
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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THREATS TO CHARITABLE ORGANIZATIONS AND GIVING

As most exempt organization executives know by now, Congress is considering sweeping changes to the laws governing exempt organizations. Many of these changes amount to taking a sledge hammer to kill a fly. The burden that these changes will impose on smaller exempt organizations will be tremendous. Last year Congress asked Independent Sector, an exempt organization that serves other exempt organizations, to convene a panel of experts and issue a report for the use of the Senate Finance Committee. This was in response to the Senate Finance Committee discussion draft and that committee's request to the Joint Committee on Taxation to provide proposals to reduce the size of the gap between actual tax liability of taxpayers and the amount of taxes actually reported and paid. A Joint Committee on Taxation issued its report on January 27, 2005. That report can be found at: www.house.gov/jct/s-2-05.pdf . The Senate Finance Committee document was issued June 22, 2004 and can be found at: www.finance.senate.gov/sitepages/round.htm . Independent sector's report can be found at: [www.ncpg.org/gov_relations/Panel_on_Nonprofit Sect final report.pdf](http://www.ncpg.org/gov_relations/Panel_on_Nonprofit_Sect_final_report.pdf) . David Wills, President of the National Christian Foundation, has said that the two greatest threats posed by this initiative are: (1) severely limiting deductions from non-cash charitable contributions such as land and closely held stock, because discouraging these donations will cost charity billions of dollars, stifling major donor gifts from well over 50% of the assets they own; and (2) imposing private foundation self-dealing rules on public charities. He also points out that there are a number of other concerns, including broad increases in the potential for lawsuits by expanding the types of individuals and entities that have standing to sue charities; severe limitations on deductions for gifts of clothing and household items, which will discourage this type of donation and cost charities billions of dollars more; so-called one-sized-fits-all governance rules and administration, including rules about board size, composition and duties; restricting the "rebuttable presumption of reasonableness" procedures that have ensured good internal processes that protect charities from liability under the "excess benefit" rules; requiring all foundations and charities to file a substantial package of information every five years to justify their continued tax-exempt status; and requiring charities to become members of an IRS/government sanctioned private accreditation organization. You should call, write or e-mail any Congress person or Senator with whom you have a relationship, especially key people such as Senator Grassley who chairs a Senate Finance Committee, Representative Thomas who chairs the House Ways and Means Committee, and other committee members and staff; President Bush; Claude Allen and Tevi Troy, of the Domestic Policy Counsel; and Kristen Silverberg, of the Chief of Staff's Office. The mailing addresses and e-mail addresses of members of Congress can be found at: www.interactive.lwv.org/Team . This is a high priority for the IRS who believes that there are many exempt organization abuses out there. Even though the IRS's budget was only increased by 1/2%, they have reallocated funding so that there is a 30% increase in the budget for exempt organization enforcement personnel.

**IRS GUIDANCE ON SPOUSAL ELECTION RIGHTS FOR CHARITABLE
REMAINDER TRUSTS – REVENUE PROCEDURE 2005 - 24**

The issue involved here is that common law states give surviving spouses a statutory right to elect to take a share of the spouse's estate instead of what is provided for them in the Will. In the past this right of election applied only to probate assets. However, the Uniform Probate Code now has something called the "augmented estate" and this uniform act has been adopted by many states. The augmented estate includes non-probate assets such as trusts. The expectation of a CRT is that a charity will receive the remainder of the trust upon the death of the income beneficiary or beneficiaries. That underlying assumption may not be true if a surviving spouse can elect to take a portion of the "augmented estate" that includes lifetime gifts such as those made to a charitable remainder trust. The IRS's position is that if this right of election exists, it will disqualify the CRT under Code Section 664, even if the right is not exercised. If the CRT is created before June 28, 2005, the IRS will not require a spousal waiver of right of election. For those trusts, the tax exemption will not be lost unless the surviving spouse actually exercises the right of election. If the right of election is exercised, the CRT fails from the date of creation. For CRTs created on or after June 29, 2005, the IRS is requiring the donor's spouse to sign a waiver of his/her right of election, and if the waiver is not signed, the CRT will fail to qualify from the date of creation whether or not the spouse actually exercises his/her right of election. All of this means that a CRT that qualifies upon inception may become unqualified, retroactive to its date of creation, if the donor's state adopts an "augmented estate", or if donor moves to a state that has such a provision, or you divorce and remarry. These waivers must meet state law requirements that if your state doesn't adopt an "augmented estate" until sometime in the future, then the state law requirements will be unknown. The same is true if this comes into play because you moved to another state. It is probably best to have a waiver (or waivers if the trust is created by both husband and wife) signed at the time the trust is executed. You will have to use your imagination as far as the requirements are concerned. The waiver must be irrevocable, and I recommend that it be very clear and unequivocal and executed with witnesses and a notary. Current state law on waiving rights to probate assets may also provide some guidance. This revenue procedure has raised a storm of protest and we can only hope that the IRS will respond by modifying it. If you would like to protest this rather absurd ruling, you can call the principle author, Susan H. Levy, at (202) 622-3090. The revenue procedure is available at www.irs.gov by entering: RevProc2005-24 in the "search for" box. A. Charles Schultz has provided additional information and some sample forms at www.crescendointeractive.com under eNotes Archive.

**IRS HAS ISSUED FINAL REGULATIONS REGARDING THE TAXATION OF CRT
DISTRIBUTIONS BY AMENDING REGS. SECTION 1.664-1(d) et. seq.**

These amended regulations keep the four basic tiers governing taxation of distributions from CRTs, which are as follows:

1. Ordinary income – gross income, other than gains from sale or disposition of capital assets.
2. Capital gains – gains and amounts treated as gains from the sale or other disposition of capital assets.
3. Other income – municipal bond income.
4. Corpus.

The amended regs. Then introduce the new concept of tax rate classes. This means subcategories within the original four categories. This idea was first used to differentiate between mid-term gains, Unrecaptured Section 1250 gains, and other long term gains. Later it was used to distinguish between the 28% rate class for collectibles gains and Section 1202 gains, and the preferential 18%\8% rate for qualified 5-year gains. Now there is a new rule for qualified dividends. Dividends received after December 31, 2002, will now be ordered as follows: first, other ordinary income; then qualified dividends. The qualified dividends provision of the tax law expires December 31, 2008. Under capital gains, the breakdown will be as follows: first, short-term capital gains; second, long-term capital gains; and within long-term capital gains, will be first the 28% rate gains under Section 1202, then 25% rate gains under Section 1250, then the 15%\5% other long-term capital gains (which will return to a 20% rate on January 1, 2009), then the 18%\8% qualified five-year gains which is currently suspended through December 31, 2008. Third will be other income and fourth will be corpus. The new regs. also provide for phase out of temporary tax rate classes and for temporary suspension of a permanent tax rate class. All determinations of the character of distributions of income are to be made at the end of the tax year no matter when the income is distributed during the year. These regs. contain several helpful examples. The new regulation can be found at www.irs.gov by entering “TD 9190” in the *search for* box.

**CAPITAL GAIN TREATMENT OF PROPERTY TRANSFERRED BY A
CORPORATION TO AN EXEMPT ORGANIZATION**

Laura H. Peebles, CPA, PFS, the Tax Director at the national office of Deloitte and Touche, LLP, points out a trap for generous corporations. Donating property to charities is usually not a taxable event for purposes of gain or loss. However, in an effort to thwart corporations from avoiding gain by transferring all of its assets to an exempt organization in the process of converting from a for-profit to not-for-profit, IRS promulgated Reg. Section 1.337(d)-4(a)(1). This regulation provides that if a corporation transfers

“substantially all” of its assets to a “tax-exempt entity”, gain will be recognized. “Substantially all” is defined for purposes of this regulation the same as it is defined in IRC Section 368(a)(1)(C). Obviously, the important issue is determining whether the transfer of assets is of “substantially all” the assets. There is no clear or bright line rule. Generally, the IRS has determined under Section 368 that the “substantially all” requirement is satisfied if there is a transfer of assets representing at least 90% of the fair market value of the net assets and at least 70% of the fair market value of the net assets and at least 70% of the fair market value of the gross assets held by the corporation immediately before the transfer. Ms. Peebles points out that this is not a safe harbor. Case law has made determinations that fall outside of these parameters. The cases focus on the percentage of corporate operating assets rather than all corporate assets. However, all of the cases were determined with respect to “substantially all” under Section 368 which has nothing to do with transferring or donating assets to an exempt organization. What Ms. Peebles recommends is that if the corporation wishes to donate a substantial amount of assets to an exempt organization, it should have this issue reviewed by its tax advisors considering the specific assets and liabilities should be selected for the donation keeping Reg. Section 1.337(d)-4(a)(1).

**MORE ON GUIDELINES FOR TAX OPINION COMMUNICATIONS IN REVISED
CIRCULAR 230**

In the spring edition, reference was made to the newly revised Circular 230 and pointed readers to the IRS website where the Circular can be obtained. This is a major issue of concern to estate, gift and charitable planning practitioners. In the past, Circular 230 dealt with tax shelter opinions, but the revision speaks of “covered opinions.” A “covered opinion” is any written communication (including e-mail or other electronic means) that concerns one or more federal tax issues arising from: (1) a listed transaction (which is a tax shelter transaction the IRS has previously identified); (2) any plan or arrangement, the principle purpose of which is the avoidance or evasion of any tax, or (3) any plan or arrangement, a significant purpose of which is the avoidance or evasion of tax if the written advice (A) is a reliance opinion, (B) is a marketed opinion, (C) is subject to conditions of confidentiality, or (D) is subject to contractual protection. Most of these terms are defined in the Circular. This brief note is just to comment on a couple of matters of relevance to estate, gift and charitable planners. There are particular exclusions provided for in the rules. One of those is that written advice will not be treated as a reliance opinion if the practitioner prominently discloses in the written advice that it was not written to be used and cannot be used for the purpose of avoiding penalties. “Prominently disclosed” means readily apparent to the reader determined in the particular facts and circumstances, and at a minimum must be in a separate section in the same or larger type face as compared to the rest of the written advice. Note that this disclaimer exception only applies to reliance opinions and not on any of the other types of written advice, which is commented on below. Excluded advice includes negative advice, i.e., when you tell a client that a transaction will not provide the purported tax benefit. A reliance opinion is defined as written advice that concludes at a confidence level of at least more likely than not that one or more significant federal tax issues would

be resolved in the taxpayer's favor. The definition of "the principle purpose" of tax avoidance excludes transactions claiming tax benefits that are consistent with the statute and congressional purpose. For example, a general discussion of the federal estate tax marital deduction, credit shelter, or charitable remainder trust would not require a covered opinion letter whereas advice that an untried terminable interest (not a QTIP) will qualify for the marital deduction and most opinions concerning family partnerships probably would require a covered opinion letter. A covered opinion letter is a very formal legal opinion and if you expect to render such an opinion, you need to look at Circular 230 for all of the details and requirements. Even if advice is not a covered opinion, it may be other written advice which is also addressed in Circular 230 at Section 10.37. In other written advice, the IRS requires that the practitioner not base the written advice on unreasonable factual or legal assumptions; unreasonably relied upon representations, statements, bindings or agreements of the taxpayer or any other person; fails to consider all relevant facts; or takes into account the possibility the tax return will not be audited, that an issue will not be raised on audit, or an issue will be settled. Unlike covered opinions, other written advice is not required to describe in the written advice the relevant facts, assumptions and representations, the application of the law to those facts, or your conclusion with respect to the law and facts. The new rules expand upon "other written advice" by making it applicable to written advice covering "one or more federal tax issues" not just if there are significant federal tax issues. Some practitioners are thinking about putting a standard disclaimer, mentioned above, on their e-mail forms. This might work as would putting the disclaimer on any opinion. However, the client may not be happy about paying your fee if they cannot rely on the opinion to avoid penalties. The new rules became effective June 20, 2005.

NEW BANKRUPTCY LAW

This new act is effective October 1, 2005. It makes sweeping changes with respect to many asset protection-planning devices. One major change deals with the homestead exemption. The act seems to be aimed primarily at states with overly generous homestead exemptions. Under this new act, a debtor will still have a homestead exemption but it must meet certain requirements. First, there must be a state homestead exemption that applies. Next, the homestead has to have been acquired at least three years and four months prior to filing for bankruptcy. If the homestead does not meet the holding period, then only the first \$125,000.00 is protected (assuming that much is protected by the applicable state law). Also, a debtor can no longer use cash to reduce the mortgage on a homestead for the purpose of increasing their homestead exemption. Even if the homestead was acquired more than three years and four months prior to the filing, the equity in excess of \$125,000.00 may not be protected if the bankruptcy court determines that the debtor has liabilities related to securities fraud, civil RICO fines, from a violent crime causing serious injury or death, or if the bankruptcy filing was abusive. It is also possible to piggyback the holding periods of more than one residence if both residences were located in the same state.

The act also contains changes affecting retirement benefits. Payments from certain types of retirement plans are exempted, but only to the extent reasonably necessary for the support of the debtor and dependents. This has previously been the case, but there was some question as to whether IRAs were included. The new act now specifically provides that they are included, irrespective of estate exemption provisions, but only up to one million dollars. The one million dollar cap has an exception for rollovers from qualified plans. The unlimited exemption applies to tax deferred annuities, deferred compensation plans under Section 457, ERISA plans under IRS Section 414, and also to ASEP IRAs, and SIMPLE IRAs.

More will be provided in the next edition of this newsletter.

BRIEFS

- IRS has issued a new form, Form 8892, for the purpose of obtaining extensions for gift tax filing and payment of gift and GST tax. This is for taxpayers who want to apply for a separate extension to file a gift tax return, or to make a payment of gift tax before filing the return. An automatic extension of time to file the income tax return continues to automatically extend the due date for the gift tax return. The form can be found at the IRS website: www.irs.gov.
- IRS rollover legislation has again been introduced in the U.S. House of Representatives. This legislation, proposed by Representatives Wally Herder (R-CA) and Earl Pomeroy (D-N.D.) would allow individuals aged 59½ or older to make contributions from their IRA accounts directly to charities without having to reflect the income on their personal return and then take a charitable deduction. If this proposal is adopted, the charitable deduction can be obtained without having to recognize the income first.
- The National Conference of Commissioners on Uniform State Laws is working on an update of the Uniform Management of Institutional Funds Act (UMIFA). Many states have already adopted the previous version. This legislation, if adopted in your state, impacts charitable institutions that hold funds for their exclusive use, benefit or purposes; and especially endowment funds, which are defined as an institutional fund and is not wholly expendable by the charity on a current basis under the terms of the gift instrument. This legislation effectively overrides the usual understanding of an endowment by stating that a restriction upon the expenditure of net appreciation may not be inferred from a designation of a gift as an endowment, from a direction or authorization and the gift instrument to use only “income,” “interest,” “dividends,” or “rents, issues or profits,” or “to preserve the principle intact,” or from a direction that contains other words of similar import. In other words, it allows endowment funds to distribute principle irrespective of restrictions by the donor to the contrary. You can find this proposal at: www.nccusl.org. There is still plenty of time to submit

your comments to the National Conference of Commissioners on Uniform State Laws.

NOTE THAT A PRIVATE LETTER RULING IS NOT A PRECEDENT AND CAN ONLY BE RELIED ON BY THE TAXPAYER TO WHOM IT IS ISSUED. THEY ARE HOWEVER AN INDICATION OF WHAT THE IRS IS THINKING.

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

THE ONE WHO SOWS SPARINGLY WILL ALSO REAP SPARINGLY, AND THE ONE WHO SOWS BOUNTIFULLY WILL ALSO REAP BOUNTIFULLY. 2 CORINTHIANS 9:7.