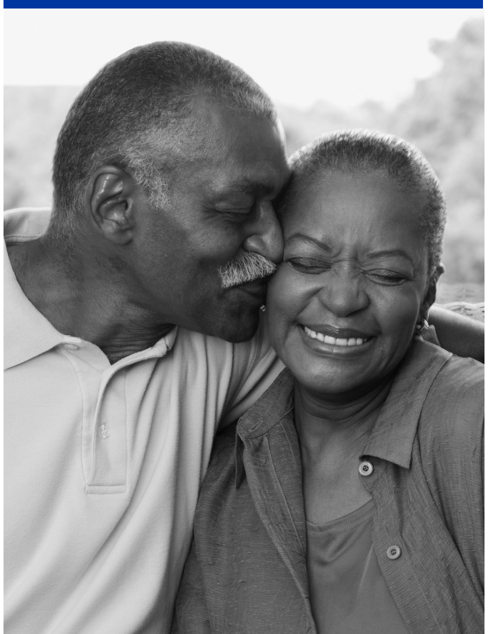
Thanks to the generous donations of corporate supporters and individuals like you, we're leading the fight for a world without cancer.

Volume XXV Issue 3
2020



Contents

American Cancer Society®
NATIONAL PROFESSIONAL ADVISOR NETWORK

Gift Planning

Briefs

For Professional Advisors

Salt in the Tax Wound

The IRS has issued final regulations on the deductibility of certain payments to state and local governments as charitable contributions (T.D. 9907). Under the *Tax Cuts and Jobs Act*, the deduction for state and local taxes is limited to $10,000. In response to the lower limit, some states established charitable funds. Taxpayers paying into the funds were entitled to a credit on state taxes that could offset, in whole or in part, their state income taxes.

In Notice 2019-12, the IRS said payments to the state charitable funds were subject to the same quid pro quo rules that apply to gifts to public charities where donors receive a return benefit. If a taxpayer makes a payment or transfer and receives or expects to receive a state and local tax credit in return, the charitable deduction must be reduced.

Under the final regulations, taxpayers must reduce the amount deducted as a charitable contribution by the amount of the state and local tax credit received or expected to be received in return. There is an exception for de minimis benefits not exceeding 15% of the taxpayer's charitable payment.

Déjà Vu With Gift Annuity Rates

The American Council on Gift Annuities recently lowered its recommended rates effective July 1. This was the second rate reduction in 2020, after new rates were introduced January 1. One-life rates now range from 3.9% at age 60 to 8.6% for age 90 and older, compared with 4.3% to 9% previously. Two-life recommended gift annuity rates have also been trimmed. Although the new rates result in lower payouts to annuitants, charitable deductions are larger. The chart compares payouts and deductions at various ages for a $10,000 gift annuity for rates in effect beginning January 1 and July 1, assuming quarterly payments and the use of a 1% §7520 rate.

Age	January 1 payout rate	Charitable deduction	July 1 payout rate	Charitable deduction
60	4.3%	$1,842	3.9%	$2,601
70	5.1	3,354	4.7	3,875
80	6.9	4,527	6.5	4,845
90	9.0	6,108	8.6	6,281

Focus On: The Incredible Shrinking §7520 Rates

For more than 30 years, deductions for split-interest gifts – charitable remainder trusts, charitable lead trusts, charitable gift annuities and remainder interests in homes and farms – have been calculated using the federal midterm rate, also referred to as the §7520 rate. Donors may use the rate for the month the split-interest gift is created or the rates for either of the two prior months, whichever is most advantageous [Code §7520(a)].

The §7520 rate has been as high as 11.2% but since May of this year has been below 1%. Low rates result in reduced deductions for charitable remainder trusts and gift annuities but generate larger deductions for charitable lead trusts and retained life estates in homes and farms. Exactly how do §7520 rates influence deductions?

Charitable remainder unitrusts

Fluctuating rates have minimal effect on deductions for unitrusts. For example, a $100,000 unitrust established by a 65-year-old donor, assuming quarterly payments, generates a charitable deduction of $44,656 using a 1% §7520 rate. The deduction for the same trust at a 3% §7520 rate is $45,053.

Charitable remainder annuity trust

Lower §7520 rates have a significantly greater effect on annuity trusts. The same trust as above produces deductions of $26,974 and $34,998 at 1% and 3% respectively. Even though both would satisfy the 10% remainder requirement of Code §664(d)(1)(D), annuity trusts are also subject to the 5% probability test of Rev. Rul. 77-374. No deduction is allowed for an annuity trust, and the trust is not a qualified charitable remainder trust, if the probability exceeds 5% that a noncharitable beneficiary of the trust will survive to the exhaustion of the trust fund.

Rev. Proc. 2016-42 enables donors to use annuity trusts in times of lower §7520 rates by allowing a trust to terminate prior to the payment of any amount that would cause the value of the corpus to drop below 10% of the initial value of the trust. Trust assets would instead be distributed to the remainder charity. The early termination, available for both inter vivos and testamentary annuity trusts, is considered a qualified contingency under Code §664(f). Trusts including the exact language provided in Rev. Proc. 2016-42 are not subject to the 5% probability test, although they must still meet the 10% remainder requirement when created.

Charitable gift annuity

Lower §7520 rates affect charitable gift annuities in two ways – one of which may be favorable for donors. As with charitable remainder trusts, the charitable deduction for a gift annuity drops along with §7520 rates. However, lower §7520 rates result in a larger share of the annual annuity being tax-free during the annuitant's life expectancy. This may be especially attractive to donors who don't itemize but are looking for higher tax-free payments. Gift annuity payments are taxed under Code §72(b), providing some ordinary income, some tax-free return of principal, and some capital gain income if the gift annuity is funded with appreciated assets. The chart shows how charitable deductions and the tax-free portion of the annuity are affected by §7520 rates. The example assumes a 75-year-old donor who funds a gift annuity with $10,000 cash. The donor receives $540 (5.4%) annually in quarterly payments. The tax-free portion continues for the donor's 12.4-year life expectancy, after which the entire amount is taxed as ordinary income.

§7520 rate	Tax-free portion	Ordinary income	Charitable deduction
1%	$449.28	$ 90.72	$4,428
3%	390.96	149.04	5,150

Charitable lead trusts

Deductions for charitable lead trusts – both unitrusts and annuity trusts – increase as §7520 rates drop. Larger deductions reduce the transfer tax cost of establishing non-grantor lead trusts. The chart shows deductions for a $100,000 lead unitrust and annuity trust paying 5% to charity, for the life of a 65-year-old donor at 1% and 3% §7520 rates, assuming annual payments to charity.

§7520 rate	Lead unitrust	Lead annuity trust
1%	$55,223	$72,874
3%	54,586	64,364

Remainder interests in homes and farms

The deduction for a gift of a home or farm with a retained life interest [Code §170(f)(3)(B)(i)] also benefits from low §7520 rates. Consider a couple, both age 65, who deed farm land valued at $100,000 to charity. They can farm the land or rent it out for income for their joint lives. At a 1% §7520 rate, their charitable deduction is $79,905; at a 3% rate, the deduction is $52,146.

Court Turns to Extrinsic Evidence

Lois DeConca left 5% of her estate to a trust for "Alzheimer's Association, New Jersey," in Denville, New Jersey. The executors asked the Superior Court to determine which charity was the intended beneficiary. When DeConca's trust was established in 2000, the Alzheimer's Association in Chicago was the beneficiary. She amended the trust in 2009, naming the New Jersey chapter in Denville. Although no such entity existed by that name, the Alzheimer's Disease and Related Disorders Association, Inc., Greater New Jersey Chapter, was located in Denville. In 2015, the New Jersey entity ended its affiliation with the national chapter and incorporated as Alzheimer's New Jersey, Inc. (ANJ). The national Alzheimer's Association had no New Jersey affiliate. DeConca's last gift to the national organization was in 2009, following which she amended her trust.

After reviewing DeConca's history with the organizations, the court determined that ANJ was not a new organization, but "really had been the New Jersey Alzheimer's entity." The court found DeConca probably intended to limit her gift-giving to New Jersey residents.

The Superior Court of New Jersey Appellate Division affirmed the probate court ruling. Where a will or trust is unclear, the doctrine of probable intent permits reformation by "searching out the probable meaning intended by the words and phrases in the will."

Donation Scheme Lacked Substantiation

Roderick and Sandra Campbell paid $50,000 for one unit of an eyeglass frames donation program. Designer eyeglass frames were bought in large quantities, held for one year and then contributed to Lions in Sight. The plan's promoter stored, insured and shipped the frames and also prepared Form 8283, signed by a qualified appraiser. The charity acknowledged the gift in late December 2007.

The IRS disallowed the carryover deduction, saying the Campbells did not comply with the substantiation requirements of Reg. §1.170A-13(c)(3)(i). The Tax Court agreed that the appraisal obtained by the couple valued the entire collection of frames, not the specific ones in the fractional interest purchased and donated by the taxpayers. The description was not in sufficient detail "to ascertain that the property that was appraised is the property" contributed, said the court.

Additionally, the letter from Lions in Sight did not qualify as a contemporaneous written acknowledgment under Reg. §1.170A-13(f)(2), the court held, because it lacked the required quid pro quo statement. Regardless of whether a taxpayer receives any consideration for the gift, the acknowledgment must include a statement that no goods or services were received in exchange, or a good faith estimate of the value of any benefit, said the court, noting this is "a mandatory requirement." *Campbell v. Commissioner,* T.C. Memo. 2020-41.

Gift Planning Briefs

IRS: Payments Okay

A decedent left his interests in several grantor-retained annuity trusts to a charitable lead annuity trust that was to make payments to a named charity. His surviving spouse is the trustee. The charitable recipient was split, pursuant to court order, into two separate foundations, with each receiving half the annuity interest in the lead trust. The trust is to last for a term of years following the decedent's death, after which principal will be distributed to the children of the decedent and his spouse. In the course of winding up the trust, the spouse anticipates legal and accounting expenses. She intends to seek reimbursement for these expenses prior to distributing the assets to the remainder beneficiaries. Both charities will receive their entire annuity amount. The IRS ruled that distribution of the remainder after all charitable distributions are made and reimbursement of legal and accounting expenses will not constitute self-dealing under Code §4941. Letter Ruling 202021001.

No Self-dealing

A decedent's estranged wife challenged his will on the grounds of lack of testamentary capacity and undue influence. She eventually entered into a settlement agreement with the bank trustee under which she receives a principal distribution from the decedent's irrevocable trust and cash equal to the present value of her lifetime interest. The balance of the irrevocable trust and marital trust passes to a charitable trust that is to distribute the net income at least annually. No income tax deduction has been or will be allowed for any assets passing to the charitable trust prior to the contemplated exchange. The wife will, however, be entitled to a gift tax charitable deduction under Code §2522(a) for property deemed as gifts from her to the charitable trust. Although she is considered a disqualified person with respect to the trust, her transfers will not be self-dealing under Code §4941. Letter Ruling 202016002.

Quick Tip

One way for grandparents to help their grandchildren with college expenses while also assisting favorite charities is through a term-of-years charitable remainder trust with sprinkling powers. The trustee can be given the power to pay income in varying amounts to different beneficiaries within the stated class, according to their changing needs [Code §674(c)]. A term-of-years charitable remainder trust can last up to 20 years and generally satisfies the 10% remainder requirement [Code §§664(d)(1)(D), (d)(2)(D)] that might otherwise cause a problem for young beneficiaries of lifetime trusts. However, an independent trustee is required in order to avoid the grantor trust rules and potential disqualification of the remainder trust [Code §§671-678].

Punishment Exceeds Crime, Court Finds

A charitable remainder unitrust was created in 2002 by Eleanor Stevens, naming her grandson Preston Marshall as the sole trustee. Preston was to pay his father a 10.4% unitrust amount for his life and, at his death, continue the payments for the life of his mother, Elaine Marshall. Preston paid the unitrust amount to his father until his death in 2006 and made payments to his mother through 2014. At that time, Elaine terminated Preston's employment with a corporation administering the Marshall family's various trusts and businesses. In return, Preston stopped making distributions from the unitrust and providing tax forms or annual accountings. In 2017, Elaine sought to enjoin Preston from withholding payments or tax reporting. She also asked the court to prevent Preston from using trust assets to pay legal fees related to the dispute. Shortly before the court hearing, Preston paid all distributions due for 2015 through 2017. The trial court granted the motion for injunctive relief but denied the request to have Preston removed as trustee.

In 2018, Elaine filed suit to have Preston held in contempt for again failing to make quarterly distributions. The trial court found him in contempt and removed him as trustee. Preston appealed, arguing that his conduct did not meet the high standards required for a finding of constructive contempt and that Elaine did not request his removal as part of the contempt proceeding. He also argued the judgment exceeded the limits of punishment for contempt and violated his due process right to a full and fair hearing.

The State of Louisiana Court of Appeals noted Preston was aware that his failure to make the payments as expected under the earlier court ruling and found his actions "intentional and without justifiable excuse." However, the trial court erred in removing Preston as trustee as punishment for contempt, naming a successor trustee and ordering him to repay unitrust funds used to pay his litigation costs. The matter was remanded to resentence Preston within the limitations imposed under state law for contempt. *Marshall v. Marshall,* 2019 CA 0879, 2019 CW 0601.

For information on charitable planning services, visit cancer.org/npan or call **1-866-332-3216** to contact your local American Cancer Society estate and gift planning professional.