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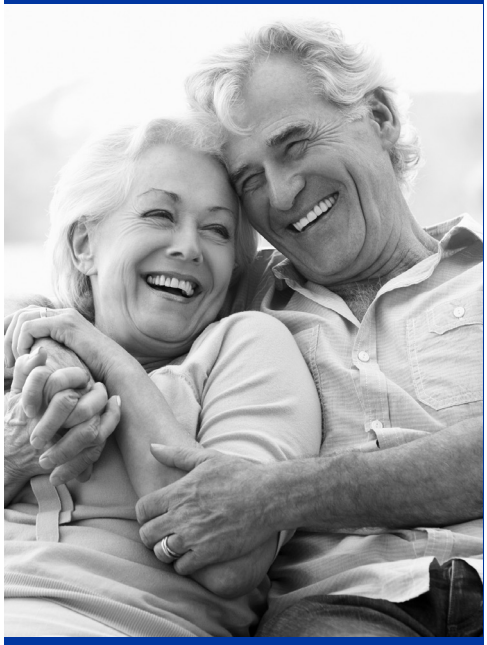

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For Professional Advisors

Payments Were Compensation, Not Gifts

Several years after forming the Bethel Aram Ministries (BAM), Frederic and Elizabeth Gardner took vows of poverty and transferred their assets to BAM. The couple then assisted more than 300 others in setting up similar corporations, which they claimed owed no tax. "Donations" for their services were given to BAM.

BAM's net taxable bank deposits for 2002 to 2004 were about $100,000, $218,000 and $235,000 respectively. The Tax Court agreed with the IRS that these amounts constituted taxable income to the Gardners, saying the funds were compensation, not gifts to BAM. The court noted that the couple used BAM accounts to pay personal expenses and "exercised complete dominion and control" over the accounts.

The US Court of Appeals (9th Cir.) agreed, saying the couple's vows of poverty were an attempt to "disguise their enjoyment of their personal income." They retained complete control over the money they earned and cannot avoid the tax by an arrangement that shifts the receipt to a charity, said the court. *Gardner v. Commissioner*, No. 13-72699.

Unitrust Can Be "Torn Asunder"

A husband, using his own assets, established a charitable remainder unitrust for his and his wife's joint lives. Now going through a divorce, they propose to divide the trust into two separate trusts. Each spouse would be the sole income beneficiary of his or her own trust, which would distribute to charity at his or her death. The IRS ruled that because the division of the trust is incident to a divorce, no gain or loss would be realized under Code §§61 and 1001. The trust division will constitute a transfer of a portion of the husband's interest to his wife, who will take a pro rata share of his basis and have the same holding period. The transfer is made for full and adequate consideration and will not be subject to gift tax under Code §2501. The value of trust assets will be included in each ex-spouse's gross estate, but the remainder interests will qualify for charitable deductions under Code §2055, ruled the IRS. Letter Ruling 201648007.

Scheme Now a "Listed Transaction"

Charitable deductions are allowed for qualified conservation contributions – defined in Code §170(h) as contributions of real property interests to qualified organizations exclusively for conservation purposes. The restrictions must be granted in perpetuity [Code §170(h)(2)(C)]. The IRS has now labeled certain conservation easements as listed transactions [Reg. §1.6011-4(b)(2)], meaning participants will have to make disclosures when claiming charitable deductions.

The IRS said it became aware of promoters offering prospective investors interests in multi-layered partnerships or other pass-through entities for the purpose of claiming charitable deductions. Promotional material suggests that investors may be entitled to deductions that equal or significantly exceed the amount of the investment. Promoters obtain an appraisal greatly exceeding the value of the easement, based on "unreasonable conclusions about the development potential of the real property." A conservation easement is then contributed to a tax-exempt entity. Investors, some of whom have held their interests for a year or less, nevertheless treat the contribution as long-term capital gain property, based on the pass-through entity's holding period.

The IRS said that in addition to challenging the valuation of the easements, it has identified transactions similar to these as "listed transactions," which must be disclosed by the taxpayers. This applies to transactions entered into on or after January 1, 2010. Notice 2017-10.

Conservation Easement Lands in Rough

Two years after ceasing operation of a golf course, PBBM contributed a conservation easement over 234 acres to the North American Land Trust (NALT). Three days later, the course was sold for $2.3 million to a homeowners association. On its partnership tax return, PBBM claimed a charitable deduction of $15,160,000 for the easement, which the IRS disallowed.

The Tax Court agreed with the IRS that the value of the easement was only $100,000, but added that PBBM was not entitled to any deduction, on other grounds. The court found that the conservation easement restrictions were not in perpetuity, as required under Code §170(h)(5)(A). In the event of the easement's extinguishment due to a judicial proceeding, NALT would be entitled to an amount determined by a formula. The court noted that it was possible that NALT would not receive the minimum amount required under Reg. §1.170A-14(g). The interest would not be protected in perpetuity and PBBM is not entitled to a charitable deduction.

In addition, a significant portion of the property subject to the easement is inaccessible to the general public. Code §170(h)(4)(A)(iii) requires that, where the conservation purpose is for the preservation of open space, the land must be for the scenic enjoyment of the general public. Only a small portion of the property is even visible from off the property, and the general public is not allowed to drive to the park. The Tax Court concluded that PBBM was not entitled to a deduction, noting that if PBBM thought the property was worth more than $15 million, it would not have sold it for only $2.3 million. *PBBM-Rose Hill, Ltd. v. Commissioner*, 2016ARD 201-1.

Rules Are Rules

Stewart Oatman told the Tax Court that although he lacked contemporaneous written acknowledgments for his $7,950 charitable deduction, he thought the *Cohan* rule applied [*Cohan v. Commissioner,* 39 F2d 540]. The court noted that since passage of the Pension Protection Act of 2006, strict adherence to the substantiation requirements of Code §170(f)(8) apply. For cash contributions of less than $250, a bank record or written communication is required. For contributions of $250 or more, the donor must obtain a contemporaneous written acknowledgment from the donee. *Oatman v. Commissioner*, T.C. Memo. 2017-017.

Charity Has No Standing, Court Has No Jurisdiction

Avis Chase's will provided that, at the death of the last named annuitant, the residue of her estate was to pass in fee simple to the YWCA of Philadelphia. The YWCA was to maintain cottages previously owned by Chase for the "rest and recreation" of members. In the event it could not accept the gift, the residue was instead to pass to the YWCA of Boston. The Orphan's Court ordered title to the cottages to pass to the YWCA of Philadelphia in 1994, at the death of the last annuitant.

In 2012, the YWCA of Boston filed suit seeking ownership of the cottages, saying that by failing to remain affiliated with the YWCA and to provide the cottages for its members, the Philadelphia organization did not satisfy the terms of Chase's will.

The Appeals Court of Massachusetts noted that the YWCA of Philadelphia had already taken absolute title to the cottages. Because there is no trust in existence, the YWCA of Boston has no standing to claim status as a proposed beneficiary of an implied or resulting trust. The court found that there is no estate in probate over which the court can exercise jurisdiction. *Young Women's Christian Association of Boston v. Young Women's Christian Association of Philadelphia*, 15-P-1594.

One Thumb Up, One Thumb Down

Brian Holman's will left $1 million each to Cabrini Medical Center in support of its hospice and to St. Rose's Free Home, Servants of Relief for Incurable Cancer. If an organization was not in existence or merged into another entity at Holman's death, the bequest was to lapse. The residue of Holman's $18 million estate was to pass to charities selected by his executor.

When Holman died in 2013, Cabrini was in the final stages of a bankruptcy liquidation. It had ceased functioning as a hospital in 2008. Servants of Relief originally operated two facilities – St. Rose's Free Home and Rosary Hill Home. St. Rose's closed in 2009, but Rosary Hill remains in operation, carrying out the same functions.

The executor of Holman's estate asked the Surrogate's Court of New York County to determine how the two bequests should be handled. Cabrini argued that because it was still a qualified charity, it was entitled to the bequest. The court noted prior cases holding that the cessation of charitable functions, whether or not accompanied by bankruptcy, defeated a claim to a bequest. Cabrini had not merged with another organization, so the bequest lapses.

The functions of St. Rose's have been assumed by Rosary Hill, the court found. Because there has, in essence, been a merger, under the terms of Holman's will, the bequest does not lapse and should be paid to Rosary Hill. *In re Duckworth*, 2016 NY Slip Op. 32278(U).

Gift Planning Briefs

Large Grant "Unusual"

One or more unusually large grants or contributions can cause an organization to lose its status as "publicly supported" under Code §170(b)(1)(A)(vi). There is an exclusion for "unusual grants" in determining whether a charity meets a 33 1/3% of support test. A charity has received a multi-year grant to help end teen homelessness from a private foundation that has no prior connection to the charity. The IRS said that the grant would be from a disinterested party and is "unusual or unexpected with respect to the amount," within the meaning of Reg. §1.509(a)-3(c)(4). The charity's status as publicly supported will not be affected, the IRS ruled. Letter Ruling 201704019.

No Enforcement Authority

An estate that owned a portion of land encumbered by a scenic conservation easement asked the Superior Court of Maine to require enforcement of the easement provisions by the land trust that held the easement. The Town of Cumberland, which owned another part of the underlying land, planned to construct a parking lot and to allow use of the property for a public beach. The land trust determined that the use was allowed under terms of the easement grant. The Maine Supreme Judicial Court agreed with the Superior Court that the estate lacked standing to enforce the easement, saying the easement did not authorize enforcement by one property holder against another. *Estate of Robbins v. Chebeague & Cumberland Land Trust*, 2017 ME 17.

Quick Tip

Most charitable remainder trusts are created by individuals, but there's nothing to prevent a corporation from establishing a trust. Code §664 merely requires that trust income be paid to at least one "person" who is not a charity. The Code §7701 definition of "person" includes partnerships, associations, companies and corporations. A company that owns a highly appreciated asset could fund a charitable remainder trust and retain income from the trust. Capital gains tax (at corporation rates) would be avoided. The company would be entitled to an income tax charitable deduction that can be taken up to 10% of taxable income. Trust payments made to a corporation, trust, estate, partnership, association or company must be for a term of no more than 20 years [Reg. §§1.664-2(a)(5), -3(a)(5)].

Bequests Can Extend Outside US Borders

The estate of a US citizen and resident was entitled to a charitable deduction for a bequest to an organization located in a foreign country. The charity, founded more than 40 years ago to improve the quality of life of the handicapped and elderly, was subject to a code of ethics and good governance that prohibits directors or employees from benefitting from any of the organization's net earnings. The charity may not engage in or use any of its assets for lobbying or for political activities. The IRS was asked to rule on whether the estate was entitled to a charitable deduction under Code §2055(a). The IRS ruled that because the foreign charity prohibits private inurement and does not engage in lobbying or other political activities, the bequest is deductible (Letter Ruling 201702004).

Reg. §20.2055-1(a)(4) provides that the estate tax deduction is not limited to transfers to domestic corporations or associations, or to trustees for use within the US. The private foundation rules of Code §4948 do, however, provide that no deduction is allowed for a bequest to a foreign organization that engages in prohibited transactions [Code §4948(c)(2)].

The rules governing the estate tax deduction differ from those for the income tax deduction. In general, an income tax deduction is allowed only for organizations "created or organized in the US." Gifts may be made to US charities that have operations in foreign countries where the money is used to further the charitable goals of the US charity. The US charity must maintain control over the use of the funds and cannot serve as merely a conduit for the transfer of funds to a foreign charity [Revenue Rulings 63-252 and 66-79].

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