions for inter vivos and testamentary charitable remainder unitrusts with varying measuring terms. Until this time, the IRS had issued sample trust instruments for certain types of CRUTs. This updates previously issued samples and adds new samples for additional types of CRUTs.

They are:

1. Rev. Proc. 2005-52; 2005-34 IRB 326 (Inter Vivos CRUT Declaration for One Measuring Life)
2. Rev. Proc. 2005-53; 2005-34 IRB 326 (Inter Vivos CRUT Declaration for a Term of Years)
3. Rev. Proc. 2005-54; 2005-34 IRB 353-(Inter Vivos CRUT Declaration for Consecutive Measuring Lives)
4. Rev. Proc. 2005-55; 2005-34 IRB 367- (Inter Vivos CRUT Declaration for Concurrent and Consecutive Measuring Lives)
5. Rev. Proc. 2005-56; 2005-34 IRB 383- (Testamentary CRUT Declaration for One Measuring Life)
6. Rev. Proc. 2005-57; 2005-34 IRB 392- (Testamentary CRUT Declaration for a Term of Years)
7. Rev. Proc. 2005-58; 2005-34 IRB 402- (Testamentary CRUT Declaration for Consecutive Measuring Lives)
8. Rev. Proc. 2005-59; 2005-34 IRB 412- (Testamentary CRUT Declaration for Concurrent and Consecutive Measuring Lives)

61) Form 1098-C- IRS Released New Form 1098-C for Vehicle Donations

The IRS released the new Form 1098-C, Contributions of Motor Vehicles, Boats, and Airplanes. Donee organizations use Form 1098-C to report the contribution of qualified vehicles to the IRS under new Code section 170(f)(12). Form 1098-C may also be used to provide the donor with a contemporaneous written acknowledgment of the contribution.

Generally, the American Jobs Creation Act of 2004 requires that charitable deductions taken for a donated vehicle that exceed \$500 to be limited to the charity's gross proceeds from the sale of the vehicle. However, the donor may be able to take a fair-market-value deduction if the charity sold the vehicle at significantly below fair market value to a needy individual. However, the IRS has

warned that it will not recognize fair-market-value deductions if the vehicle was sold to a needy individual at auction.

62) PLR 200534015 – Taxpayer’s Assignment to Irrevocable Trust Will Be a Completed Gift When Assigned

As background to this PLR, the Taxpayer proposes to assign a portion of the potential award or settlement in a wrongful death claim to an irrevocable trust set up for benefit of her children and more remote descendants. The trust instrument prohibits Taxpayer from serving as Trustee and requires that there always be at least one independent trustee. Additionally, the power of Trustees to amend the instrument is limited; in particular, they may not amend it in such a way that would alter or expand the set of beneficiaries. The Service has ruled that the Taxpayer will have made a completed gift at the time of the assignment of a portion of the potential proceeds from the wrongful-death action, irrespective of the fact that the Taxpayer will continue to be involved in the administrative aspects of the claim.

63) PLR 200535006- Service Allows Estate Tax Charitable Deduction After Trust in Will Reformed

A decedent’s will created a trust for the benefit of his son during the son’s life and then for charity. The charitable remainder interests in the trust did not qualify for the estate tax charitable deduction under Code § 2055(a). In an effort to qualify the charitable remainder interests for the deduction, the son disclaimed the discretionary invasions of principal for his medical expenses provided for in the trust. Next, the trust was partitioned into two trusts and the second trust was replaced with a CRUT. The IRS ruled that an estate tax charitable deduction will be allowed for the value of the charitable interests in the new CRUT, resulting from the trust reformation.

64) PLR 200537019 – Service Rules on Estate’s Payments to Charitable Beneficiary

The Service has ruled that an estate’s tax year, which does not end on the last day of any month, is not a permissible tax year. Further, the Service ruled that the income from the estate’s surrender of a nonqualified annuity contract formerly held by the decedent constitutes income in respect of a decedent, but the estate may take deductions for any IRD given to charities or earmarked for charitable purposes.

65) PLR 200537020 – Funding of Charitable Lead Unitrust Constitutes A Complete Gift

The Service has ruled the funding of a charitable lead unitrust will constitute a completed gift, that the grantors may take a gift tax deduction calculated from the

unitrust interest's present value, and that, when either grantor dies, the trust principal will not be considered part of the grantors' gross estate.

66) REG-111257-05- IRS released proposed Regulations on Intermediate Sanction and Recognition of Exempt Status

The IRS released Proposed Regulations on the standards for recognizing tax-exempt status if an organization: (1) benefits a private interest, (2) has engaged in excess benefit transactions. The Proposed Regulations amend existing regulations and add examples that illustrate the requirement that an organization serve a public rather than a private interest. The examples show that prohibited private benefits can involve non-economic and/or economic benefits. The Proposed Regulations state that prohibited private benefits may arise even when payments made to private interests are reasonable.

The Proposed Regulations provide guidance on factors the IRS will consider to determine whether a 501(c)(3) organization that engages in one or more excess benefit transaction continues to qualify under section 501(c)(3). The Proposed Regulations clarify the relationship between the requirements for tax exemption under section 501(c)(3) and the imposition section 4958 excise taxes. The imposition of excise taxes for excess benefit transactions does not foreclose revocation of an organization's tax-exempt status by the IRS. The Proposed Regulations also clarify that the IRS can refuse to issue a ruling recognizing exemption under section 501(c)(3) to any applicant whose purpose or activities violate any provision of section 501(c)(3), even when the violation could serve as grounds for imposing section 4958 excise taxes if the applicant's tax-exempt status were recognized.

67) Katrina Emergency Tax Relief Act of 2005 - President Signed the Katrina Relief Bill

The President signed this legislation designed to assist hurricane victims and encourage charitable donations ("the Act"). The Act encourages donations of food to relief organizations by extending the deduction available to producers and sellers of food to all businesses. The Act encourages donations of books to schools impacted by Katrina. The Act relaxes the contribution limits for contributions from corporations and individuals to charitable organizations and increases the mileage rate for calculating charitable contribution mileage deduction for Katrina-related activities. In addition, the Act assures that reimbursements for charitable mileage up to the standard business mileage rate are not taxable income for Katrina-related activities.

Unfortunately, a provision that would have allowed *direct* tax-free rollovers of IRA assets to charity failed to make it into the final Act. However, other provisions in the Act may facilitate the indirect IRA rollovers. The Act temporarily suspends the 50% limitation for "qualifying contributions" to the

extent such gifts exceed the donor's "other" charitable contributions. A qualifying contribution must be made: (1) in cash; (2) to a public charity as described in IRC 170(b)(1)(A), excluding gifts to supporting organizations and donor advised funds; and (3) between August 28, 2005 and ending on December 31, 2005. In addition, the Act provides an exception to the 3% reduction of itemized deductions in section 68 for "qualified contributions."

68) Roger Wortmann et ux. et al. v. Commissioner; T.C. Memo. 2005-227 – Tax Court Relies on Prior Sale Price of Gifted Property in Determining Its Value

The present case concerns the value of real property owned by four married couples and donated to charity. The property in question had been held by Monks of Tintern, Inc. (a nonprofit) and had been used as a monastery. Monks of Tintern, Inc. had recently experienced difficulty finding a religious order to occupy the property, and was considering selling it to pay off its debts. The nonprofit's president and founder insisted that the buyer use the land for religious purposes. The purchasers were four married couples (petitioners), who bought the property for \$75,000 and, seventeen months later, donated it to a religious charity, claiming a total charitable deduction of \$475,000. The Service reduced the total deduction to \$76,200.

The Court ruled in favor of the Service, finding that the actual sale price of the property seventeen months prior to donation was more indicative of the property's actual value than was the appraisal prepared by petitioners' expert, especially considering that no improvements had been made to the property that would justify such rapid and dramatic appreciation. The Court had doubts concerning the independence of the petitioners' appraiser and the method of his analysis. In contrast, the Court was impressed by the experience and credentials of the Service's expert and by the thoroughness of his analysis. Moreover, the value for the property determined by the County Assessor closely matched the sale price seventeen months prior.

69) PLR 200539008 - Trust's division does not render it invalid as a CRUT

The Service has ruled that a trust may be divided into two separate trusts following a marital dissolution without any of the trusts then failing to qualify as charitable remainder unitrusts under section 664. Additionally, the Service ruled that the proposed division will not cause the trusts to recognize any gain or loss.

70) PLR 200539022 – Court-Reformed Trust Remains Legitimate CRUT

The Service has ruled that a judicially modified trust will continue to qualify as a charitable remainder unitrust under section 664.

71) PLR 200539010 – Trust's Modification Won't Result in Loss of GSTT-Exemption

The Service has ruled that the transfer of trust assets to a newly created trust will not consequently trigger any generation-skipping transfer tax obligation for the original trust.

72) PLR 200539028 – Grants via Foundation’s Scholarship Program do not Constitute Taxable Expenditures

The Service has ruled that a foundation’s scholarship program, intended to assist low-income students with higher education expenses, is compliant with sections 4945(g)(1) and 4945(g)(3), and that expenditures made via the program will not be considered taxable expenditures.

73) PLR 200542037 – Foundation’s Compensation of Board Member Not Self-Dealing

Recognizing that the term “government official” has a relatively narrow meaning for purposes of section 4946, the Service has ruled that a district court judge does not fall within that meaning. Consequently, a private foundation’s compensation of such a judge for his services on the foundation’s board would not be considered self-dealing. *However*, this PLR was subsequently revoked by PLR 200604034.

74) PLR 200543060 – Foundation Receives Favorable Ruling on Asset Transfer

The Service has ruled that a private foundation may transfer all of its assets to another private foundation without losing its private-foundation status and without realizing net investment income. Further, the transaction will not subject either foundation to any termination tax.

75) PLR 200543061 – Early Termination of CRUT will not Constitute Self-Dealing

The Service has ruled that a proposed early termination of a charitable remainder unitrust will not be considered self-dealing under section 4941(d). Consequently, those persons disqualified with respect to the trust will not be liable for taxes under sections 4941(a) and (b).

76) Estate of Marie A. Maniglia v. Commissioner; T.C. Memo. 2005-247; No. 20141-03 (October 26, 2005)

The U.S. Tax Court ruled in favor of the Service when it ignored a taxpayer’s claims that a piece of property was held by a partnership in which the decedent held a 50% interest. All available documentary evidence indicated the property was held by a trust, of which the decedent was the sole beneficiary and of which the estate’s executor was trustee. Although the trust had filed certain tax returns as if it were a partnership, the taxpayer was unable to provide any objective evidence that the ownership of the property was other than that indicated by the

available documents. The Court ruled that the Service had correctly included the full value--not just 50%--of the property in the decedent's gross estate.

77) Sidney E. Smith III et al. v. United States, No. 02-264 ERIE (W.D. Pa.)

A magistrate judge in U.S. District Court held that the Service correctly disregarded a restriction in a family limited partnership agreement when assessing the value of a gifted interest in the partnership. This restriction dictated the price and conditions of the partnership's payment of a partner for his or her interest in the event that the partnership exercised its right of first refusal. The Court was persuaded that § 2703 applied to this restriction, and that the Service was therefore correct in ignoring this restriction for purposes of marketability discount in its assessment of the value of partnership interests gifted by a partner.

78) Tax Reform Panel Makes Recommendations to Encourage Charitable Giving

The President's Advisory Panel on Federal Tax Reform issued six recommendations in its final report intended to encourage charitable giving and improve tax administration.

Recommendation 1: Create a deduction, available to all taxpayers, for charitable contributions that exceed one percent of income.

Recommendation 2: Allow tax-free IRA distributions to be gifted directly to qualified charities, without first including the amount in the donor's income.

Recommendation 3: Require charities to report gifts that exceed a certain amount (recommended to be at least \$600) directly to both the IRS and the donor.

Recommendation 4: Allow taxpayers to give the proceeds from sold property to charity, without recognizing gain on the sale and taking a full charitable deduction, *provided that* the sale is an arm's-length transaction and that the proceeds are donated within sixty days of the sale's closing.

Recommendation 5: Clarify standards for appraisals; require appraisers to report appraised values to the IRS, the donor, and the charity; implement new penalties for appraisers who misrepresent the value of appraised property; and allow deductions for donations of used personal property (clothing, household items, etc.) only when the charity furnishes a price list and itemized receipt to the donor.

Recommendation 6: Improve oversight and governance of tax-exempt entities; in particular, legislators should take a fresh look at which types of organizations should qualify as tax-exempt.

79) In the Matter of Judicial Settlement of Final Account of Chase Manhattan Bank, Pioch Trust, NY Sup. Ct. App. Div. (Fourth Dept.), No. CA 04-02972 (July 1, 2005)

In 1974, the settlor, Charles Pioch, created two trusts—a charitable remainder annuity trust and a “lifetime” trust. The CRAT paid an annuity to Pioch for his lifetime, then to the lifetime trust, and lastly to a charitable remainderman. The lifetime trust paid income and, as appropriate, principal to Pioch during his lifetime. After his death, the trust supported his daughter, Kathleen, for her lifetime. Upon her death, the remaining principal would go to two specified charities. At issue is whether or not approximately half a million dollars of accumulated annuity payments from the CRAT were included in the principal of the lifetime trust at Kathleen Pioch’s death. The trustee considered this amount to be income of the lifetime trust, which would be distributable to Kathleen Pioch’s heirs. The charitable remaindermen objected, claiming all funds left in the lifetime trust upon Kathleen Pioch’s death. The state Surrogate Court decided in favor of the trustee, and, upon appeal, the appeals court upheld this decision. The appeals court noted that Charles was the sole income beneficiary of the CRAT annuities, and the trust documents did not indicate that the annuities would serve a different purpose when the income beneficiary changed to Kathleen; she was still the beneficiary, irrespective of whether the annuity money was used immediately or saved for a later time.

80) S. 2020, “Tax Relief Act of 2005” (TRA2005) passed by Senate 11/18/05

Senate Bill 2020 contains a number of provisions concerning charitable giving.

First of all, the bill affects charitable deductions by individual donors with a mix of incentives and restrictions. It contains stricter rules concerning the appraisal of gifts, and larger penalties for overvaluation. It permits non-itemizers to deduct charitable cash gifts greater than \$210 (or \$420 for taxpayers filing jointly). Additionally, it allows taxpayers to make tax-free distributions from IRAs to charitable organizations. However, the bill places a floor of \$210 (or \$420, as the case may be) for gifts by itemizers, effectively preventing a deduction for the first \$210 or \$420 of a gift’s value. Another important restriction on charitable deductions contained in the bill is the elimination of “reliable written records” (other than cancelled check or receipt) as an option of recordkeeping for deductible gifts of less than \$250. Finally, the bill would raise the AGI limitation from 30% to 50% for contributions of qualified conservation property, and permit farmers and ranchers to deduct up to 100% of their AGI for such gifts.

Most notable among the provisions concerning private foundations are proposed tax increases for self-dealing. The bill also contains numerous new restrictions on SOs. SOs would be prohibited from having deductible DAFs. They would be prohibited from making payments to their substantial contributors or these persons’ families, unless this contributor is a non-SO charity; in effect, this

prevents SOs from making grants to other SOs. The bill applies the excess holdings rules of § 4943 to all Type III SOs and some Type II SOs.

Type III SOs, in particular, would feel the effects S. 2020 should it pass into law as-is. The bill contains stricter distribution requirements for this type of SO. Also, new Type III SOs would be limited to five supported organizations (SedOs) and would not be allowed to name foreign charities as SedOs. Existing SOs would be prevented from naming additional SedOs if doing so would have them supporting more than five organizations. Type III SOs would be prohibited from making grants to DAFs. Type III SOs would be required to submit a letter from each of their SedOs on their Forms 990 stating the SedOs consent to be supported and how it expects being a SedO will help to further its mission. Lastly, to ensure responsiveness, Type III SOs would have to inform each SedO of their support.

S. 2020 seeks to regulate DAFs. Perhaps most significantly, it takes the unprecedented step of putting forth a statutory definition of a DAF. A DAF would be defined as a fund or account that is “separately identified contributions of donor(s) that are owned by a Sponsoring Charity (SC) eligible to receive them where donor(s) (or their designee) [reasonably] expect to have advisory privileges regarding distributions and investing.” Other provisions for DAFs set how much they must distribute, how often distributions should be advised, which types of assets should or should not go into them, and in which ways donors should not benefit.

S. 2020 has two stipulations concerning charities’ UBIT. It requires that charities publicly disclose their UBIT by making their Forms 990T open for public inspection. It also requires that charities have their UBIT certified by an independent auditor.

The bill provides for penalties against charities involved in tax shelters. Charities that participate knowingly in a prohibited listed tax shelter would face an excise tax of 100% of the attributable net income or 75% of the attributable gross income, whichever is greater. The excise tax would apply to any attributable income from the tax shelter if it is listed after the charity becomes involved. Charities that fail to disclose their involvement in a tax shelter or fail to identify other known participants would face a \$100/day penalty, up to \$50,000. A charity’s manager that approves involvement in a tax shelter would be subject to a \$20,000 fine.

The bill would implement the following miscellaneous incentives to charitable giving: allow all businesses to take deductions for food donations; implement more favorable basis adjustment on contributions of S corp. stock; expand book donation deductions; implement UBIT rules for controlled subsidiaries’ payments; improve allowable deductions for literary, musical, artistic and scholarly compositions; and exclude from gross income mileage reimbursements for charitable volunteers.

S. 2020 has miscellaneous restrictions concerning charity-owned life insurance, gifts of façade easements, “related-use” property gifts not used for exempt purposes, gifts of clothing and household items, fractional interest donations, appraisals, and credit counseling organizations. The bill also defines “associations” or “conventions” of churches, and requires a broader class of entities to file with the IRS.

81) Estate of Mildred S. Jackson v. United States; No. 2:04CV34 – Estate was Wrongly Denied Charitable Deduction

The decedent, Jackson, had created prior to her death a revocable inter vivos trust that, upon her death, became irrevocable and was to make payments to a nephew and three nieces, with a church as the remainder beneficiary. Soon after her death, the trustees and beneficiaries terminated the trust due to conflict-of-interest concerns, and the estate claimed a charitable deduction for the amount left to the church. The Service denied the deduction. The government defends the denial based on its narrow interpretation of IRC Section 2055(e), which disallows charitable deductions when the decedent passes on both charitable and noncharitable interests in the same property. The government asserts that section 2055(e) is inapplicable only when the split interest is resolved by settlement of a will or to prevent an impending breach of fiduciary duty. Observing that Congress’ intent behind section 2055(e) was to ensure that charitable estate deductions accurately reflect the benefit imparted to charity, the Court opined that the government’s interpretation is overly narrow. Moreover, the Court reiterated four factors courts have previously recognized in resolving section 2055(e) issues: (1) the directness of the gift of property to charity, (2) the presence or absence of noncharitable interest in the property, (3) the match between the amount of the deduction and the actual benefit realized by the charity, and (4) the sincerity of the estate’s charitable intent. The Court observed that the church had received an outright and undivided cash distribution equal to the amount of the deduction claimed by the estate. Furthermore, the trustees and beneficiaries terminated the trust out of good-faith concerns of conflict-of-interest, not to circumvent section 2055(e). Accordingly, the Court ordered the United States to refund the amount of tax at issue, plus interest.

82) PLR 200548023 – CRUT’s Early Termination Will Not Constitute Self-Dealing

The Service has ruled that the early termination of a charitable remainder unitrust and the division of the actuarial income and remainder interests between the current beneficiary and the remainderman will not be considered self-dealing under section 4941(a)(1) and will not require payment of any termination tax under section 507(c).

83) PLR 200548026 – IRS Issues Ruling on Foundation’s Interest in Partnership

The Service has granted several favorable rulings regarding a private foundation's investment in a limited liability limited partnership—among them, that the investment is not an excess business holding under section 4943, that it is not a jeopardizing investment under section 4944, and that it is not impermissible self-dealing under section 4941.

84) P.L. 109-135 – Gulf Opportunity Zone Act Clears, Signed into Law

On December 21, 2005 the President signed the Gulf Opportunity Zone Act of 2005 (“GOZA”) into law. GOZA creates a “Gulf Opportunity Zone” composed of hurricane-stricken areas of Louisiana, Mississippi, and Alabama (“the Zone”). Title I of GOZA is concerned chiefly with tax incentives to rebuild residential housing, repair commercial buildings, and relieve some of the burden on employers that provide their employees with housing. Title I of GOZA also provides certain tax breaks for recovering businesses located within the Zone, and contains provisions for states and municipalities to recover revenue with tax-favorable bonds. Title II of GOZA provides tax relief for individuals and families affected by the hurricanes, as well as charitable giving incentives for hurricane-related contributions. Title III of GOZA contains several miscellaneous provisions including the option for military personnel to include combat pay as earned income for purposes of calculating Earned Income Credit.

85) IR 2005-144 – IRS Announces New User Fee Schedule for 2006

Effective February 1, 2006, Exempt Organization letter ruling fees, which presently range from \$155 to \$2,750, will increase to \$275 to \$8,700. Effective July 1, 2006, Exempt Organization fees for determination letters and requests for group exemption letters, which presently range from \$150 to \$500, will increase to \$300 to \$900. The Service also announced that the Exempt Organizations division will no longer issue rulings on joint ventures of an exempt organization with a for-profit organization or on the qualifications of state-run programs under IRC section 529. Rev. Proc.s 2006-1 and 2006-8, both released January 3, 2006, give detailed information on the changes in user fees.

86) Richard Lewis Field v. Commissioner; T.C. Summ. Op. 2005-184; No. 9552-04S – Tax Court Denies Taxpayer's Deductions for Business Expenses and Charitable Contributions

The U.S. Tax Court ruled against an individual taxpayer's claim of deductions for business expenses and charitable contributions. The Court found that taxpayer's “investment management service” was not a trade or business, noting that taxpayer had no clients and had never charged a commission or fee, and did not segregate his personal and business expenses. Further, the Court reiterated prior case law which holds that managing one's personal investments never constitutes carrying on of a trade or business. Taxpayer had also deducted travel expenses from his tour of England and Wales with the Houston Symphony Chorus, a tax-

exempt organization for which he volunteered. Observing that the group's itinerary for the tour allotted more time for tourist activity than rehearsal or performance, the Court agreed that taxpayer's deductions for travel expenses incurred during the tour were correctly disallowed. Such deductions are permissible only in the absence of significant personal or recreational benefits from the traveling in question, and the Court did not have to rely on taxpayer's uncorroborated assertion that he did not take advantage of sightseeing opportunities during the tour.

87) Michael Sklar et ux. V. Commissioner; 125 T.C. No. 14; No. 395-01 – Tuition Payments Are Not Gifts to Charity

Mr. and Mrs. Sklar, an Orthodox Jewish couple, took a charitable deduction on their 1995 income tax return for a portion of their tuition payments to their children's Orthodox Jewish day schools, which corresponded to the portion of each school day devoted to religious instruction. The Service denied said charitable deduction. Observing that the Sklars received the substantial benefit of their children's education for the money, and that they produced no evidence of genuine charitable intent, the Court concluded in favor of the Service. The Court also addressed the Sklars' assertions that sections 170(f)(8) and 6115, as they stood at the material time, allowed a deduction for that portion of tuition payments going to religious instruction. The Court ruled against the Sklars, since the sections in question do not explicitly overturn the large body of case law that prohibits deduction of tuition payment to religious school. The Court further maintained that these sections do not apply in the instant case, because the day schools attended by the Sklar children provide both religious and secular education. Finally, the Court did not agree with the accuracy-related penalty imposed by the Service, in part because the Sklars had taken charitable deductions for part of their tuition payments in previous years, and these deductions had gone unchallenged by the Service.

88) PLR 200552018 – Foundation Denied Extra Time to Dispose of Excess Business Holdings

The Service has ruled against a private foundation's requests for an extended five-year period for disposal of excess business holdings. After several large gifts in 1999, the foundation and its disqualified persons came to control, between themselves, over 60% of the common stock of a publicly-traded corporation. The Service noted that the foundation had five years in which to dispose of its excess shares. The Service further noted that in January 2005, the foundation had turned down an offer to purchase all of its excess shares, and had been advised orally by the Service that depressed market price of the stock was not sufficient grounds for granting an extension. Most importantly of all, the Service observed that the foundation had presented neither a specific plan of disposition that could reasonably be expected to be accomplished within five years, nor a specific deadline by which the excess stock would be sold.

89) PLR 200552015 – Early Termination of CRUT Will Not Constitute Self-Dealing

The Service has ruled that the early termination of a charitable remainder unitrust and division of the income and remainder interests between the current beneficiary and the remainderman will not be considered self-dealing under section 4149(a)(1) and will not require any payment of termination tax under section 507.

90) PLR 200601003 - IRS Rules on Unintentional Transfer of Funds to Account of Charitable Remainder Unitrust

The Service has ruled on a situation in which the settlor of a CRUT accidentally placed money in the investment account of the trust. The funds in question were the liquidation of a personal investment with which the settlor was dissatisfied. The trustee, who was also the settlor's personal financial advisor, understood that the funds were to be put into the settlor's personal money market account, and believed that the account described on the redemption notice was this same personal account. The account was in fact that of the CRUT. While the settlor took no tax deduction for the gift, the amount was included in calculating unitrust distributions for three years. When the mistake was noticed upon review of the CRUT's performance, the settlor and spouse obtained a court ruling essentially intended to reverse the mistake, contingent upon a favorable letter ruling from the Service. The Service has indeed ruled favorably, agreeing that the erroneously transferred funds were never part of the trust's corpus, and that the return of the funds will not be an act of self-dealing and will not jeopardize the trust's status as a CRUT.

91) Notice 2006-15 – Spousal Consent Waivers No Longer Required for CRTs

The June 28, 2005 grandfather date in Rev. Proc. 2005-24 has been extended until further guidance has been issued by the Service. Until such time, the Service will disregard the existence of a spousal right of election when determining whether a trust qualifies as a CRT, even in the absence of a waiver, provided that the spouse does not exercise said right of election.

92) PLR 200607023 – IRS Approves Private Foundation's Settlement in Estate Litigation

A private foundation was funded by a distribution of real estate from the revocable trust of a decedent. However, the transfer was completed before the probate of the decedent's Will, before her creditors could make claims, and before her heirs had any opportunity to contest her estate plan. As a result, several of the decedent's relatives filed a complaint with the state probate court. After two hearings, the court appointed a receiver with limited powers over the distributed property, which did not include authority to make distributions for charitable

purposes. The situation grew more complicated as litigation ensued over administration of the decedent's estate, rightful ownership of part of her property, and a claim from a former employee of hers. The foundation has decided to settle out of court in order to cut litigation costs and maximize the assets left over for charitable purposes. The Service has ruled that carrying out the settlement agreement will not jeopardize the foundation's current status as a tax-exempt private foundation, will not result in taxable expenditures, will not result in self-dealing, and that the foundation's responsibility to make qualifying distributions or contingent set-asides will be deferred until it receives its agreed-upon distribution from the decedent's estate.

93) PLR 200607028 – Foundation's Use of Disqualified-Person Bank Is Exception to Self-Dealing

The Service has ruled that a private foundation's engagement of a bank owned by the donor, for investment-management purposes for reasonable compensation, is an exception to self-dealing under section 4941(d)(2)(E).

94) PLR 200608002 and PLR 200608003 – IRS Rules Favorably on Trust Agreement of Real Estate Pooled Income Fund

A tax-exempt hospital intends to renovate two of its buildings. The hospital will fund the renovation by creating a pooled income fund which will accept contributions, liquidate contributed property if necessary, and use the proceeds to buy the buildings and rent the land from the hospital. Then, the fund will renovate the buildings and lease them. The fund's income beneficiaries will receive pro-rata shares of its net rental income. The Service has ruled that four provisions in the fund's trust agreement that do not appear in the sample trust forms of Rev. Proc. 88-53 will not adversely affect its qualification as a pooled income fund under § 642(c)(5).

95) TAM 200610017 – Gifts of Railroad Rights-of-Way Were Gifts of Partial Interest in Real Property

In this advice memorandum, the Service has determined that gifts of railroad rights-of-way were transfers of partial interests in real property, and consequently might be deductible under certain factual circumstances. The issue arose during an IRS audit of four railroad companies that had obtained clearance to end service along certain of their rail lines, and had given their rights-of-way on those lines to qualified donees. The railroads had held the rights-of-way as easements, and claimed that they had gifted their entire interest in these easements and were therefore entitled to a charitable deduction. The Service disagreed, noting that the railroads could legally reclaim their rights-of-way in the future if they were to apply to resume rail service along the routes in question. Nonetheless, the railroads might still be allowed a charitable deduction if they retained only an "insubstantial" interest. On the other hand, Treas. Regs. §1.170A-7(a)(3) say that

a donor's deduction for a gifted partial interest in property will not be impermissible solely because the benefit to charity might be defeated by some future act or event, as long as the possibility of such an act or event coming to pass is "so remote as to be negligible." Because these questions of substantiality and remoteness are purely factual, and because the IRS auditor and the railroads could not agree on a statement of facts, the National Office could not reach a conclusion in this advice memorandum.

96) IR-2006-25 – IRS Announces “Dirty Dozen” Tax Scams for 2006

The Service has released its list of the twelve most notorious tax scams for 2006. The “Dirty Dozen” tally, briefly listed here, comprises the following:

1. “Zero Wages”
2. Form 843 Tax Abatement
3. “Phishing”
4. “Zero Return”
5. Trust Misuse
6. Frivolous Arguments
7. Return Preparer Fraud
8. Credit Counseling Agencies
9. Abuse of Charitable Organizations and Deductions
10. Offshore Transactions
11. Employment Tax Evasion
12. “No Gain” Deductions

The Service has subsequently given particular attention to “phishing,” a scam in which identity thieves pose as IRS agents and send phony emails to taxpayers that request various kinds of personal information (discussed in detail in Steve Leimberg's Estate Planning Newsletter # 948 [March 27th, 2006] at <http://www.leimbergservices.com>). Typically, the email will say that the taxpayer is entitled to a refund and must submit a PIN, bank account number, etc. to receive it. The emails look genuine, and often link to websites that also appear legitimate. Nonetheless, the Service does not send unsolicited emails to

taxpayers, and likewise does not request personal access information of the type that would interest identity thieves. The Service has set up an email address, phishing@irs.gov, to which taxpayers can forward suspicious emails for investigation. The Service's website offers detailed instructions for forwarding emails to this address.

97) Ian G. Koblick et ux. V. Comr.; T.C. Memo. 2006-63; No. 13808-04 – Tax Court Decides in Favor of Service in Dispute over Gifted Stock

In 1994, Mr. and Mrs. Koblick made a bargain sale to a charity of their 45% stake in a closely-held corporation, and claimed a charitable deduction of the value of the stock minus the sale price. The deduction was carried over through 1999. The Service did not accept the claimed value of the deduction, and consequently determined that the Koblicks owed a deficiency on their 1998 and 1999 returns. At issue in this case is the value of the stock itself and of the corporation's single most valuable asset, a submersible barge known as the "Jules Undersea Lodge" (JUL). The Court's finding of the replacement value of the JUL was based on the appraisal report attached to the Koblicks' 1994 return, primarily because the consulting engineer who had prepared it had worked for the JUL's manufacturer, and knew that the vessel was not certified by the American Board of Shipping. The Court then applied the same adjustments for depreciation that the Koblicks' expert witness testified he would have applied had he been aware of the 1994 appraisal report. The resulting fair market value was even lower than that supplied by the Service's expert at trial. On the other hand, the Court applied a smaller minority discount to the gifted stock than that claimed by the Service, observing that the stock was donated as part of an overall plan by the Koblicks and the other two minority shareholders to simultaneously transfer all stock to the charity. Under these circumstances, a large minority discount is not applicable, since the shareholders were effectively acting in concert as a single majority shareholder. Even so, the minority discount applied was still large enough to sustain the deficiency found by the Service, and the decision was entered in favor of it.