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UNIVERSITY of ROCHESTER

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New Charitable Coalition Pushes to Make IRA Charitable Rollover Permanent

Several leaders in gift planning and philanthropy from across the country have come together to form a new organization, the Charitable IRA Initiative, to advocate for making legislation allowing the tax-free transfer of individual retirement account (IRA) assets to charitable organizations permanent and to expand the scope of prior legislation allowing for such transfers.

Under previous versions of the so-called "IRA rollover" legislation, IRA account owners aged 70½ and older could make tax-free transfers of IRA assets for outright gifts to charity up to $100,000 per taxpayer per year. The most recent version of this law expired at the end of 2014 and, like its predecessors, did not provide for a charitable deduction for IRA rollover gifts.

The leadership of the Charitable IRA Initiative comes from several prominent charities and organizations that promote philanthropy. It has a stated purpose of encouraging members of the U.S. Congress and the President to enact permanent legislation enabling owners of IRAs to transfer their IRA assets to American charities.

Lindsay Lapole, chair of the American Council on Gift Annuities, serves as president of the Charitable IRA Initiative, while Michael Kenyon, president and chief executive officer of the Partnership for Philanthropic Planning, is the vice president. Other officers include Secretary John Pierce, senior gift planning officer at Concordia College in Minnesota and Treasurer Sister Georgette Lehmuth, president and chief executive officer of the National Catholic Development Conference. Noted charitable legal expert Conrad Teitell serves as the volunteer legal counsel for the organization.

The IRA charitable rollover was first introduced as part of the Pension Protection Act of 2006. The law has been renewed multiple times since then, with each version continuing the same provisions for a maximum $100,000 transfer per taxpayer per year that would qualify for tax-free treatment. Extensions of the law often have come very late in the year—or even after the end of the year and made retroactive—which has made planning challenging for IRA owners who would like to take advantage of IRA rollover opportunities.

In a recent press release, Lapole set out the objectives for the new alliance.

"Our dual agenda items are to first make the outright gift IRA rollover provision permanent," he said. "This will allow IRA owners 70½ years and older to give $100,000 annually in outright gifts from the personal IRA accounts without having to wait until late December to receive word from Congress and the White House. Rather, the expansion of the legislation will also allow IRA owners 59½ and older to create life-income agreements with portions of the IRA assets up to a limit of $500,000 annually.

"These agreements will pay income to those IRA owners and their spouses for life, often with a larger payout (5% minimum in the case of charitable trusts) than their IRA required minimum distribution (RMD). At the same time, these donors will be taking the opportunity of having a phenomenally positive impact on America's needy. Because these IRA rollover gifts are not deductible, we believe that permanent and life-income IRA rollovers will be revenue neutral or even positive to the Treasury."

If IRA owners were allowed to transfer IRA assets to charity in exchange for life-income gifts—such as charitable remainder trusts or charitable gift annuities—the IRA owners would be able to receive payments for life. The principal of any such gift arrangements would be permanently committed to charity.

Charitable Provision That Is Not Permanently Set Aside Costs Estate Income-Tax Charitable Deduction in Tax Court

The estate of Eileen Belmont took an income-tax charitable deduction for funds it had earmarked for distribution to charity on its 2008 income-tax return (Belmont v. Commissioner, 144 T.C. No. 6, February 19, 2015). The estate took the position that Internal Revenue Code §642(c)(2) permits a deduction even though the funds have not been distributed if they are permanently set aside for a purpose specified in IRC §170(c), and the intended charitable distribution fell clearly within those purposes.

However, §1-642(c)-2(D) states that no amount will be considered to be permanently set aside "unless under the terms of the governing instrument and the circumstances of the particular case the possibility that the amount set aside … will not be devoted to such purpose or use is so remote as to be negligible." That proved to be the undoing of the claimed deduction.

The decedent's will provided for a distribution of the first $50,000 of her residuary estate to her brother David with the balance to charity. Among the assets assigned to the residuary estate were the proceeds of a state teachers' pension fund that constituted income in respect of a decedent. On the estate-tax return for the period ending March 31, 2008, the estate claimed the amount of the distribution of the retirement fund assets and a small amount of interest as income that produced a net of $219,580 after a capital loss, taxes, and other expenses. The estate designated that amount as permanently set aside for charity.

At the same time, the brother was advancing claims to an interest in real estate owned by the decedent at the time of her death, specifically a condominium in Santa Monica, California. He claimed that his sister's disposition of the property through her will was contrary to an oral agreement among himself, his sister, and their mother (who predeceased the sister). He argued that as a result of that agreement, under a theory of constructive trust he was entitled to a life tenancy interest in the California condo.

He continued to live in the condo following his sister's death and initiated formal legal proceedings to register his claims after his offer to exchange his $50,000 bequest for a life estate in the condo was rejected by the estate. The estate did offer a $10,000 stipend for him to vacate the premises, which he did not accept.

David eventually prevailed in a ruling by the Los Angeles Probate Court, a judgment upheld by the California appellate court. Because of the protracted legal proceedings, the estate had to dip into the amount intended for distribution to the charity—and therefore was not able to completely fulfill the intended distribution.

The Tax Court ruled that under the facts and circumstances of the case the estate should have known that the possibility that it would not be able to preserve the entire $219,580 for distribution to charity was more than negligible at the time it claimed a deduction for that amount as permanently set aside on its 2008 federal income-tax return. The court concluded, "The information that was known or reasonably knowable to the estate when it filed its Form 1041 on July 17, 2008, indicates that David's claim to a life tenancy interest in the Santa Monica condo was a serious claim based on alleged events that predated the end of the taxable year ending March 31, 2008."

This, according to the court, was sufficient to put the estate on notice that there was the possibility of an extended and expensive legal fight—especially because David had taken substantial steps to dispute ownership of the condo prior to the date on which the return was filed. Further, the court pointed out, the estate should have realized that based on the assets

it held at that time in excess of the amount designated as set aside for charity, the chance that those additional assets could be depleted was not so remote as to be negligible.

Consequently the Tax Court found that the $219,580 had not been permanently set aside within the meaning of the code and regulations because the possibility those funds would be depleted was not so remote as to be negligible. It rejected the estate's claim of a deduction for that amount and upheld the IRS claim of a deficiency of $75,662 for the tax year ending March 31, 2008.

IRS Gives Taxpayers Tips On When and How to Claim Deductions

The IRS has provided taxpayers with a list of eight tax tips to help them know how to claim deductions when filing their income taxes (IRS Tax Tip 2015-47). The list includes the following:

1. **Qualified Charities.** You must donate to a qualified charity if you want to deduct the gift. You can't deduct gifts to individuals, political organizations, or candidates. To check the status of a charity, use the IRS Select Check tool.

2. **Itemized Deduction.** To deduct your contributions, you must file Form 1040 and itemize deductions. File Schedule A, Itemized Deductions, with your federal tax return.

3. **Benefit in Return.** If you get something in return for your donation, your deduction is limited. You can deduct only the amount of your gift that is more than the value of what you got in return. Examples of benefits include merchandise, meals, tickets to an event, or other goods and services.

4. **Donated Property.** If you gave property instead of cash, the deduction is usually that item's fair-market value. Fair-market value is generally the price you would get if you sold the property on the open market.

5. **Clothing and Household Items.** Used clothing and household items must be in at least good condition to be deductible in most cases. Special rules apply to cars, boats, and other types of property donations. See Publication 526, Charitable Contributions, for more on these rules.

6. **Form 8283.** You must file Form 8283, Noncash Charitable Contributions, if your deduction for all noncash gifts is more than $500 for the year.

7. **Records to Keep.** You must keep records to prove the amount of the contributions you made during the year. The kind of records you must keep depends on the amount and type of your donation. For example, you must have a written record of any cash you donate, regardless of the amount, in order to claim a deduction. For more about what records to keep, refer to Publication 526.

8. **Donations of $250 or More.** To claim a deduction for donated cash or goods of $250 or more, you must have a written statement from the charity. It must show the amount of the donation and a description of any property given. It must also say whether the organization provided any goods or services in exchange for the gift.

Organized and Operated: Key Factors to Gain Exempt Status

Two recent private letter rulings demonstrate that the IRS takes seriously two main tests for an organization to be recognized as exempt as set forth in IRC §501(c)(3) and §1.501(c)(3)-1(a)1 of the regulations. They provide that an organization must be both organized and operated exclusively for the purposes described in §501(c)(3).

In PLR201510058, the constitution of the organization in question stated the purpose was "to provide a service to the community and to local farmers/producers by:

"1. Providing a local, producers-only market for direct sales to the public.

"2. Offering the consumer a source of high-quality, locally grown, nutritional products.

"3. Promoting the development of a sustainable local farm-economy.

"4. Educating the consumer on the production, preparation, and growing practices of healthy food."

The organization carried out its mission "to provide regional, small-family farmers with an opportunity to sell directly to consumers" by organizing and conducting weekly markets where member vendors sell their products to the community at large. Members pay a yearly membership fee and pay a vendor's fee at each market.

According to the ruling, §1.501(c)-1(b)(1)(iv) of the regulations provides that "in no case shall an organization be considered to be organized exclusively for one or more exempt purposes, if, by the terms of its articles, the purposes for which such organization is created are broader than the purposes specified in IRC §501(c)(3)." The IRS determined that the purpose set out in the organization's articles were broader than the purposes set out in IRC §501(c)(3), leading to the conclusion that the entity was not organized exclusively for permissible purposes. Similarly, the Service concluded that the organization was operated for the substantial purpose of private benefit to vendors of products at its markets. As such, it also failed the test of operating exclusively for an exempt purpose described in §1.501(c)(3)-1(c)(1) because more than an insubstantial part of its activities are not in furtherance of an exempt purpose.

PLR 201510059 deals with an organization whose articles of incorporation state that it is organized exclusively for one or more of the purposes specified in IRS §501(c)(3). The articles also state that the entity is organized to provide affordable pharmaceuticals to the poor and to manufacture early cancer detection tests, natural immunity boosters, and rural health advocacy.

The ruling observed that the primary activities of the organization of producing and selling herbal supplements, cancer testing kits, and books about biological agents were conducted in a manner indistinguishable from commercial herbal supplement producers in price and operation. It further found that its clinical trials and research for cancer vaccines were not "scientific" within the meaning of §1.501(c)(3)-1(d)(5)(ii) because it was incidental to commercial drug development. Based on these observations, the ruling concluded that the organization did not qualify for exemption under IRC §501(c)(3).

Recommended Gift Annuity Rates Unchanged

At its recent board meeting the American Council on Gift Annuities (ACGA) voted to make no changes in the current recommended maximum charitable gift annuity rates. The current recommended rates have been in effect since January of 2012.

The rates are reflective of actuarial and expense assumptions applied to the current projected gross return on a model portfolio of invested assets allocated 55% in 10-year Treasury bonds, 40% in equities with an assumed return of 8%, and 5% in cash or cash-equivalent, generally reflected in the rates on 90-day Treasury securities. As of the dates of the ACGA board meeting, April 13, 2015, the projected gross return was just slightly above the 4.25% assumed gross return on which the current rates are based.

Generally, ACGA does not recommend changes in the rates currently in effect unless the projected gross return on the model portfolio varies by more than 50 basis points from the assumed gross return on which current rates are based. With rates on 90-day Treasuries currently near zero and the return on equities a fixed assumption, the primary player in potential swings in the recommended rates is the return on 10-year Treasuries. Current 10-year rates are near 2%. The 13-week moving average would need to rise above approximately 2.8% to produce an increase in the projected return on the model portfolio in excess of 50 basis points, assuming no changes in the return on 90-day Treasuries or the assumed return on equities.

__Financial Strategies__ is intended for a select group of attorneys, accountants, trust officers, insurance advisors, investment counselors, and financial planners. It is designed to keep these planners up to date on developments in estate planning as they relate to testamentary and lifetime plans in support of qualified charities.

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