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Participant Guide

The Sometimes Complicated World of Charitable Giving

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Presents

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By

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* * * * * * * * *

TABLE OF CONTENTS

Page

The Sometimes Complicated World of Charitable Giving

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I. An Overview of Tax Deductions Available for Contributions to or for Charity

A. Limitations on Deductibility

The amount of the income tax charitable deduction allowed for a contribution to a charitable organization depends in part on the type of organization to which the gift is made and in part on the type of property being contributed.

1. <u>Percentage Limitations</u>. The amount deductible depends on whether the organization is a public charity or a private foundation. Contributions, whether to private foundations or public charities, that exceed the percentage limitation in the year of the gift may be carried over for five succeeding taxable years. IRC §§ 170(b)(1)(B), (b)(1)(D)(ii). Any unused carryover is lost at the donor's death.

2. <u>Public Charities</u>. Public charities include churches, educational organizations (e.g., high schools, colleges and universities that are publicly supported), hospitals, governmental units, and organizations that generally receive a substantial amount of their support from governmental units or from the general public. IRC §§ 170(b)(1)(A)(i)-(vi), (viii).

- <u>Fifty Percent Limitation</u>. The income tax charitable deduction for gifts to public charities of cash and ordinary income property generally is limited to 50% of the donor's contribution base (generally, the donor's adjusted gross income ("AGI")). IRC § 170(b)(1)(A).

- <u>Thirty Percent Limitation</u>. The income tax charitable deduction for a gift to a public charity of long-term capital gain property (*e.g.*, stock held for more than one year) is limited to 30% of the donor's AGI. Additionally, a contribution "for the use of" a public charity is deductible only to the extent of 30% of the donor's AGI (versus a 50% limitation on contributions "to" a public charity). IRC § 170(b)(1)(B); Treas. Reg. § 1.170A-8(a)(2). A contribution is made "for the use of" a public charity if property is transferred in trust and is held for the continuing benefit of the charity. Treas. Reg. § 1.170A-8(a)(2).

- <u>Long-Term Capital Gain Property</u>. In the case of contributions to a public charity of long-term capital gain property, a donor can avoid the 30% limitation by electing to limit the income tax charitable deduction to the donor's cost basis in the property (the deduction generally is equal to the fair market value of the property, as discussed below). If the election is made, then the contribution is subject to the 50% limitation rather than the 30% limitation. IRC § 170(b)(1)(C)(iii). The election must be made by attaching a statement to the donor's income tax return for the year to which the election applies.

- Unrealized Capital Gains. Unrealized capital gains generally are not subject to income tax when a gift of appreciated assets is made to a public charity, even though they may be part of the income tax charitable deduction.

3. Private Foundations. A private foundation generally is a charitable organization that has been established by an individual donor or family. A charitable organization is classified as a private foundation unless it requests and receives a ruling that it is a public charity.

- Thirty Percent Limitation. The income tax charitable deduction for gifts of cash or ordinary income property to private foundations generally is limited to 30% of the donor's AGI in the year of the contribution. IRC § 170(b)(1)(B).

- Twenty Percent Limitation. The income tax charitable deduction for a gift of long-term capital gain property to a private foundation generally is limited to 20% of a donor's AGI in the year of the contribution. IRC § 170(b)(1)(D)(i).

- The maximum deduction allowable for contributions to a private foundation must be determined after the donor's contributions to public charities are considered IRC § 170(b)(1)(A). For example, as noted above, the deduction for contributions to public charities of cash and ordinary income property generally is limited to 50% of donor's AGI. Therefore, the maximum deduction allowable for a contribution of cash to a private foundation would be equal to the lesser of (i) 30% of donor's AGI or (ii) the amount of donor's 50% limitation remaining after donor's contributions to public charities are considered.

4. Valuation Limitations. The value of the property that is deductible depends on the nature of the property and may depend on whether the gift is made to a public charity or a private foundation.

- Ordinary Income Property. The allowable deduction for a contribution of ordinary income property, such as stock held for less than one year, is reduced by the amount of ordinary income that would have been realized had the contributed property been sold at its fair market value at the time of the contribution. IRC § 170(e)(1); Treas. Reg. § 1.170A-4(b)(1). This means that the income tax deduction is limited to the donor's cost basis in the property. This rule applies regardless of the identity of the charitable donee (*i.e.*, public charity or private foundation).

- Long-Term Capital Gain Property. Generally, the amount of a charitable deduction for a contribution of long-term capital gain property is the property's fair market value. Treas. Reg. § 1.170A-1(c)(1). For example, securities that are held for more than one year are deductible for income tax purposes at their full fair market value. The deduction for contributions to a private foundation of appreciated long-term capital gain property, however, must be reduced by the amount of long-term capital gain that would have been realized had the property been sold at its fair market value at the time of the contribution, so the donor receives a deduction in an amount equal to the donor's basis in the property. There is an exception for contributions of "qualified appreciated stock" to a private foundation, which are not subject to the long-term capital gain reduction. When the exception applies, the donor receives a deduction for the stock's full fair market value. Qualified appreciated stock is stock for which market quotations are readily available on an established securities market and that is long-term capital gain property. IRC § 170(e)(5).

- Tangible Personal Property. The deduction for gifts of tangible personal property (*e.g.*, works of art, books, antiques) held long term is the full fair market value of the property if use of the property is related to the charity's exempt function. IRC § 170(e)(1)(B)(i); Treas. Reg. § 1.170A-4(b)(3). If the gift is not related to the charity's exempt function, the deduction must be reduced by the amount of gain that would have been long-term capital gain if the property were sold at its fair market value (*i.e.*, the deduction is limited to the donor's basis). IRC § 170(e)(1)(B). Gifts of tangible personal property held short term are deductible at their cost basis. IRC § 170(e)(1)(A).

5. Estate and Gift Tax Charitable Deductions. IRC § 2055(a) allows an estate tax charitable deduction, and IRC § 2522(a) allows a gift tax charitable deduction, for transfers to charitable organizations. The charitable deductions for income, estate and gift taxes cover the same basic areas, although they are not identical. For example, the estate and gift tax charitable deductions are not limited to gifts for use in the United States or to domestic corporations, as is the case with the income tax deduction. Treas. Reg. §§ 20.2055-1(a), 25.2522(a)-1(a). Therefore, it is important to consult the applicable IRC sections to determine the exact parameters of the desired deduction.

Unlike the rules governing the income tax charitable deduction, no distinction is made for estate and gift tax charitable deduction purposes among the types of qualified donees or between long-term and short-term capital gain property. Thus, none of the percentage and valuation limitations on the income tax charitable deduction under IRC § 170 apply to the estate tax or gift tax charitable deduction. In this sense, the gift tax and estate tax charitable deductions are "unlimited." For estate tax purposes, however, charitable deduction property must be property that was included in the decedent's gross estate, and the amount of the deduction cannot exceed the value of the transferred property required to be included in the gross estate. IRC § 2055(d). Generally, the value of the gift or estate tax deduction is the value of the property on the date of gift or on the date of death, as the case may be.

A charitable deduction may be denied if the charitable gift is indefinite or discretionary. A deduction will not be disallowed, however, if the testator designates a third party to select the charitable organization recipients and to allocate the bequest among them. See Rev. Rul. 81-20, 1981-1 C.B. 471.

B. Charitable Set Aside Not Too Remote As To Be Negligible for Purposes of IRC § 642(c) Given Ongoing Potential for Will Challenge

Estate of John D. DiMarco v. Commissioner, T.C. Memo 2015-184 (September 21, 2015).

1. Factual Background. John DiMarco ("Decedent") died testate on December 16, 2008 as a resident of New York. Decedent was single and left no children. Decedent's Will was executed in Connecticut on February 25, 1983 and witnessed by three individuals. Article I directed the Executor to pay expenses, funeral costs, taxes and debts other than real property encumbrances. Article III of Decedent's Will conveyed his residuary estate to the church Decedent regularly attended at his death but did not specify whether gross income was to be set aside or placed into a separate account. Decedent's father, who was named as Executor, predeceased Decedent, and Decedent's Will designated the "pastor at [Decedent's] church" as successor Executor. At his death, Decedent regularly attended two churches. Accordingly, each pastor assumed duties as Co-Executor.

In May 2009, Sandra DiMarco Solomon, Decedent's heir-at-law, met with attorney Frederick Killeen ("Killeen") to determine whether she and other heirs had any claims against Decedent's estate. In August 2009, she met with additional heirs to notify them of the possibility. The Executors filed a petition for probate on October 26, 2009 naming seven individuals as "distributees," all of whom were Decedent's paternal cousins, despite no specific devises in the Will to any of them. Killeen entered an appearance on behalf of the paternal heirs in February 2010. Shortly thereafter, the New York State Assistant Attorney General entered an appearance on behalf of the charitable beneficiaries. Preliminary letters testamentary were then issued to the two pastors.

The Executors amended the petition for probate on October 25, 2010, naming Decedent's maternal heirs. The following day, a guardian-ad-litem was appointed to represent any unascertained heirs. In the guardian's December 2010 report, he expressed concern over the Will's ambiguous and vague provisions. Meanwhile, the guardian initiated a genealogical search for additional hears, but the search obtained no results and the guardian-ad-litem was discharged.

Killeen wrote a letter to his clients in April 2011 urging them to settle with the Estate. A settlement conference was held March 22, 2012, at which time Decedent's Executors prepared a proposed distribution accounting for the estates expenses, distributions to beneficiaries and executors' commissions. The parties reached a settlement during the conference, which provided that Decedent's heirs would share equally in 1/3 of the Estate. The remaining 2/3 of the Estate would be equally distributed to each church. The settlement was stipulated on record in late April 2012, and Decedent's Will was admitted to probate on May 1.

A second settlement was reached in December 2012 in which Decedent's heirs agreed to pay their own attorneys' fees from the assets they received, and the Executors would share 1.5

times the statutory commission. Each heir executed a receipt and release which was then filed with the court reflecting the amount received and date of payment. The settlement was approved by the court on or about January 28, 2013.

The 2010 Form 1041 for Decedent's estate was submitted April 19, 2012 and claimed a deduction of $314,942 as a charitable set aside under IRC § 642(c)(2). In October 2013, the IRS denied the deduction in its entirety and issued a deficiency notice in the amount of $108,588.

2. **<u>Analysis</u>**. IRC § 642 provides that an estate may take an income deduction for income that is "permanently set aside for a purpose specified in section 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes." To receive the deduction, the charitable contribution must be from the estate's gross income, the governing instrument's terms must make the charitable contribution, and the contribution must have been set aside for a charitable purpose. Assets are "permanently set aside" when income is appropriated and dedicated finally such that no changes could impair the character of the action. The IRS contended that Decedent's assets were not permanently set aside under this definition.

The estate, therefore, had to prove that the likelihood the amount set aside could go to non-charitable beneficiaries was "so remote as to be negligible." This standard has been interpreted to mean, "[a] chance which persons generally would disregard as so highly improbable that it might be ignored with reasonable safety in undertaking a serious business transaction." (Citing *Estate of Belmont v. Commissioner*, 144 T.C. 84, 92 (2015)). The Tax Court found that the numerous, ongoing legal controversies present at the time the estate's income tax return was filed should have alerted the parties that there was still a possibility assets could go to entities or individuals other than the churches.

Specifically, the Tax Court pointed to Killeen's appearance on behalf of potential heirs in February 2010 and the attorney general's appearance on behalf of charitable beneficiaries, whose interests conflicted with those of the individuals represented by Killeen, as evidence that too many contingencies regarding the charitable contributions existed during the tax year in question. Furthermore, the Tax Court found it illuminating that the first settlement regarding distributions was not finally settled until January 28, 2013 when the heirs agreed to pay their own attorneys' fees and filed receipts and releases with the courts. This settlement came nine months after the Estate filed its income tax return.

The estate argued that the settlement meeting on March 22, 2012 was evidence that prolonged controversy was unlikely. The Tax Court dismissed this argument stating that the first settlement was still not approved until one week after the return was filed. Therefore, until such time, anyone could have brought another challenge. Further still, the first settlement only allocated the beneficial interests, but additional legal fees could have arisen that would have reduced the amount ultimately distributed to charitable beneficiaries.

II. Trusts and Other Mechanisms by Which to Make Charitable Gifts

A. Net Income with Makeup Charitable Remainder Unitrust Fails to Qualify for Charitable Deduction

Estate of Schaefer v. Commissioner, 145 T.C. No. 4 (July 28, 2015)

Arthur Schaefer ("Decedent") created the AES Family Limited Partnership (the "Partnership") in November 2004. Decedent transferred 3.83% of the Partnership to each of his sons, Ronald and Benjamin, and transferred the remaining 92.34% to Schaefer Investment, LLC along with a money market checking account. Decedent also created two charitable remainder trusts (the "Trusts") and transferred a 49.5% nonvoting interest to each of the Trusts. Decedent was the income beneficiary of the Trusts during his lifetime, and Ronald and Benjamin would each become income beneficiaries of one of the Trusts, respectively, following Decedent's death.

The governing instrument of each Trust required that the Trustee distribute the lesser of the annual Trust income or a fixed percentage of the fair market value of the Trust assets, valued annually, to the income beneficiary. In any year the income exceeded the fixed percentage, the Trustee could also distribute the additional income to Decedent's sons to make up for years in which the fixed percentage was greater than the annual income. These provisions qualified the Trusts as net income with makeup charitable remainder unitrusts (commonly known as NIMCRUTs) pursuant to IRC § 664(d)(3). The Trusts were to terminate upon the later of the date of death of the last income beneficiary or twenty years from the date the Trusts were funded.

In preparing the federal estate tax return, the Executor reduced the amounts reported as transferred to the Trusts by the amounts the Executor deemed charitable. The Executor did not claim a charitable deduction for the Trusts. The IRS argued that the Executor improperly calculated the charitable remainder and asserted that, for the estate to receive the deduction, the remainder must be calculated by reference to the fixed percentage, which would have resulted in a less than 10% remainder interest attributable to each Trust – thus not satisfying the requirements of IRC § 664(d)(2). Decedent's estate claimed that the charitable remainder should have been calculated by using the anticipated net income from the Trusts, determined by using the IRC § 7520 rate, so long as the income distribution was at least 5% of the net fair market value of the assets annually.

Pursuant to IRC § 664(d)(2), the remainder interest of a charitable remainder unitrust must be at least 10% of the net fair market value of the property contributed to receive a charitable deduction. Treas. Reg. § 1.664-4(a) provides that the charitable remainder interest must be computed using the life contingencies of the beneficiaries, the IRC § 7520 rate and the assumption that the fixed percentage is distributed in accordance with the payout sequence of the trust. The parties disagreed regarding whether the regulations address the calculation of the remainder interest for a NIMCRUT. In Rev. Rul. 72-395, 1972-2 C.B. 340, and Rev. Proc. 2005-54, 2005-2 C.B. 353, the IRS stated that the remainder interest of a NIMCRUT is valued using the fixed percentage stated in the trust instrument, regardless of the fact that distributions are limited to trust income.

The Tax Court noted that both the IRS' approach and the estate's approach were flawed. The IRS' approach typically resulted in an undervaluation of the charitable remainder interest, while the estate's approach had no basis in the statutes or regulations. Pursuant to IRC § 664(e):

> For purposes of determining the amount of any charitable contribution, the remainder interest of a charitable remainder annuity trust or charitable remainder unitrust shall be computed on the basis that an amount equal to 5 percent of the net fair market value of its assets (or a greater amount, if required under the terms of the trust instrument) is to be distributed each year.

The Tax Court found the language of IRC § 664(e) ambiguous because it does not specifically state whether the "5 percent of net fair market value" amount is a "sum certain" as reflected in IRC § 664(d)(1) (addressing charitable remainder annuity trusts) or whether such amount is a "fixed percentage" of the net fair market value as reflected in IRC § 664(d)(2) (addressing charitable remainder unitrusts).

As a result of the ambiguity, the Tax Court looked to the legislative history of IRC § 664(e) to determine the proper computation method. Ultimately, the Tax Court relied heavily on the Senate report that added IRC § 664(e) to the IRC. The Senate report stated that the remainder interest was to be determined by assuming that the beneficiary will receive the greater of either (1) 5% of the net fair market value or (2) the amount provided in the trust instrument. The Tax Court stated that "[t]he Senate report makes clear that where there is a net income provision, the distribution amount or rate set forth in the trust instrument is to be used for valuation purposes even though distributions may be limited by net income."

The Tax Court also found Treas. Reg. § 1.664-4(a)(3) ambiguous. This regulation discusses the value of the remainder interest in a charitable remainder unitrust. However, the Tax Court found that Rev. Rul. 72-395 and Rev. Proc. 2005-54 were consistent with the legislative history of IRC § 664(e). Both rulings found that the NIMCRUT remainder interest should be valued by using the amount provided in the trust instrument, even where distributions are limited by net income. Accordingly, the Tax Court held that the remainder interests for Decedent's Trusts should be valued using the fixed percentage provided in the trust instrument because it represented the higher distribution amount. As a result, the Trusts did not qualify for a charitable deduction because less than 10% of the initial fair market value contributed to the Trusts would pass to charity upon termination.

B. Donor-Advised Funds

A donor-advised fund is a separate fund, but not a separate entity, within a public charity (called the "sponsoring organization"). The donor's contributions are accounted for separately within the public charity's records, and often the donor is permitted to "name" a fund after the donor or the donor's family, thus providing the name recognition benefit of a private foundation. Not only may traditional public charities operate donor-advised funds, but some charitable entities, such as those established by mutual fund companies, are formed to solely administer donor-advised funds. Rothschild & Fox, "What Every Estate Planner Needs to Know About

Tax-Exempt Organizations and Charitable Gift Planning," 46TH ANNUAL HECKERLING INSTITUTE ON ESTATE PLANNING (2012).

The public charity is the legal owner of the assets within the donor-advised fund. Thus, the public charity controls the gift in all respects, including the right to control investments and to control the disposition of the donated funds for charitable purposes. The donor or his or her designees, however, generally exercise the privilege of making nonbinding recommendations to the governing body suggesting which public charities should receive grants from that particular fund. Control is sacrificed because the donor's recommendations can be advisory only, and the right to advise generally is limited by the life spans of the advisors. Although the public charity must retain control over investments, donors may be given the option of selecting types of investments within the overall investment portfolio of the public charity.

Under IRC § 4966(c)(2), a donor-advised fund is defined as a fund: (1) which is separately identified by reference to contributions of a donor or donors; (2) which is owned and controlled by a sponsoring organization; and (3) with respect to which the donor is allowed to offer advice regarding distributions from and investments in the fund. A private foundation may not hold a donor-advised fund. IRC § 4966(d)(1)(B). Also, the sponsoring organization must make distributions to more than one organization. IRC § 4966(d)(2)(B)(i).

Gifts to donor-advised funds, unlike gifts to private foundations, receive the maximum charitable income tax benefits available to a charitable donor. For example, deductions for contributions of cash and ordinary income property to a donor-advised fund are limited to 50% of the donor's AGI, whereas deductions for such contributions to a private foundation are limited to 30% of the donor's AGI. Further, a contribution to a private foundation of appreciated property (other than "qualified appreciated stock," IRC § 170(e)(5)(B)) is limited to the income tax basis of such property, a limitation that does not exist with respect to contributions to a donor-advised fund.

Donor-advised funds are easier to create than a private foundation. Usually, the donor needs only to enter into an agreement with the public charity. A private foundation must be established as a separate tax-exempt entity under state law and apply to the IRS for tax-exempt status. Rothschild & Fox, *supra*. Because a donor-advised fund is merely a bookkeeping entry within the records of the public charity, neither the donor nor any other person is required to keep records or prepare separate tax returns. Such procedures are required with respect to a private foundation. Instead, the donor-advised fund is reported as part of the public charity's assets on its Form 990.

Some restrictions similar to those imposed on private foundations are imposed on donor-advised funds, such as the rules regarding excess business holdings. IRC § 4943(e)(1). Furthermore, donors with respect to donor-advised funds may be subject to intermediate sanctions if participating in excess benefit transactions. IRC § 4958. However, donor-advised funds are not subject to IRC § 4942, which, in general, requires a private foundation to distribute at least 5% of its earnings each year. Donor-advised funds are also not subject to the excise tax under IRC § 4940 imposed on a private foundation's investment income. Rothschild & Fox, *supra*.

Under IRC § 4966, an excise tax of 20% is imposed on the sponsoring organization on each "taxable distribution" from a donor-advised fund. In addition, a 5% excise tax may be imposed on a fund manager of the sponsoring organization if such distribution is approved by such fund manager, subject to a maximum tax of $10,000 for each taxable distribution. A "taxable distribution" includes any distribution to an individual for any purpose. In contrast, a private foundation can make distributions to individuals under certain circumstances. IRC § 4945(g). A taxable distribution also includes most other distributions for a non-exempt purpose.

Under IRC § 4967, another excise tax may be imposed on a fund manager due to the receipt of incidental benefits by the donor or other related individuals or entities.

III. IRA Charitable Rollover Made Permanent

Protecting Americans From Tax Hikes Act, 2016 Consolidated Appropriations Act, Division Q, P.L. 114-113 (December 18, 2015) (PATH Act)

The PATH Act makes permanent IRC § 408(d)(8), which allows individuals age 70½ and older to distribute up to $100,000 in a given taxable year from their IRAs to charities and have the amount so distributed excluded from gross income.

IRC § 408(d)(8) applies only to "qualified charitable distributions," which are any distributions out of an IRA directly to an organization described in IRC § 170(b)(1)(A) (other than an organization described in IRC § 509(a)(3) or a donor advised fund (as defined in IRC § 4966(d)(2)). Qualified charitable distributions do not include distributions from employer-sponsored retirement plans, including SIMPLE IRAs and simplified employee pensions ("SEPs").

The exclusion applies only if a charitable contribution deduction for the entire distribution otherwise would be allowable, determined without regard to the generally applicable percentage limitations. IRC § 408(d)(8)(C). The Technical Explanation of House Amendment #2 to the Senate Amendment to H.R. 2029, the "Protecting Americans from Tax Hikes Act of 2015," Prepared by the Staff of the Joint Committee on Taxation, JCX-144-15 (the "JCT Report"), elaborates by stating that, "for example, if the deductible amount is reduced because of a benefit received in exchange, or if a deduction is not allowable because the donor did not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution." JCT Report, p. 19.

Under IRC § 408(d)(8)(D), a qualified charitable distribution is treated as consisting, first, of what otherwise would have been taxable distributions up to the aggregate amount that would have been includible in gross income if the aggregate balance of all IRAs having the same owner were distributed during the same year. The apparent purpose of this ordering rule is to ensure that qualified charitable distributions will contain all of the distributions that would have been taxable without this new provision, leaving as much as possible of the nontaxable distributions to be distributed to noncharitable recipients. In determining the amount of subsequent IRA distributions includible in income, proper adjustments are to be made to reflect the amount treated as a qualified charitable distribution. IRC § 408(d)(8)(D).

Distributions that are excluded from gross income by reason of the new provisions are not taken into account in determining the deduction for charitable contributions under IRC § 170. IRC § 408(d)(8)(E). The provisions do not effect distributions that are not qualified charitable distributions, the determination of whether an IRA qualifies as an IRA or the treatment of any noncharitable distribution for minimum distribution purposes.

IV. Issues Associated with Transferring Closely-Held Business Interests to Charity

Estate of Victoria E. Dieringer v. Commissioner, 146 T.C. No. 8 (March 30, 2016)

A. Factual Background

Victoria E. Dieringer ("Decedent") died testate on April 14, 2009, a resident of Oregon. Decedent, a widow, had 12 children. Decedent's trust instrument generally provided for distribution of certain personal effects to her children and pre-residuary gifts totaling $600,000 to unrelated charities. The balance of her trust was to be distributed to the Bob and Evelyn Dieringer Family Foundation (the "Foundation"). Decedent's son, Eugene Dieringer ("Eugene") was Executor of her Estate, Trustee of her trust and a director of the Foundation.

The bulk of Decedent's assets consisted of a majority interest in Dieringer Properties, Inc. ("DPI"), a closely-held business that managed commercial and residential real estate. Decedent owned 425 of 525 voting shares and 7,736.5 of 9,220.5 nonvoting shares of DPI at the time of her death. The estate hired an appraiser to value the DPI stock on a majority interest basis. The appraiser determined that the voting shares had a value of $1,824 per share, and the non-voting shares had a value of $1,733 per share. The non-voting shares were accorded a 5% discount due to the non-voting status. The adjusted value of DPI as of Decedent's date of death was $17,777,626.

The United States Estate Tax Return ("Form 706") for Decedent's estate stated that she owned an interest in DPI with a fair market value of $14,182,471. The estate also claimed an estate tax charitable deduction on the Form 706 of $18,812,181. The estate reported no estate tax liability.

In November 2009, DPI elected S corporation status on the advice of Thomas Keepes, who was a director of DPI. DPI became concerned that the Foundation would be required to make annual distributions of income and could be subject to a tax on the value of its excess business holdings under IRC § 4943. DPI decided to redeem the trust's interest in DPI. Prior to redemption, the two voting shareholders were the trust and Eugene, and the non-voting shareholders were the trust, Eugene and Patrick Dieringer (another of Decedent's sons). DPI agreed to redeem the trust's interest in DPI in exchange for two notes receivable, a short-term note in the amount of $2,250,000 and a long-term note in the amount of $3,776,558. The redemption price was $779 per voting share and $742 per non-voting share.

Eugene arranged for an appraisal of the DPI shares on a minority interest basis, and the appraiser determined that the per-share price was $916 per voting share and $870 per non-voting share. In April 2010, the redemption agreement was modified so that DPI redeemed all of the trust's voting shares and 5,600.5 of the trust's non-voting shares. The long-term promissory note was amended to reflect a value of $2,968,462. The appraised values included a 15% lack of control discount and a 35% lack of marketability discount. The non-voting share value also included a 5% lack of voting power discount.

Separately, Eugene, Patrick and Timothy Dieringer (another of Decedent's sons) entered into subscription agreements with DPI to infuse the company with cash to pay the short-term promissory note. After modifying the subscription amounts to reflect the appraised value on a minority basis, Eugene purchased 100 voting shares and 2,190 non-voting shares for $1,997,568. Patrick purchased 65 shares of voting stock and 86 shares of non-voting stock for $134,393. Timothy purchased 25 shares of voting stock and 108 non-voting shares for $99,611. After the redemption and subscription, Eugene owned 70% of the voting stock of DPI and 48.6% of the non-voting stock.

For calendar year 2009, the trust reported a capital loss in the amount of $385,934 from the sale of the voting stock and a capital loss of $4,831,439 for the sale of 5,600.5 shares of non-voting stock.

On January 1, 2011, the Foundation received 2,163 non-voting shares of DPI, a short-term note receivable in the amount of $2,250,000 and a long-term note receivable in the amount of $2,921,312 in satisfaction of its interests in the trust.

In September 2013, the IRS reduced the charitable deduction based upon the value of property actually distributed to the Bob and Evelyn Dieringer Family Foundation (the "Foundation"). The IRS issued a deficiency notice in the amount of $4,124,717 and assessed an IRC § 6662(a) accuracy-related penalty of $824,943.

B. Analysis

The Tax Court stated that "[i]f a trustee has the power to divert property to be transferred for charitable purposes 'to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent'. . . the charitable contribution deduction is limited to the portion, if any, of the property that is exempt from the trustee's exercise of the power." (Citing to Treas. Reg. § 20.2055-2(b)(1)).

The estate argued that the value of the assets in the trust and the corresponding charitable deduction should be based upon the value of the assets as reported on the Form 706. The estate argued that the decrease in value of the DPI shares occurring between Decedent's date of death and the redemption of shares was the result of several post-death events and should not reduce the value of the charitable deduction permitted under IRC § 2055. The IRS argued that the decrease in value "was primarily due to the specific instruction to value decedent's majority interest as a minority interest with a 50% discount," rather than the post-death events cited by the estate.

The Tax Court upheld the deficiency, finding that the Foundation did not receive the bequeathed shares of DPI nor the value of those shares as part of the redemption. The Tax Court determined that the charitable amount that could properly be deducted was the amount actually transferred to the Foundation, rather than the amount reported on Decedent's Form 706, because the executor's actions altered Decedent's estate plan by diverting value that should have been transferred to the Foundation in favor of three of Decedent's children.

In addition to the estate tax deficiency, the IRS sought an accuracy-related penalty on the basis that the underpayment of estate tax was due to the estate's negligence or disregard of the rules and regulations. The Tax Court found that the IRS met its burden of proof that the estate's position was negligent due to Eugene's specific instructions to the appraiser to appraise a minority interest without informing the appraiser that the redemption was for a majority interest in DPI.

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