
NEW HOPE CHRISTIAN COMMUNITY FOUNDATION

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A newsletter about charitable gift planning and
exempt organizations for professional advisors.

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FEDERAL ESTATE & GIFT TAX PLANNING:
WHERE WE HAVE BEEN AND WHERE WE MIGHT BE GOING

The gradual phase out of the Federal Estate Tax continues with the exclusion increasing to Two Million Dollars as of January 1, 2006. The Federal Gift Tax Annual Exclusion has increased to \$12,000.00 as of January 1, 2006. The estate tax exclusion is to increase again to \$3,500,000.00 in 2009, with the estate tax disappearing in the year 2010 and reappearing in the year 2011 as it was in the year 2001. The Republicans in Congress would like to repeal the estate tax entirely. However, pressure from the Democrats and the need to lower the federal deficit have postponed this indefinitely. It is likely that there will be a “permanent” increase in the exclusion from federal estate tax. My guess is that it will be in the vicinity of Five to Ten Million Dollars.

Many people have established Irrevocable Life Insurance Trusts (ILIT) to assist their children with the payment of federal and state estate taxes using estate tax free funds. Some older clients with estates in the Two Million to Ten Million Dollar range are questioning whether they need to continue paying the premiums for the policies held in these ILITs. They would like to have that money for some other use, and it can be several thousand dollars per year. This is a tough call. Probably the best advice right now is to hang in there and see if Congress acts this year. For those clients with combined estates of Two Million to Three Million Dollars, it is a pretty safe bet that there will be an exclusion for them which will eliminate federal estate taxes. Nonetheless, it is a bet. Anything can happen in politics and it usually does.

**RECOMMENDATIONS OF THE PRESIDENT’S ADVISORY PANEL ON TAX
REFORM THAT AFFECTS CHARITIES & CHARITABLE GIVING**

The Advisory Panel issued its report in November, 2005. Among its recommendations are to allow tax payers to sell property and then donate the proceeds to charity without having to recognize gain and receive the full charitable deduction. The property proceeds would have to be donated to a charity within sixty (60) days of the sale. The sale would have to be an arm’s-length sale to an unrelated party. This will facilitate selling appreciated property and donating the cash, at the same time providing an objective measure of the fair market value of the property.

Of course, the proposal contains a provision relating to tax-free distributions from IRAs directly to charitable organizations. The donor would have to be age 65 or over. The proposal does not contain any provision for IRA contributions to split-interest trusts, such as Charitable Remainder Trusts.

They also propose a 1% floor on charitable contributions. That is, only charitable contributions exceeding 1% of adjusted gross income would be available. Since most people give more than 1% of their income to charity, it is hoped that this fixed percentage

of income for the deduction would provide an incentive for everyone to contribute, irrespective of their income.

The President's Advisory Panel wants to increase reporting requirements for "large" charitable contributions. This proposal would have charitable organizations reporting large gifts to the IRS and the taxpayer. It is thought that this will improve the accuracy of claimed charitable contribution deductions and permit the IRS to verify those deductions. Their concern is that the IRS currently has no way of determining whether a claimed charitable deduction was actually made other than through an audit. The report would not be required unless the donor's total annual contributions to the charity were more than \$600.00. They would also exempt small charities from the reporting requirements if they received no more than 250 contributions of \$600.00 or more, or total contributions of no more than \$150,000.00. All cash and non-cash contributions of \$250.00 or more would be considered in determining the \$600.00 threshold.

The panel wants to reduce controversies involving valuation of charitable gifts. Part of their proposal is to establish new rules for valuation by providing clear, objective standards for establishing the fair market value of donated property. The proposal includes information reporting by appraisers to the IRS, the donor, and the charity; and requiring that appraisals be done by qualified appraisers in accordance with generally accepted and customary appraisal standards. There would be minimum qualifications for appraisers. They also want to increase the penalties for overvaluation.

The panel also recommends tightening the requirements for charitable organizations to obtain a tax exemption, and recommends that effective action be taken to ensure greater oversight and better governance of exempt organizations.

IRS ANNOUNCES REVISED DEDUCTIONS & OTHER INDEXED TAX ADJUSTMENTS

Annually, the IRS announces changes to variable deductions and tax adjustments. This year's figures can be found in Rev. Proc. 2005-70. One of those adjustments is to the level of income after which itemized charitable and other deductions must be reduced. They must be reduced by 3% of adjusted gross income over \$150,000.00 (over \$75,250.00 if married, filing separately). For tax year 2006, a charity can provide a donor with a benefit in exchange for the donor's gift, if the thing given in exchange has a value of \$86.00 or 2% of the donation, whichever is less, or the donor gives the charity at least \$43.00 and receives a low-cost or token item that costs the charity no more than \$8.60. The item must have the charity's name or logo on it. Unsolicited, free, low cost articles given to donors will not reduce the donor's deduction if the low-cost item costs the charity no more than \$8.60.

The mileage rate for volunteers using their vehicle for charitable purposes remains at \$.14 per mile. Parking fees and tolls are also deductible. Volunteers must keep accurate

records. If the volunteer uses their vehicle for relief activities related to Hurricane Katrina, they may deduct 70% of the current, standard business mileage rate. However, the business mileage rate for 2006 has not yet been announced. This higher deduction for Hurricane Katrina relief ends December 31, 2006.

CHOOSING A FORUM FOR FEDERAL TAX CASES

Federal tax cases can be heard in the Tax Court, Federal District Courts and the Court of Federal Claims. The Tax Court will follow the decisions of the Federal Circuit Court to which appeal will lie. The District Court must follow the decisions of the Federal Circuit Court in which it is located. A taxpayer can bring a refund suit in the Federal District Court where the plaintiff resides. Appeals from decisions of the Tax Court or a Federal District Court will be to the U.S. Circuit Court of Appeals where the individual plaintiffs reside. The Fifth U.S. Circuit Court of Appeals has the reputation for being taxpayer friendly. This has lead some commentators to suggest that attorneys and clients be proactive in determining the forum in which a tax case will be heard. In cases involving estates, it is the residence or domicile of the executor that is determinative. Accordingly, they suggest that you can, in effect, choose your forum by simply choosing an executor who lives where appeal will lie to the Fifth Circuit (Texas, Louisiana and Mississippi). See Mecom v. Fitzsimmons Drilling Co., 248 U.S. 183 (1931); Kruskal v. U.S., 178 F. 2d 738 (2d Cir. 1950); Jack E. Golsen, 54 T.C. 742 (1970) Aff'd., 445 F. 2d 985 (10th Cir. 1971); Estate of Willis E. Clack, 106 T.C. 131 (1996); Estate of Arthur H. Clayton, 97 T.C. 327 (1991), Rev'd., 976 F. 2d 1486 (5th Cir. 1992).

IRS EXAMINATION ACTIVITIES FOR 2006

The IRS has announced that their 2006 Exempt Organization Examination Plan is designed to balance enforcement with educational activities, as well as provide the exempt organization personnel with a list of priorities. Their priorities include so-called critical initiatives, referrals (always scary, don't make any enemies, especially with the income tax agents), compliance programs, and market segment programs.

New critical initiatives for 2006 include conservation easements and charitable trusts. The ongoing critical initiatives include excessive compensation and donor advised funds, among others. The IRS compliance projects for this year include tax exempt bonds, political activity compliance, disaster relief, and gaming, among others. They will also continue their market segment programs from 2005 but will not add any new ones for 2006. Included in those are arts and humanities organizations, private foundations, elder housing, among others.

The IRS hopes to issue guidance this year on donee reporting of vehicle donations. Other projects include federal-state relations, legislation, Form 990 revisions, and a web-based taxpayer assistance program they call "Cyber Assistant."

As to donor advised funds, they continue to be alarmed by both the growth in donor advised funds and the amounts maintained in these funds that are not being distributed currently for charitable purposes. The IRS is concerned with material restrictions preventing the exempt organizations from employing the assets/income in furtherance of their exempt function. Lack of uniform guidance is also an issue. They will begin a compliance initiative regarding donor advised funds this year.

Last year, the IRS Exempt Organizations Section issued 319 compliance check letters, of which 1/3 resulted in additional tax and delinquent returns being secured. This brought in an additional \$3,500,000.00 to \$4,000,000.00 in revenues.

DEFECTIVE DRAFTED CRUT PROVIDES DEDUCTION NONETHELESS

The Federal District Court has determined that a defective Charitable Remainder Trust will nonetheless provide a charitable deduction for the decedent's estate. In this case, the decedent's trust was drafted in such a way that it did not qualify as a Charitable Remainder Unitrust or Charitable Remainder Annuity Trust. In order to resolve that issue and some others, the trustee and the beneficiaries negotiated an agreement. Under the agreement, the individual beneficiaries and the Charitable Remainder Beneficiary would each receive the actuarial value of their respective interests outright. The District Court looked at what it called the "distinct goal of the statute" in ensuring that an estate's charitable deduction will correspond to the value actually received by the charity. They reasoned that in this case the charity actually received what the estate was trying to deduct. However, this is a very fortuitous outcome for the taxpayer and I suggest that it cannot be relied upon. Your best bet is a well drafted trust. See Estate of Mildred S. Jackson v. U.S., No. 2: 04-CV34.

EARLY TERMINATION OF CRUT NOT SELF DEALING

The Internal Revenue Service has ruled again that the early termination of a Charitable Remainder Unitrust (C.R.U.T.) will not be treated as an act of self dealing under I.R.C. Section 4941(a)(1) and will not result in the imposition of a termination tax under I.R.C. Section 507(c). The Income Beneficiary and the Charitable Remainder Beneficiary agreed to terminate the trust and allocate the assets between them based on the present actuarial value of their respective interests as of the date of termination. The IRS relied on I.R.C. Section 4947(a)(2)(A). Their analysis was that the question is whether early termination may reasonably be expected to result in a greater allocation of trust assets to the Income Beneficiary as opposed to the Charitable Beneficiary. They found in this case

that the Income Beneficiaries are not expected to receive more than they would during the full term of the trust; and that the Charitable Remainder Beneficiaries might receive more because the donors have the right to change the Remainder Beneficiaries, or designate additional ones and change the proportions. See P.L.R. 200548023.

IRS CLARIFICATION OF DONATED VEHICLES RULES

The IRS has issued some clarifications concerning donated vehicles. The IRS has determined vehicles sold at an auction will not be treated as sold at prices significantly below fair market value qualifying for the exception for sales to needy individuals. See I.R.-2005- 145. They have also answered the question of whether the charity must have sold a vehicle in 2005 for the donor who donated it to receive a deduction on their 2005 tax return. The IRS's answer is that the vehicle does not have to be sold in 2005, but a taxpayer cannot take a charitable deduction of \$500.00 or more for the vehicle unless the donor has received a written acknowledgement from the charity and attached it to their return. If the written acknowledgment isn't received until after the return is filed, the taxpayer can file an amended return. See I.R.-2005—149.

BRIEFS

- For a detailed analysis of the Tax Court's rules concerning valuation of real estate, see Wortman, T.C. Memo 2005-227.
- For tax year 2006, exempt organizations with total assets at the end of the tax year in excess of Ten Million Dollars and that file at least 250 tax forms during the year will have to file their 990 electronically. Note that, although, 250 tax forms sounds like a lot, they count every conceivable tax form and count every time one is filed (for example, W-2s do not count as one form but rather they count every W-2 that is filed, as well each 1099 and each 1098, W-4, 940, 941, etc.).

A Federal District Court in New York has upheld the right of The Salvation Army to discriminate on the basis of religion under Section 702 of the Federal Civil Rights Acts of 1964, *Iowa v. Salvation Army*, 2005 WL2415978 (S.D.N.Y.).

To find the cases, statutes and rules cited in this newsletter, try the following free websites:

www.findlaw.com
www.firstgov.gov
www.access.gpo.gov
www.irs.gov
www.law.cornell.edu

“Each man should give what he has decided in his heart to give, not reluctantly or under compulsion, for God loves a cheerful giver.”

2 Corinthians 9:7