Recent Developments in Charitable Gift Planning and Charitable Organizations

Laura Hansen Dean, J.D.
Executive Director of Gift Planning
Office of the Vice President for Development
The University of Texas at Austin
lhdean@austin.utexas.edu

Michelle Rosenblatt, J.D.
Associate Director of Gift Planning
Office of the Vice President for Development
The University of Texas at Austin
mrosenblatt@austin.utexas.edu

San Antonio Estate Planning Council

January 20, 2008
San Antonio, Texas

SPEAKERS

Laura Hansen Dean

Laura Hansen Dean, Attorney at Law (Indiana, Texas), joined The University of Texas at Austin in April 2007, and serves as the Executive Director of Gift Planning. She is recognized as one of the most experienced and knowledgeable charitable gift planners in the country.

A magna cum laude graduate of Indiana University School of Law, she has led gift-planning teams at public universities, community foundations, and academic centers on philanthropy, has served as Chief Executive Officer of publicly-supported foundations, and as consultant for multi-year grants funded by some of the country's largest private foundations.

She has served the charitable gift planning field in leadership positions with local planned giving councils and estate planning councils, on the board of directors and committees of the National Committee on Planned Giving, and on the editorial review committee of the Journal of Gift Planning since its inception. She is a frequent speaker and teacher and contributor to publications on philanthropy. She serves on the board of directors of the Ball State University Foundation and the Chisholm Trail Communities Foundation, the foundation serving Williamson County, Texas.

Michelle Rosenblatt

Michelle Rosenblatt joined The University of Texas at Austin Office of Gift Planning in May 2008. She previously worked a boutique estate and tax planning law firm in Los Angeles and for Crescendo Interactive, Inc., a national provider of gift-planning consulting, software, and education. She earned a bachelor's degree in psychology from UT Austin, a law degree from Pepperdine University School of Law, and is admitted to practice law in California and Texas. She is also a member of the National Committee on Planned Giving and the Estate Planning Council of Central Texas.

STATUTORY CHANGES

Pension Protection Act of 2006 – Extended Provisions

IRA Rollover – Under the Pension Protection Act of 2006, IRA participants who were age 70½ and above (not the taxable year an individual reaches age 70½) could make tax-free outright distributions in tax years 2006 and 2007 of up to $100,000 from their IRAs directly to charitable organizations without reporting the distribution as income and without the distribution counting toward the individual's limit on charitable contributions. Such gifts were not permitted to private nonoperating foundations (endowed private foundations generally), donor advised funds (held by many community foundations), and supporting organizations (Code section 509(a)(3)). In addition, only outright distributions applied, so rollovers could not be used to fund charitable gift annuities, pooled income fund contributions or to create or add to charitable remainder or lead trusts. Under the Emergency Economic Stabilization, Energy Improvement and Extension, and Tax Extenders and AMT Relief Acts of 2008 (signed into law October 3, 2008), this provision has been extended and made retroactive from the beginning of 2008 to the end of 2009. Notice 2007-7 provides guidance on how the distribution should be reported on the donor's tax return.

Increase in Percentage Limitations for Contributions of Conservation Easements – Under the Pension Protection Act, a gift of a conservation easement entitled the donor to a more favorable charitable deduction in tax years 2006 and 2007. Instead of being deductible at the appreciated property limit of 30%, the gift was deductible at the more favorable 50% adjusted gross income limitation typically applied to cash gifts with no requirement that the charity use the real estate to further its exempt purposes. IRC §§ 170(b)(1)(E), 170(e). In addition, the carry forward period was increased from five years to 15 years. This provision has been extended for tax years 2008 and 2009 by the Food Conservation and Energy Act of 2008 (also known as the Farm Bill or H.R. 2419). Similar favorable rules apply to conservation gifts by corporate donors.

It is also of note that under the more favorable conservation rules, qualified farmers and ranchers may deduct up to 100% of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions and carry forward the excess for 15 years. IRC § 170(b)(1)(E)(iv)(I). To qualify as a qualified farmer or rancher, the donor must receive more than 50% of his or her gross income (as defined in IRC section 2032A(e)(5)) from ranching or farming activity and the land must remain available for agricultural or livestock production. IRC § 170(b)(1)(E)(iv)(I). However, where a closely held C corporation is a qualified farmer or rancher, the qualified conservation contribution deduction may not exceed 100% of the taxable income of the corporation. Any excess contribution may be carried over for up to 15 years with the same limitation and the limitation for property used for agricultural and livestock production. The enhanced ceiling is not subject to limitations on the value or income of the corporation or on the number of shareholders.

Contributions by S Corporations of Appreciated Property – Basis Adjustment to Stock
Prior to the Pension Protection Act, when an S corporation made a contribution of appreciated property deducted at fair market value, the shareholder's basis in his/her S corporation stock was reduced by the amount of the charitable deduction reported on the shareholder's K-1 for the year. This was contrary to the treatment of basis by partners in a partnership for contributions of appreciated property. The Act amends section 1367(a)(2)(B) to provide that the basis reduction in the S corporation stock is equal to the shareholder's allocable share of the tax basis of the contributed property, not the share of the allocable share of the fair market value charitable

deduction. This provision applies to contributions made in tax years 2006 and 2007 and has been confirmed by Rev. Rul. 2008-16; 2008-11 IRB 1. On Oct. 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (P.L. 110-343), providing an extension of such treatment through tax year 2009.

Contributions of "Apparently Wholesome Food," Book Inventory and Qualified Computer Contributions - On Oct. 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (P.L. 110-343) ("EESA"), providing an extension of favorable treatment through tax year 2009. The enhanced deductions for contributions or food and book inventory were enacted in the Katrina Emergency Tax Relief Act of 2005 (KETRA). Contributions of "apparently wholesome food," defined as food intended for human consumption that meets all the quality and labeling standards but may not be marketable due to other factors (appearance, age, surplus, etc.), to be used directly in the care of the ill, needy or infants, can be valued at the lesser of 1) half the difference between cost and fair market value, or 2) twice the cost. Any business (C corporation, S corporation, partnership, and sole proprietorship) may take advantage of the enhanced limitations for food contributions. EESA also eliminates the percentage limitation for contributions made by certain farmers and ranchers after Dec. 31, 2007, but before Jan. 1, 2009.

KETRA and EESA also include a provision allowing C corporations an enhanced charitable deduction for donations of books to public elementary and secondary schools, public libraries and literacy programs. Under KETRA and EESA, however, *only C corporations* are permitted to deduct the value of contributions of book inventory.

KETRA and EESA provide for a third enhanced deduction for gifts of qualified computer contributions. This provision encourages businesses to contribute computer equipment and software to elementary, secondary, and postsecondary schools by allowing an enhanced deduction for such contributions.

Emergency Economic Stabilization Act of 2008 – New Charitable Provisions

Temporary Suspension of Charitable Limitations for Midwest Relief - The Emergency Economic Stabilization Act of 2008 (P.L. 110-343) ("EESA"), signed into law by President Bush on October 3, 2008, temporarily waives these limits regarding charitable cash contributions dedicated to Midwestern disaster relief efforts. One of the incentives suspends until December 31, 2008, the charitable contribution deduction limitation for donations to organizations assisting those areas of the Midwest affected by storms, tornadoes, or floods. Qualified contributions are those paid in cash to organizations described under section 170(b)(1)(A) during the period beginning on the earliest applicable disaster date for all states and ending on December 31, 2008. A qualified contribution must be made for relief efforts in one or more Midwestern disaster areas, and the taxpayer must obtain contemporaneous written acknowledgement from qualified organizations that the contribution was used for such purposes. Finally, to benefit from the temporary limitation suspension, the taxpayer must make an election to apply this new subsection of paragraph (4) under section 1400S(a).

Under EESA, Midwestern disaster areas are defined as those the President declared as major disaster areas on or after May 20, 2008, and before August 1, 2008, and those in need of individual and/or public assistance from the federal government by reason of severe storms, tornadoes, or flooding that occurred in any of the states of Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and Wisconsin.

EESA, however, makes two exceptions to the temporary limitation suspension. Under the new law, the suspension does not apply to contributions made to private foundations, nor to supporting organizations described under section 509(a)(3). The temporary suspension also excludes contributions made for the establishment of new, or maintenance of existing, donor-advised funds as defined under section 4966(d)(2).

Increase in standard mileage rate for charitable use of vehicles - The mileage rate individuals may use to compute a tax deduction for personal vehicle expenses associated with charitable work is statutory and has not been increased since 1997. The rate is currently at 14 cents per mile. For a taxpayer assisting in relief efforts related to the Midwestern disaster, EESA sets the charitable mileage rate at seventy percent of the current standard business mileage rate, beginning on the applicable disaster date and ending on December 31, 2008.

Exclusion from income of mileage reimbursements for charitable volunteers - In general, reimbursements received for operating expenses of a personal vehicle used in connection with charitable work in excess of the statutory charitable mileage rate are taxable income to the recipient. However, reimbursements for charitable mileage attributable to the Midwestern disaster up to the amount of the standard business mileage rate will not be considered taxable income through December 31, 2008.

OTHER ITEMS OF INTEREST

IRA Required Minimum Distributions Waived in 2009

On December 23, 2008, President Bush signed into law The Worker, Retiree and Employer Recovery Act of 2008 (H.R. 7327). In addition to significant pension legislation, this law waives the 2009 requirement that IRA, 401(k) and 403(b) plan owners age 70 ½ or older during 2009 take minimum distributions. Also, beneficiaries of traditional and Roth IRAs are not required to take minimum distributions from IRAs for 2009. Similar waiver rules may apply to employer plan participants and their beneficiaries. It is expected that the normal withdrawal rules will apply in the year 2010.

Treasury Blue Book Revenue Proposals for 2009 – On February 4, 2008, the Treasury Department released its "General Explanations of the Administration's Fiscal Year 2009 Revenue Proposals," also known as the "Blue Book." Included were: 1) making the IRA charitable rollover provision permanent for individuals who have reached age 70 ½ with a maximum $100,000 distribution per each taxable year; 2) permanently extending the enhanced charitable deduction for contributions of food inventory; 3) permanently extending the enhanced deduction for corporation contributions of computer equipment for educational purposes; 4) permanently extending increased limits on contributions of partial interests in real property for conservation purposes; and 5) permanently extending the basis adjustment to stock of S corporations contributing appreciated property. A new proposal would replace the current two-tier 2%/1% excise tax applicable to the net investment income of private foundations with a single tax rate of one percent.

REGULATIONS

Supporting Organizations:
Texas Legislators Express Concern about Proposed Regulations Defining "Functionally Integrated" Type III Supporting Organizations and 5% Payout Requirement for "Non-Functionally Integrated" Type III Supporting Organizations
On February 29, 2008, Texas legislators Ron Paul, Gene Green, Nick Lampson and Kay Bailey Hutchison sent a letter to Henry Paulson, Secretary of the Treasury Department, expressing their concern about possible unintended consequences that may result from proposed rulemaking to historical supporting organizations. Their concerns are that some Type III supporting organizations that have operated in Texas for decades and have amassed large endowments will not be able to meet the definition of "functionally integrated" supporting organizations because they can't treat their investments as assets used for the benefit of their supported organizations. The legislators proposed a special rule for these types of historical supporting organizations, especially where the organization's donors are deceased, suggesting an exclusion from the asset test or allowing prior asset distributions in the asset test. The legislators also expressed concern that a mandatory 5% annual payout rate for non-functionally integrated Type III supporting organizations will force untimely liquidations of assets. These tests were included in Advance Notice of Rulemaking REG – 155929-06, Announcement 2007-87; 2007-40 I.R.B. 753. The February letter followed a letter from Texas legislators Ron Paul, Gene Green and Nick Lampson voicing similar concerns.
Authors' Note: The author understands that the Houston Endowment may be one of the historical supporting organizations to which the Texas legislators were referring.

Charitable Deductions:
Proposed Regulations Requiring Independent Economic Effect for IRD Distribution Preference Clauses in Wills and Trusts - Reg. Sections 1.642(c)-2(b) and 1.643(a)-5 contained in REG-101258-08, 2008-28 I.R.B. 111 provide that an ordering provision (contained in a will or trust) to distribute specific types of income to a charity or to some other beneficiary will not be respected for federal income tax purposes unless the instruction has "economic effect independent of income tax consequences." Under the proposed regulations, the following should have independent economic effect: "Pay all taxable retirement benefits my estate receives to Charity A" or "Pay the first $x of taxable retirement benefits my estate receives to Charity A."

Charitable Remainder Trusts:
Proposed Regulations Address Impact of UBTI on Trust Accounting for CRTs Beginning 2007
On March 17, 2008, corrected proposed regulations were issued by the Treasury that invited written comments and gave notice on a public hearing on April 11, 2008. The hearing was cancelled on April 4, 2008 because there were no requests to speak on this matter. The proposed regulations under Code section 664(c), REG -127391-07; 73 FR 12313-12315, provide that beginning after December 31, 2006, charitable remainder trusts with UBTI are exempt from federal income tax, but are subject to a 100% excise tax on any UBTI; the excise tax is treated as paid from corpus; and the UBTI is assigned to one of three categories of income (ordinary income, capital gains, or other income) as current year income. The proposed regulations clarify that, consistent with section 1.664-1(d)(2), the excise tax imposed upon a charitable remainder trust with UBTI is treated as paid from corpus and the trust income that is UBTI is income of the trust for purposes of determining the character of the distribution made to the beneficiary.

ESTATE TAX CHARITABLE DEDUCTION

Defective Disclaimer Prevents Estate Tax Charitable Deduction for Charitable Lead Trust - In *Estate of Christiansen et. al. v. Comm'r*, 130 T.C. No. 1; No. 13190-05 (24 Jan 2008), the Tax Court allowed an estate tax charitable deduction for disclaimed property passing to a private foundation but denied the deduction for the property passing to a charitable lead trust. The decedent's will left the bulk of her estate (primarily family limited partnership (FLP) interests) to her daughter. In anticipation that the daughter would disclaim her interest in the estate, the will directed that 25% of any disclaimed property would pass to a private foundation and 75% would pass to a 7% charitable lead annuity trust (CLAT). In fact, the daughter disclaimed everything over $6.35 million, but did not specifically disclaim the contingent remainder from the CLAT. For 20 years, the CLAT paid the annuity amount to the private foundation, then distributed the remainder to the daughter at termination. The IRS challenged the value of the FLP assets, and denied the charitable deduction for the disclaimed property passing to the CLAT and the private foundation. The parties agreed to a 35% increase in the partnership interests prior to trial. After a trial, the Tax Court allowed an estate tax charitable deduction for the disclaimed property passing to the private foundation (including the amount resulting from the valuation increase) but denied the deduction for the transfer to the CLAT. The daughter's disclaimer contained a broad savings clause, but the Court found it was not sufficient to revive the charitable deduction for the CLAT because it was a not a qualified disclaimer under section 2518(b)(4).

Estate Tax Charitable Deduction Denied for Charitable Remainder Trust – In *ESB Financial v. United States*; No. 6:07-cv-01059 (23 Sep 2008), the United States District Court for the District of Kansas denied an estate tax charitable deduction for a testamentary charitable remainder trust based on the fact the trust did not conform to the requirements of section 2055 and a petition to reform the trust was not filed before the 90th day after the last date (including extensions) for filing the estate tax return.

Final Regulations Address Portion of Split-Interest Transfers Includable in Gross Estate - On June 7, 2007, the Treasury issued proposed regulations that address the portion of a trust that is includable in a deceased grantor's gross estate under sections 2036 and 2039 in the event the grantor has retained the use of trust property or the right to an annuity or other income payment from the trust for life. Following the comment period and public hearing, the Treasury has issued final regulations that are effective July 14, 2008. In addition to amounts includable with respect to GRATs, GRUTs, GRITs and CRTs measured by life, the final regulations address pooled income funds, remainder interests in personal residences and farms, and CRTs measured by a term of years. REG-119097-05; 72 F.R. 31487-31491; T.D. 9414; 73 F.R. 40173-40179**.**

INCOME TAX CHARITABLE DEDUCTION

Trust Document Language Important When Seeking Deduction-C.C.M. 200848020- Decedent's will created a testamentary trust funded wholly with decedent's IRA. The trust was to pay a percentage of the trust property to the decedent's children and to several charities; however, it failed to meet the regulatory definition of a designated beneficiary trust under section 401(a)(9). The trust was subsequently modified by court order to comply and the Service determined the purpose of the modification was to permit the trust to deduct payments made to charities. Citing a revenue ruling and court decision, the Service concluded that since the modification was not made as the result of a conflict, the payments to the charities were not considered to be made under the governing instrument and, therefore, were not deductible under section 642(c)(1).

Accuracy-Related Penalties – In Rev. Proc. 2008-14; 2008-7 IRB 1, the IRS updated Rev. Proc. 2006-48 and identified circumstances under which the disclosure on a taxpayer's return with respect to an item or a position is adequate for the purpose of reducing the understatement of income tax under section 6662(d) and for the purpose of avoiding the preparer penalty under section 6694(a).

Tax Preparers Enjoined from Claiming Excess Charitable Deductions: *United States v. Samuel J. DeAngelo et al.*, No. 8:03-cv-00251 (6 Aug 2008) – In *DeAngelo*, the U.S. District Court permanently enjoined several tax return preparers from preparing returns for compensation based on the court's finding the defendants understated the tax due (and overstated the refunds due) on customers' federal income tax returns by claiming false and inflated itemized deductions for charitable contributions and employee business expenses.

Substantiation: *Nicholas v. Comm'r*; T.C. Summ. p. 2008-155; No. 18199-07S (15 Dec 2008). In 2005, Mr. and Mrs. Nicholas reported an adjusted gross income of $89,092 with charitable contributions of $32,875 in cash and $4,906 in non-cash gifts. They also deducted $6,012 from a 2004 contribution carry forward. The Nicholas' accountant improperly deducted the $4,906 as a cash gift. When the couple was audited by the IRS, the discrepancy was noted and they promptly filed Form 8283, valuing the gifts using the gift receipt or letter from the charitable recipient. Mrs. Nicolas often frequented garage sales and flea markets and was a good judge of value. The gift items included books, CDs, used furniture and lamps. Nonetheless, the IRS denied the deduction and claimed there was not sufficient proof. At trial, the Tax Court judge determined that the deduction would be permitted and the $712 IRS deficiency was dismissed. The judge noted that Mrs. Nicholas had "forthright testimony," she and her husband had an "extremely generous" history of charitable giving, and through both documentation and oral testimony, she was a very credible witness. The case reinforces the rule that for non-cash items cumulatively valued at less than $5,000, an appraisal is not required. The donor should keep accurate records of the date of the gift, the charitable recipient, the general description of the item and the method used for valuation.

Substantiation: *Burkley v. Comm'r*; T.C. Summ. Op. 2008-20; No. 13748-04S (27 Feb 2008). The Tax Court detailed numerous problems with the taxpayers' return including a charitable deduction substantiated by an unsigned receipt on the letterhead of the Screaming Eagle M.B. Church. The Tax Court denied the charitable deduction expressing "grave doubts as to the trustworthiness of the receipt…or that the church did, in fact, exist at the address listed on the receipt provided, if it did exist at all."

Substantiation: *Gomez v. Comm'r*; T.C. Summ. Op. 2008-93; No. 13167-07S (30 Jul 2008). The Gomezes claimed more than $6,500 in charitable deductions for over 20 separate contributions made to their church by check. The IRS denied the deduction on the basis of lack of proper substantiation and allowed only $420.50, the amount of the cancelled checks of less than $250 each. The church provided the Gomezes with a receipt in 2008, but the Tax Court did not accept it because it was not contemporaneous and did not contain the required information (amount contributed, whether any goods or services were received, and if so, a good faith estimate of the value). The Court said the canceled checks and the letter from the church were "reliable" but did not satisfy the requirements in the Tax Code. The Court allowed the couple a deduction for only the $420 as the IRS had argued.

Proposed Regulations Clarify Substantiation Changes - The Treasury has released proposed regulations, NPRM REG-140029-07, to reflect changes to the substantiation rules contained in the American Jobs Creation Act of 2004 and the Pension Protection Act of 2006. The regulations

address cash, checks and monetary gifts, noncash contributions, the timing of appraisals and gifts of used clothing and household items.

No Deduction for Religious Schooling: *Sklar v. Comm'r*; No. 06-72961 (12 Dec 2008). The Ninth Circuit affirmed a Tax Court decision denying a deduction for tuition payments to a religious school. The Sklars argued that 55% of the $27,283 in tuition and fees they paid to two religious day schools for their five children's tuition was a charitable contribution under section 170 because the schools devote part of their school day to education and part to prayers and religious studies. In an earlier case, the Ninth Circuit also determined that the Sklars would not qualify for charitable deductions for a portion of their 1993 and 1994 tuition payments. *See Sklar v. Comm'r*, 282 F.3d 610 (9th Cir. 2002). The Sklars claimed that they should qualify for a deduction of $15,000 (55% of the total tuition) on the dual payment theory of *United States v. American Bar Endowment*, 477 U.S. 105 (1986). They also claimed that section 170(f)(8) should permit the deduction. Finally, they argued that the Closing Agreement between the IRS Commissioner and the Church of Scientology in 1993 that permitted partial deductions should require the Court to extend this same benefit to them.

The Court determined that the Sklars were not in a similar position to the Church of Scientology with respect to any deductions permitted for "auditing." The Sklar children were voluntarily attending a religious school and tuition payments were mandatory for the education received. In *Hernandez v. Commissioner*, 490 U.S. 680 (1989), the Court indicated that tuition payments to parochial schools would not be deductible and stated, "Such payments . . . . have long been held not to be charitable contributions under Sec. 170."

With respect to the "dual payment" claim, the Ninth Circuit noted that there are two specific requirements. First, the payment must exceed the fair market value of the eduction. Second, there must be an intent to make a gift. Because the tuition payments at the private religious schools were higher than some private schools but lower than others, there was no proof of a specific excess payment. Finally, because the students would be expelled if the tuition payments were not made, there was no gift. Therefore, the payments for religious school tuition did not qualify for any charitable deduction.

No Letter Rulings for Certain Categories of Deductions and Other Charitable Items - In Rev. Proc. 2008-3, 2008-1 IRB 110, issued January 7, 2008, the IRS updated the list of areas of the Code for which it will not issue private letter rulings or determination letters, including: (i) whether a charitable contribution deduction under section 170 is allowed for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in section 170(c); (ii) whether a taxpayer who advances funds to a charitable organization and receives therefore a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsement on the note; (iii) whether under section 642(c) a deduction is permitted for amounts paid or permanently set aside by a trust or estate for charitable purposes when there is a possibility that the corpus of the trust or estate may be invaded; (iv) whether the settlement of a charitable remainder trust under section 664 upon the termination of the noncharitable interest is made within a reasonable period of time under section 664; (vi) whether a charitable contribution deduction under section 2055 is allowed for the transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in section 2055(a); (vii) actuarial factors under section 2512 for valuing prospective or hypothetical gifts of a donor: (viii) whether a charitable contribution deduction under section 2522 is allowable for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an

organization described in section 2522(a); and (ix) whether a trust exempt from generation-skipping transfer (GST) tax under section 26.2601-1(b)(1), (2), or (3) of the Generation-Skipping Transfer Tax Regulations will retain its GST exempt status when there is a modification of a trust, change in the administration of a trust, or a distribution from a trust in a factual scenario that is similar to a factual scenario set forth in one or more of the examples contained in section 26.2601-1(b)(4)(i)(E).

Rev. Rul. 2008-16; 2008 -11 IRB 1 – The IRS ruled that a Sub-S corporation shareholder could claim a charitable income tax deduction that exceeded the shareholder's basis in the Sub-S stock.

Valuation: Art Advisory Panel: On January 24, 2008, the IRS announced that the Art Advisory Panel will be extended for two additional years. 73 F.R. 4308. The panel reviews the fair market value claimed for contributions of works of art which general income, gift or estate tax charitable deductions.

Transactions of Interest: In Notice 2008-99 (I.R.B. 2008-47), the IRS announced a use of charitable remainder trusts as a "transaction of interest" (having potential for abuse, but without sufficient information to be characterized as tax avoidance transactions). The suspect use involves creating a charitable remainder trust and then contributing appreciated assets to the trust. The trust then sells the appreciated assets and reinvests in new assets, such as money funds or marketable securities. The donor and the charitable beneficiary then sell or dispose of their interests in the trust to a third party for an amount equal to the value of the trust's assets. The taxpayer typically claims little or no taxable gain due to the higher basis in the new trust assets. In the future, the IRS could designate these as listed transactions with penalties imposed on those involved. *Authors' Note: The IRS is concerned that the CRT is being established purely to avoid the recognition of the capital gain inherent in the contributed assets. The IRS could attack this scheme based on lack of donative intent, deny the charitable deductions, and find that the trust is not a qualified CRT.*

2008 Dirty Dozen Tax Scams: Misuse of Trusts and Abuse of Charitable Organizations and Deductions Included – In IR-2008-41, on March 13, 2008, the IRS issued its annual "Dirty Dozen" tax scams for 2008. The IRS warns of "unscrupulous promoters" who urge taxpayers to transfer assets into trusts. The IRS states that it continues to observe the misuse of tax-exempt organizations, including arrangements to improperly shield income or assets from taxation, attempts by donors to maintain control over donated assets or income from donated property, overvaluation of contributed property and attempts to disguise private tuition payments as contributions to charitable or religious organizations.

Deductible Mileage Rates Increase – Rev. Proc. 2008-72; 2008-50 IRB 1 contains the 2009 optional standard mileage rates used to calculate the deductible costs of operating an automobile for business, charitable, medical or moving purposes. Beginning on January 1, 2009, the standard mileage rates for the use of a car (also vans, pickups, or panel trucks) will be:

- 55 cents per mile for business miles driven
- 24 cents per mile driven for medical or moving purposes
- 14 cents per mile driven in service of charitable organizations

Under EESA, however, reimbursements for charitable mileage attributable to the Midwestern disaster up to the amount of the standard business mileage rate will not be considered taxable income through December 31, 2008. In addition, for a taxpayer assisting in relief efforts related to the Midwestern disaster, EESA sets the charitable mileage rate at seventy percent of the current

standard business mileage rate, beginning on the applicable disaster date and ending on December 31, 2008.

Gifts of Inventory - Notice 2008-90 announced that the IRS and the Treasury Department are studying the computation of the deductible amount and adjustment to cost of goods sold for charitable contributions of inventory property that constitute qualified contributions as defined in section 170(e)(3)(A) of the Internal Revenue Code. The regulations are effective for tax years beginning January 1, 2008. Notice 2008-90; 2008-43 IRB 1.

CHARITABLE STATUS

Procedures for Issuing Determination Letters and Rulings on Exempt Status – In Rev. Proc. 2008-9; 2008-2 IRB 258, issued January 14, 2008, the Service set forth its procedures for issuing determination letters and rulings on the exempt status of organizations under IRC sections 501 and 521 (other than retirement plans). The IRS typically issues such determination letters and rulings in response to applications for recognition of tax exempt status and revocation or modification of determination letters or rulings. This revenue procedure also provides guidance on the exhaustion of administrative remedies for purposes of declaratory judgment under section 7428.

Elimination of Advance Ruling Process - The Internal Revenue Service and the Treasury Department issued new regulations that will streamline the approval process for organizations seeking tax-exempt status as publicly supported charities. The new regulations do away with the so-called advance rulings that granted public charity status for an initial five-year period but required exempt organizations to demonstrate, after the initial period, that they in fact received a substantial part of their support from public sources to receive a final determination letter. The IRS was able to eliminate the advance rulings process because of the recent redesign of the Form 990, the tax return filed by organizations exempt from federal income tax. The Service has published temporary regulations which eliminate advance rulings and the Form 8734, Support Schedule for Advance Ruling Period, filing requirement for all new section 501(c)(3) organizations. Under the temporary regulations if, at the time of the initial application for exemption, an organization can establish to the satisfaction of the IRS that the organization can reasonably be expected to meet a public support test during its first five years, the organization qualifies as publicly supported for its first five years as a section 501(c)(3) organization. The IRS will issue a determination letter stating that the organization is exempt under section 501(c)(3) and is classified as a public charity. The organization will be a public charity for its first five years, regardless of the level of public support it in fact receives during this period. In addition, unlike a new organization's public charity status under an advance ruling, which was conditioned on its ultimate satisfaction of a public support test on a Form 8734 filed with the IRS, under the temporary regulations, a new organization that can show it can reasonably be expected to meet a public support test will be classified as a public charity for all purposes during its first five years. The organization will not owe any section 4940 tax or section 507 termination tax with respect to its first five years. Beginning with the organization's sixth year, if the organization cannot establish that it is not a private foundation, such as a public charity or a supporting organization under section 509(a)(3), it will be liable for the section 4940 excise tax and other Chapter 42 excise taxes applicable to private foundations for any year for which it cannot establish that it is not a private foundation. IR-2008-102; T.D. 9423; NPRM REG–142333–07.

Tax-Exempt Organization Complaint (Referral) Form (Form 13909) – On February 7, 2008, the IRS issued IRS Fact Sheet FS-2009-13 which included a new process for individuals

concerned about possible non-compliance by a tax-exempt organization to report such concerns to the IRS. Form 13909 can be mailed, faxed, or e-mailed to the IRS. An exempt organizations agent will review the complaint using a "reasonable-belief standard" to determine if further action is warranted. The IRS can then proceed with either an audit or a compliance check.

Higher Education Compliance Questionnaires – On October 1, 2008, the IRS announced that compliance questionnaires had been sent to 400 U.S. colleges and universities focusing on unrelated business income, the investment and use of endowments, and executive compensation practices. A report will be issued in 2009 on the responses. IR-2008-112.

IRS FORMS

Form 5227 and Instructions for Form 5227 – As a result of changes brought about by the Pension Protection Act of 2006, the IRS has issued a revised Form 5227, *Split-Interest Trust Information Return*, for reporting by charitable remainder trusts, pooled income funds and charitable lead trusts for the 2007 tax year. Split-interest trusts no longer have to file Form 1041-A. Form 5227 now satisfies the requirements of section 6034 and continues to meet the requirements of Regulations section 53.6011-1(d) and, for charitable remainder trusts, Regulations section 1.6012-3(a).

Form 990-EZ - The Internal Revenue Service has released instructions for filing the 2008 Form 990-EZ, *Short Form Return of Organization Exempt From Income Tax*, to be used for the 2008 tax year. The new form is mostly unchanged; however, it has been updated to include certain schedules from the new Form 990, which replace previously unstructured attachments.

Form 990 – On April 15, 2008, the IRS released for public comment the draft instructions to the 2008 Form 990, which is the return most tax-exempt organizations must file annually. The Service then released new Form 990 Instructions for the 2008 tax year, consisting of an 11-page, 11-part core form that is required to be completed by all organizations that file the Form 990, and Schedules to be completed by those organizations that satisfy the applicable requirements for each Schedule. On August 19, 2008, the IRS released by revised instructions. IR-2008-98.

Form 990-T (Exempt Organization Business Income Tax Return) – In Notice 2008-49, the IRS provided interim guidance on the requirement that section 501(c)(3) organizations (charities) make available for public inspection Form 990-T, *Exempt Organization Business Income Tax Return*.

Form 990 – N – In IRS News Release IR-2008-25, the IRS announced the launch of the electronic filing system for filing Form 990-N, the annual information return for tax-exempt organizations with less than $25,000 in average annual revenues. The due date for filing Form 990-N, an e-postcard, is the 15th day of the 5th month after the close of the organization's fiscal year. Tax exempt status will be revoked for organizations who fail to file 990-N for three consecutive tax years. These forms will be made available to the public through a new disclosure site on www.IRS.gov.

Publication 557- The IRS has released revised Publication 557, *Tax-Exempt Status for Your Organization* (June 2008). The publication incorporates numerous changes in law brought about by the Pension Protection Act of 2006 that affect tax-exempt organizations.

Publication 1771 – On May 17, 2008, the IRS issued a revised Publication 1771, *Charitable Contributions -- Substantiation and Disclosure Requirements*, which explains the federal tax law for organizations such as charities and churches that receive tax-deductible charitable contributions and for taxpayers who make contributions.

Publication 4303 - On May 17, 2008, the IRS issued a revised Publication 4303, *A Donor's Guide to Vehicle Donations*. The guide provides general guidelines on selecting a charity, qualifying for tax deduction, and valuation. It is considered a companion brochure to Publication 4302, *A Charity's Guide to Vehicle Donations*.

CHARITABLE GIFT ANNUITIES

American Committee on Gift Annuities Announces Lower Rates Effective February 1, 2009- At its December 2008 meeting, the board of directors of the American Committee on Gift Annuities announced lower payout rates on both immediate and deferred payment charitable gift annuities effective February 1, 2009. The rates will be available not later than January 15, 2009.

Charities Issuing Gift Annuities in New York Subject to New Reserve Requirements – The State of New York has issued new reserve requirements for charities that issue charitable gift annuities in New York. For more information, visit http://www.ins.state.ny.us/life/charanrs.htm.

CHARITABLE REMAINDER TRUSTS

Sale of Charitable Remainder Trust Interests – In Notice 2008-99, the IRS announced its interest in a type of transaction involving the sale of interests in a charitable remainder trust (CRT) that might result in inappropriate tax avoidance by the trust’s grantor. The notice requires any persons entering into and material advisers who make a tax statement regarding such transactions, as well as charitable remaindermen that participate to disclose the transaction to the IRS. In addition, the Service and Treasury are requesting public comments on how the transaction might be addressed in published guidance.

For example, a grantor creates a CRT and contributes appreciated assets to it. The grantor retains a term annuity or unitrust interest in the trust and designates a charitable organization described in sections 170(c), 2055(a) and 2522(a) as the remainder beneficiary. The payout format (standard, net income, net income plus makeup or flip) is irrelevant to the transaction. The trustee then sells the appreciated assets and purchases new assets such as money market funds or publicly traded securities.

Under the rules applicable to CRTs, the trust takes on the holding period and cost basis of assets transferred to it and realizes gain on the sale of such assets; however, since the trust is generally exempt from tax on gain from the sale of its assets, the trust pays no tax on the gain. The newly purchased assets within the trust will have a new tax basis equal to their purchase price. Only the unitrust or annuity amount payable to the trust’s income recipient(s) is taxable to income recipient(s) under the rules of section 664.

Following the sale and reinvestment of the CRT assets, the grantor and the charity join in the sale of their interests in the trust to an independent third party for an amount approximately equal to the value of the trust’s assets in a transaction they claim is described in section 1001(e)(3).

Because the entire interest in the trust is sold, the grantor claims that section 1001(e)(1), which disregards basis in the case of a sale of a term interest, does not apply to the transaction. The grantor also takes the position that, under section 1001(a) and related provisions, the gain on the sale of the grantor's term interest is computed by taking into account the portion of uniform basis allocable to the grantor's term interest under sections 1.1014-5 and 1.1015-1(b), and that this uniform basis is derived from the basis of the newly purchased assets rather than the basis of the appreciated assets used to fund the trust. The grantor and charity divide the sales proceeds based on the present value of their respective interests at the time of sale.

The IRS and Treasury Department are concerned about the coordinated sale and manipulation of the uniform basis rules being used to avoid tax on gain from the sale or other disposition of appreciated assets.

IRS Issues Guidance on the Division of Charitable Remainder Trusts – In Rev. Rul. 2008-41; 2008-30-IRB 1, the IRS detailed how a charitable remainder trust can be divided into two or more distinct charitable remainder trusts. The IRS clarified several issues, including: (i) the pro rata division of a qualified CRT into two or more trusts does not cause any of the individual trusts to fail as a CRT; (ii) the division is not a sale, exchange or other disposition producing gain or loss; (iii) the basis of each separate trust's share of each asset is the same share of the basis of that asset in the hands of the trust immediately before the division of the trust (same for the holding period of the asset); (iv) the division of the CRT does not terminate the trust under private foundation rules that would require imposition of an excise tax; (v) the division of the CRT does not constitute an act of self dealing; and (vi) the division of the CRT does not constitute a taxable expenditure.

Final Regulations Regarding Portion of CRTs Includible in Grantor's Gross Estate – The IRS has finalized regulations providing guidance on what part of trust property should be included in a grantor's gross estate under sections 2036 and 2039 if the grantor has retained a lifetime interest. The regulations cover the grantor retained trusts and charitable remainder trusts. The regulations state that the portion of the trust included in the gross estate is that part necessary to yield the annual annuity or unitrust payment without reducing or invading principal. This calculation is made using the section 7520 rate in effect on the decedent's date of death (or alternate valuation date). Note that the final regulations do apply to pooled income funds (though they do not apply to a charitable gift of a remainder interest in a personal residence or farm). T.D. 9414, Reg. Sec. 20.2036-1.

No Termination Tax When CRT Terminated to Create Supporting Organization – A and B were income beneficiaries of a net income plus makeup charitable remainder unitrust with a flip provision. C was the remainder beneficiary. A and B decided it was in their best interest, and that of C's, to terminate the trust early and distribute the remainder to D, a supporting organization of C. Therefore, A and B modified the trust to list D as the sole remainder beneficiary, replacing C.

A, B and the trustee requested a ruling that the early termination of the trust and the distribution of the trust's assets in proportion to the amount actuarial determined to each party would not result in an act of self-dealing. Section 53.4947-1(c)(2)(i) of the Regulations provides an exception to the self-dealing provisions if each party receives the present actuarial value from the trust. The Service ruled that although A and B were disqualified persons with regard to the trust, the self-dealing prohibition contained in section 4947 did not apply because each party was to receive their actuarial value from the trust.

CHARITABLE LEAD TRUSTS

Sample Intervivos and Testamentary CLAT Documents Issued – In 2007, the IRS published sample charitable lead annuity trust (CLAT) documents that comply with federal requirements. Rev. Proc. 2007-45, IRB 89 (intervivos) and Rev. Proc. 2007-46, IRB 102 (testamentary). The preamble to the forms indicates that an escalation clause may be permitted.

Sample Intervivos and Testamentary CLUT Documents Issued – On July 28, 2008, the IRS published new sample forms for charitable lead unitrusts (CLUTs). The sample forms feature annotations and alternate provisions. The new sample CLUT forms are a timely resource because CLTs are most effective in times of low applicable federal rates. Rev. Proc. 2008-45, 2008-30 IRB 224 (inter vivos) and Rev. Proc. 2008-46, 2008-30 IRB 238 (testamentary).

Regs Prorate Tax Character of Income Distributions from CLTs to Charitable Beneficiaries- The Treasury has issued proposed regulations that will amend the regulations under section 642(c) to confirm that a provision in a governing instrument of a charitable lead trust or in local law that specifically provides as to the source out of which amounts are to be paid, permanently set aside or used for a purpose specified in section 642(c) must have economic effect independent of income tax consequences in order to be respected for federal tax purposes. Accordingly, payments to a charity will consist of the same proportion of each class of the items of income of the trust as the total of each class bears to the total of all classes. *See* § 1.642(c)-3(b)(2). REG-101258-08, 73 F.R. 34670-34672.

2007 CHARITABLE GIVING TOPS $3 BILLION – Charitable giving by Americans in 2007 was estimated to be $306.39 billion in 2007, exceeding $300 billion for the first time in history, according to *Giving USA 2008*, the yearbook on philanthropy released today by Giving USA Foundation™. The estimates for 2007 indicate that giving rose in 2007 by 3.9 percent (1 percent adjusted for inflation).