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IRS Outlines SALT Treatment

With the passage of Code §164(b)(6) as part of the *Tax Cuts and Jobs Act of 2017*, the IRS acknowledges that some taxpayers have been looking for ways to avoid the $10,000 limit on deductions for state and local taxes. Proposed regulations (NPRM REG-112176-18) generally provide that quid pro quo rules apply to reduce a taxpayer's charitable deduction to the extent the taxpayer receives or expects to receive a state or local tax credit in return for a payment to a state or local tax credit program.

The IRS recently issued safe harbor rules for C corporations and pass-through entities that are regarded as separate from their owners in deducting charitable gifts for which the corporation may receive state credits. In general, if a payment is made to a Code §170(c) entity and a C corporation receives or expects to receive a tax credit reducing state or local taxes, the corporation may treat the payment as meeting the requirements of an ordinary and necessary business expense, for purposes of Code §162(a), to the extent of the credit.

Certain pass-through entities may also take advantage of the safe harbor. The IRS stressed that the safe harbor treatment was not to be construed as allowing any payment to be deductible under more than one provision of the tax code. Rev. Proc. 2019-12.

Lots Can Change in 50+ Years

A testamentary trust, created under the 1962 will of Reuben Rodecker, provided for Swedish Hospital in Brooklyn to receive a 20% share. The current purposes of Swedish Hospital differ from those in effect when Rodecker executed his will. The bank trustee asked the Surrogate's Court of New York to direct Swedish Hospital's portion to Brooklyn Hospital Center under the court's cy pres power.

The court determined that Rodecker's charitable intent would not be served unless the share of the $1 million trust passes to a charity "more nearly devoted" to Swedish Hospital's previous objectives. The court's exercise of its cy pres authority "is appropriate" in these circumstances. *In re Cy Pres*, 2018 NY Slip Op 32760(U).

Deduction Gets Dismantled

Second Chance is a charity that employs and trains disadvantaged individuals in deconstructing and salvaging building materials, which are then sold in its retail stores. Lawrence and Linda Mann entered into an agreement with the organization prior to having a home demolished. Employees from Second Chance were paid to salvage items that could be sold or recycled. To defray the wages paid to its employees, Second Chance requires donors to also provide a cash donation. The Manns paid $11,500 in cash to fund the deconstruction.

The couple claimed a charitable deduction of $675,000, based on an appraisal that presumed the structure would be moved to another site to be used as a residence. The couple also deducted $24,206 for furniture and other home furnishings given to Second Chance. The deconstruction work did not reduce the Manns' cost of eventually demolishing the home.

The IRS denied the couple's deductions. The Manns reduced the claimed deduction for the home to $313,353, which the IRS also denied. The couple eventually conceded they were not entitled to any deduction for the personal property, due to the lack of a qualified appraisal.

The U.S. District Court (MD) noted that under Maryland law, the owner of real property also owns improvements built on the land. While it is possible to sever the interest in the land and the improvements, the transaction must be properly recorded. Because the Manns failed to record the transaction with Second Chance, their donation was comparable to granting the charity the use of the house for salvage and training. The court said the transaction was not a proper conveyance of an undivided interest and the donors were not entitled to a deduction.

The court did, however, find that the Manns were entitled to deduct the cash donations, rejecting the IRS's argument that the payment was a quid pro quo for Second Chance's services. The couple received no discernible benefit from the cash contribution, said the court, adding that they made the payments to secure the ability to make a donation to a charitable cause, "which is not a specific benefit from Second Chance." *Mann v. U.S.*, 2019-1 USTC ¶ 50,145.

Court Finds Its Own Solution

Richard Rühle's 1999 will directed his executor to establish a not-for-profit corporation to administer a memorial scholarship. It was to be awarded to a male student, of specific German ancestry, enrolled in certain engineering courses offered by Brooklyn Technical High School. The funds were to be used to defray the costs of college tuition, room, board and related expenses. Rühle died in 2008.

In 2011, the executor asked the court to grant cy pres relief to establish a trust, rather than a not-for-profit corporation, citing the cost of administration that would be involved. The executor also noted the demographic and academic restrictions in the bequest could not be met. The court found a general charitable intent and permitted the will to be reformed to permit the fund to be administered by a trust. The court also broadened the pool of eligible candidates to male graduates of German ancestry on either their maternal or paternal sides.

When qualified recipients still could not be found, the court was again asked to apply the cy pres doctrine to transfer the funds to the high school's alumni foundation, to benefit current students in engineering by providing money for internships, extra-curricular programs, and college test preparation classes.

The New York Surrogate's Court declined to approve the change, saying that the proposal failed to meet several essential elements in Rühle's will and, therefore, would not accurately reflect his charitable intent. While Rühle expected the high school's role to be administrative, the proposed change would allow the school to use the funds. Further, the funds would not be used for college expenses or limited to those in engineering programs. In addition, there would be no requirement that the recipient be a male student of German ancestry – all factors that were key criteria in Rühle's will.

The court said it would invoke its cy pres authority to create a fund at the New York Community Trust, with eligible candidates to include male graduates of New York City high schools, with preference given to graduates of Rühle's high school, and having Germanic ancestry on either their maternal or paternal sides. *In re Application of A. Paul Bogaty*, 2019 NY Slip Op 50214(U).

Board Member's Law Firm Disqualified

Boca Raton Regional Hospital received approximately $75 million under Richard Blackman's revocable living trust at his death. Tim Williams, the oncologist who treated Blackman, filed suit in New York claiming the hospital and its executives were harassing him in an attempt to terminate his relationship with the hospital. Williams claimed that the hospital wanted him out of the way in order to take control of the gift, in violation of the terms of Blackman's trust. Williams was represented by the law firm of Fox Rothschild.

Jerold Glassman was a member of the law firm and also served on the board of trustees for the hospital. The hospital asked that, in light of the continuing fiduciary relationship between Glassman and the hospital, Fox Rothschild be disqualified from representing Williams in the New York case. The Surrogate's Court in New York granted the hospital's motion.

The Supreme Court of the State of New York found that, while Glassman's service on the hospital's board of trustees did not constitute a traditional attorney-client relationship, the fiduciary duty he owed to the hospital was sufficient to raise an inquiry into a potential conflict of interest in representing Williams against the hospital. As a board member, Glassman had access to confidential information regarding Blackman's gift and the ongoing dispute with Williams, the court noted. The Surrogate's Court properly exercised its discretion in granting the hospital's motion, the court said. *In re Blackman*, 2018 NY Slip Op 6528.

It's Not Charities' Turn Yet

In 1966, Frank Sawders established a trust directing that his daughter, Emily Laisy, was to receive all net income for life. If any of Sawders' four siblings were alive at Laisy's death, 10% of the income was to be paid to them for life, with the balance of the income paid in equal shares to Laisy's two children. As each income beneficiary died, the principal representing his or her share was to pass to a charitable trust for the benefit of six named charities.

Sawders' siblings all predeceased Laisy, who died in 2016. Laisy's daughter sought a declaratory judgment that she and her brother are entitled to all trust income for their lifetimes. The charities argued that Laisy's children were entitled to share 60% of the income, with the share that would have been paid to Sawders' siblings passing to the charitable trust.

The Superior Court of Pennsylvania agreed with the Orphan's Court that the charitable trust was to be funded only "upon the death of any of the income beneficiaries." The charities' right to trust principal does not vest until the deaths of Laisy's children, the court said. *In re Sawders*, 2018 PA Super 345.

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Charities "Qualified"

Under Sylvia Gelt's 1989 trust, each of her three daughters would receive income and principal distributions from respective trusts established at the death of the survivor of Sylvia and her husband. At the death of the last daughter, the trust terminates and all principal and undistributed income is to be paid to three named charities. Following the surviving spouse's death in 2016, the trustee sought to resign. The court granted the daughters' motion for summary judgment that the trustee did not have to "inform or account" to the charities because they are not qualified beneficiaries. The Florida District Court of Appeals reversed and remanded, saying such rights apply where a charity would be a distributee or permissible distributee on termination of the interests of other distributees. *Hadassah v. Melcer*, No. 4D18-623.

Delay Not "Egregious"

Five charities were to share in a testamentary trust funded with the remainder of June Johnson's estate. In 2014, when the executor sought a judicial settlement, one of the charities objected, claiming that the delay in closing the estate was grounds to disallow the executor's commissions. The Surrogate's Court denied the charity's motion. The Appellate Division of the New York Supreme Court noted that the estate was still open nearly five years after all estate assets had been liquidated. The charity had met its burden of showing prima facie entitlement to summary judgment disallowing the executor's commissions due to the extended delays. However, the court said it could not say that the Surrogate's Court erred in finding an issue of fact regarding whether the delay in distributing the estate assets was "sufficiently egregious" to warrant disallowance of the commissions. *In re Estate of Johnson*, 2018 N Y Slip Op 08219.

Quick Tip

A trust does not qualify as a charitable remainder trust if any amount, other than the annuity or unitrust amount, may be paid by the trust to or for the use of any person other than a charity [Reg. §§1.664-2(a)(4), 3(a)(4)]. If the trustee is given all the powers, duties, and responsibilities conferred by the state of the grantor's domicile, the trust may not qualify, even if the trustee does not, in fact, invade trust corpus [Rev. Rul. 77-58]. For example, a trust may have the power under state law to invade corpus to pay funeral expenses of the donor or surviving spouse. A simple way to avoid disqualification of the trust is to include language precluding the trustee from having any power under state law that would prevent the trust from qualifying as a charitable remainder trust.

Mom Had Testamentary Capacity

Several years after losing her son in the Pan Am bombing over Lockerbie, Scotland, Judith Dornstein Loe received a wrongful death settlement. When she drafted her will in 2011, she left a specific bequest to her "doorman and friend," with the balance of her approximately $4 million estate going to Brown University, her son's alma mater, to establish a scholarship in his name. Loe's two surviving children, who were expressly disinherited "for reasons best known to them," objected to probate of the will. The children claimed Loe lacked the capacity to execute her will.

Loe's children alleged that she had been a patient in a mental health facility sometime after her divorce from their father, although they presented no details or proof, noted the Surrogate's Court of New York. Her relationship with her children was "emotionally and geographically distant," although the court found it unclear whether it was Loe's choice or her children's. There was also evidence that Loe was dependent on pain-killers during much of her adult life and, at some point, dependent on alcohol.

The court said that the mental capacity for creating a valid will "is less than that required to take any other type of legal step." A testator must have a rudimentary understanding of the nature and extent of her property, the content of the will disposing of the assets and an awareness of those who would ordinarily be the natural objects of her bounty. The fact that Loe expressly disinherited her children was evidence that she recognized them as the natural objects of her bounty, said the court. Testimony from her doctors, lawyers, banking advisors and the custodial staff where she resided indicated that, although Loe was chronically depressed, she had the necessary testamentary capacity at the time the will was drafted. The court granted the executor's motion for summary judgment and dismissed the children's objections to probate of the will. *In re Estate of Loe*, 2019 NY Slip Op 30310(U).

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