DALLAS JEWISH COMMUNITY FOUNDATION

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ESTATE PLANNER'S TIP

As appealing as it sounds to pay off a home mortgage early and be "debt free," it may not be the best idea for some clients, particularly if they anticipate needing to borrow funds in the future. Interest on a qualified residence is deductible on up to $1 million of "acquisition indebtedness" [Code §163(h)(3)(B)]. Acquisition indebtedness is defined as any indebtedness incurred in "acquiring, constructing or substantially improving" any qualified residence of the taxpayer. A new mortgage that is obtained on a taxpayer's existing home may not constitute acquisition indebtedness, making the interest nondeductible personal interest [Code §163(h)(1)]. It's true that taxpayers may deduct interest on home equity loans, but only on amounts up to $100,000 [Code §163(h)(3)(C)]. If a client knows that a larger amount of capital will be needed, it may be smarter to invest the funds that would be used to pay off a mortgage, and at the same time preserve the ability to deduct interest on loans in excess of $100,000.

COURT CAN'T FIX IRA DESIGNATION

Herman died in 2004, shortly after his wife's death. Some years earlier, he had completed a beneficiary designation for his IRA naming his wife as primary beneficiary and his only child, Caroline, as secondary beneficiary. However, a subsequent designation listed only his wife. The custodian of Herman's IRA sent a new beneficiary designation form after his wife's death, but Herman died before signing it. As a result, his estate became the beneficiary of his IRA. Under the terms of his will, his estate passed to a trust.

In 2006, at Caroline's request, a court amended the beneficiary designation to conform to Herman's presumed intent, naming her as the beneficiary of the IRA.

Under Reg. §1.401(a)(9)-4, a designated beneficiary is an individual who is designated as a beneficiary under the plan. The passing of an interest to an individual under a will or under state law does not make the person a designated beneficiary under Code §401(a)(9)(E) unless the individual is designated, noted the IRS. Where an estate is the designated beneficiary, the decedent is treated as having no designated beneficiary. The timing of distributions from Herman's IRA must be made over a period not longer than his remaining life expectancy, not over Caroline's longer life expectancy, the IRS ruled (Ltr. Rul. 200742026).

A RIDE ON THE EXPENSIVE SIDE

The standard mileage rate for 2008 reflects what every driver experiences at the gas pump – the cost of driving has gone up. The IRS announced a two-cent increase in the rate for operating a vehicle for business, from 48.5 cents per mile to 50.5 cents. But apparently it doesn't cost as much to operate a car when the trips involve moving or medical travel, since the standard mileage rate for those categories have dropped a penny to 19 cents per mile for 2008. The standard rate for charitable use – 14 cents per mile – is fixed under Code §170(i). The standard mileage rate is in addition to what a taxpayer spends on parking and tolls.

Rather than use the IRS's rate, taxpayers may document actual costs of repairs, fuel, insurance and licenses and allocate a portion of the expenses to the business use of a personal vehicle (Rev. Proc. 2007-70).

COURT WON'T COMPEL IRS TO ISSUE RULING

Philip Tobin operated a business that produced radio "jingles," many of which were sold to state governments. The songs dealt primarily with public interests such as snowmobile, boating and highway safety and environmental and wildlife conservation. According to Tobin, much of the market for his products evaporated with the deregulation of the broadcast industry, which meant radio stations no longer needed to provide free air time to obtain or renew a license.

Tobin believes that the market for his jingles would recover if radio stations were informed that airing the announcements qualified as a charitable contribution. The IRS refused to issue such a ruling. Tobin then sought a declaratory judgment from the court that the announcements qualify for charitable contribution tax status.

The IRS made a motion to dismiss, saying the declaratory judgment act does not allow claims related to tax matters. Further, argued the IRS, sovereign immunity bars lawsuits against the federal government unless Congress has waived the immunity. In the absence of a waiver, the court lacks jurisdiction to decide the matter, said the IRS.

Tobin claimed the case does not address a tax question, but rather seeks to determine whether "radio airplay is tangible property as opposed to a service." He acknowledges that if it is a service, it would not qualify for a charitable deduction.

The U.S. District Court (Maine) dismissed Tobin's action, saying the requested relief is not authorized under the declaratory judgment act. Furthermore, sovereign immunity applies for claims against the IRS and its employees acting in their official capacity (*Tobin v. Comm'r.*, 2007-2 USTC ¶50,832).

PHILANTHROPY PUZZLER

Bernice and Betty, 72-year-old twins, share everything, including a favorite charity. The two heard about the benefits of charitable remainder trusts at a seminar and decided to create a trust that would provide them income for life. They plan to fund the trust with a beach home that they own as tenants in common and rarely use anymore. The charity's planned giving officer mentioned an IRS ruling that disqualified a trust funded jointly by nonspouses. They have asked if there is another option.

DEATH NEGATES UNFULFILLED PLEDGE

In late 2005, Moses Burg attended a function held by the Anti-Defamation League Foundation (ADLF), at which he told the ADLF Director that he intended to make a gift of $100,000 to the foundation's endowment campaign. Several days later, Burg signed a letter prepared by ADLF pledging to name the organization as a beneficiary in his will. ADLF also put Burg in touch with an attorney who drafted a revocable trust that included the gift commitment.

Following Burg's death several weeks later, the administrator of his estate found the unsigned document. The probate court determined that the pledge letter to ADLF was not a testamentary instrument. Burg left no will.

ADLF appealed, claiming Burg made a valid inter vivos gift. The elements of valid gift – donative intent, delivery and acceptance – were present, said ADLF. The Court of Appeals of California found that there was no valid gift "because Burg did not fulfill his intention of leaving a gift by will." The pledge letter merely indicated that he "anticipated" naming ADLF. He did not execute a will or the living trust prepared by the attorney.

ADLF also argued that Burg's pledge was enforceable as a contractual obligation under the doctrine of promissory estoppel, pointing out that mutual promises of various donors to a charity "support each other and render a pledge enforceable." The court pointed out that, as a general rule, a promise of a charitable gift may be withdrawn at any time prior to acceptance. The death of the person making the offer generally constitutes a revocation and the estate will not be liable, said the court. There is an exception where mutual promises are made, which can serve as adequate consideration for enforcing the pledge. However, the court noted that ADLF had not shown that it performed any acts or incurred any obligation based on its reliance on Burg's promise that would result in the application of promissory estoppel (*Estate of Burg v. ADLF*, 2d Civil No. B195382).

POTENTIAL BENEFICIARIES HAVE NO STANDING

W.T. Neal established a trust under his will in 1950, directing that the trustees were to pay the balance of the net income to charitable organizations to be used exclusively in Escambia County, Alabama, and Calhoun County, Florida. The trust has been the subject of litigation for many years, noted the Supreme Court of Alabama. The court had previously ruled that because the trust does not name or describe any identifiable beneficiaries, it does not vest an enforceable right to any income [*Neal v. Neal*, 856 So.2d 766 (Ala. 2002)].

St. Paul Church and Mayhaw School are among the numerous entities that could receive charitable contributions under Neal's trust. Although they concede they have no standing to seek an award of benefits, they claim they do have a right as "putative class plaintiffs" to enforce the trust and seek restitution on behalf of the entire charitable class for the "misdeeds and mismanagement" of the trustees.

In *Jones v. Grant*, 344 So.2d 1210 (Ala. 1977), the Supreme Court was asked whether anyone other than the attorney general has standing to sue a charitable trust. The court ruled that students, faculty and staff had standing under a "sufficient special interest" standard. St. Paul Church and Mayhaw School claim that they have standing to sue for enforcement of the trust under *Jones*.

The court noted that in *Jones*, the students, faculty and staff of the charitable institution were identified as actual beneficiaries of the trust. St. Paul and Mayhaw, on the other hand, are merely potential beneficiaries and therefore do not have sufficient special interest to enforce the trust terms. In the absence of a special interest, ruled the court, a party seeking enforcement should have the attorney general commence an action for trust mismanagement due to negligence or fraud (*Rhone v. Adams*, No. 1060482).

PUZZLER SOLUTION

The IRS has ruled that a trust funded by nonspouses is an "association" and not a tax-exempt charitable remainder trust (Ltr. Rul. 9547004). However, Bernice and Betty may be able to create two trusts using the home. Each could create a two-life trust with successive interests, funding them with their one-half interests in the home. The combined deductions from two trusts would be the same as the deduction from one trust for their joint lives, and although each would be considered to have made a gift to the other twin of a successor interest, they could make the gifts incomplete by retaining the right to revoke the other's interest by will [Reg. §§1.664-2(a), 1.664-3(a)(4)], thereby avoiding any gift tax.

Corporations and their owners have a variety of ways to benefit charity:

Gifts of stock by the shareholder – The majority shareholder of a closely held corporation can contribute shares of stock to charity. Because it is impractical for charity to retain the stock or to participate in company operations, the organization will likely wish to redeem the shares from the corporation.

The shareholder will be left in roughly the same ownership position as prior to the gift and redemption. The donor will be entitled to a charitable contribution deduction for the fair market value of the shares based on a qualified appraisal. The benefit of this arrangement is that the shareholder receives a personal deduction and avoids capital gains taxes, yet the contribution is made from corporate funds rather than from his or her personal funds.

The gift of stock must be unconditional, with no requirement that charity redeem the shares [Rev. Rul. 78-197, 1978-1 C.B. 83].

Gifts of pledges of stock options – These gifts require a series of steps, but it may be worth the trouble. In a typical transaction, a publicly traded corporation grants stock options to charity, permitting it to purchase shares of the company for the fair market value at the time of the pledge. The company is entitled to a deduction when the option is exercised for the excess of the fair market value over the exercise price on the date the option is exercised [Rev. Rul. 75-348, 1975-2 C.B. 75].

If the pledge is made to the corporation's charitable foundation, an intervening step is required. A purchase of stock directly by the foundation would constitute self-dealing under Code §4941 because the company is considered a "disqualified person." Instead, the foundation sells the options to an unrelated charity for the fair market value of the options (the difference between the fair market value on the day of the pledge and the exercise price of the options, less a discount). The unrelated charity would then be free to exercise the options.

The company is entitled to a deduction in the year the unrelated organization exercises the options. The amount of the deduction is the excess of the fair market value on the date the option is exercised over the exercise price (see e.g., Ltr. Ruls. 8825069, 8849018).

Contribution of stock followed by liquidation – This gift technique allows the shareholder of a closely held corporation to make a significant contribution to charity while avoiding the recognition of capital gains.

Shares are given to charity prior to any plan of liquidation being adopted. The donor receives an income tax charitable deduction equal to the fair market value of the shares, but the donor is not taxed on the capital gain that would otherwise have been realized. The shares can also be used to fund a charitable remainder trust that will provide income for the shareholder while avoiding capital gains tax on the sale of the shares.

The use of a charitable gift in connection with a liquidation works only where the plan of liquidation follows the gift. Otherwise, the donor may be subject to capital gains tax under an assignment of income theory.

Gifts of inventory for the "care of the ill, needy or infants" – Generally, corporations may claim a charitable deduction equal only to their basis in inventory items donated to charity. An exception allows a higher deduction for the contribution of inventory that will be used by charity for the care of the ill, needy or children. Code §170(e)(3)(A) permits a deduction equal to basis plus one-half the unrealized appreciation, up to twice the basis. A similar tax break exists for gift of research equipment to colleges and universities [Code §170(e)(4)(A)].

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