Advisor *Update*

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A professional advisor resource courtesy of Advocate Charitable Foundation

Latest Rulings From the Courts and the IRS

IRS Extends Grandfather Period for Charitable Remainder Trusts Subject to Spousal Election, Notice 2006-15, 2006-8 IRB 1, Modifying Rev. Proc. 2005-24, 2005-16 IRB 909

Revenue Procedure 2005-24 alerted planners to the potential disqualification of a charitable remainder trust under IRC §664 in states where the surviving spouse has the right to renounce the will and elect to receive a share of the "augmented estate." The Revenue Procedure created a "safe harbor" provision to avoid disqualification where the spouse executes a timely, irrevocable waiver giving up the right to elect against the trust for trusts created on or after June 28, 2005. Trusts created before that date will not be disqualified unless the surviving spouse elects against the trust. Notice 2006-15 extends the June 28, 2005, grandfather date "until further guidance is issued" and indicates the IRS and Treasury are reconsidering both their approach to the problem and the proposed safe harbor procedure.

Waiver of U.S. Forest Service Grazing Permit Following Property Sale Not a Charitable Deduction, Otto Bischel et ux. v. United States, No. 2:04-cv-1537 (Feb. 8, 2006)

The Tax Court granted a Motion for Summary Judgment denying the petitioners' request for refund for a charitable deduction claimed for the waiver of a 10-year grazing permit issued by the U.S. Forest Service. The grazing permit — issued after the Bischels purchased a New Mexico cattle ranch — was exclusive to the underlying property and its owners and did not allow the Bischels to transfer or sell the rights. Under its terms, permit holders must waive the permit on the sale of the property or the right will be cancelled. The Bischels sold the property in 1998, waived the permit and claimed a $40,000 charitable deduction for the value of the waived rights. The Tax Court affirmed the denial of the deduction, finding the grazing permit conveyed no legal title to the Bischels and thus was not a conveyable property interest; the waiver of the permit conveyed no value to the government (which already owned the rights in the asset); and the donor's appraisal was incorrect since the waiver had no value once the property was sold.

Lack of Substantiation Reduces Taxpayers' Deduction for Non-Publicly Traded Stock, John T. Hewitt, et ux. v. Commissioner, 82 AFTR2d Par. 98-5537, No. 98-1386

In 1990 and 1991, John and Linda Hewitt donated shares of Jackson Hewitt Tax Service, Inc., a non-publicly traded company, to two charities claiming charitable deductions based on the value of local trading prices at approximately the time of the gifts. While the market for the securities was active (the company and a regional securities firm made a market in the shares), the stock was not traded on a public exchange and the Hewitts failed to obtain or attach an appraisal to their return as required by IRS Reg. §1.170A-13. The Tax Court held the taxpayers deduction was limited to the couple's basis. The Fourth Circuit affirmed and held the Hewitts had not met the substantiation requirements, stating "the taxpayer seeking the benefit of a deduction [must] show that every condition….has been fully satisfied." The Court rejected the Hewitts' argument that they had substantially complied with substantiation requirements (finding the petitioners "utterly ignored the appraisal requirement") and an alternate argument that they were entitled to deduct at least $10,000 for each gift (the gift level at which the qualified appraisal is required).

IRS Approves Pooled Income Fund Designed to Finance Development of Land and Buildings, Ltr. Ruls. 200608002, 200608003

These pooled income fund rulings were issued at the request of a tax-exempt hospital planning to create a pooled income fund to purchase and renovate buildings. The hospital anticipated leasing the property to the pooled income fund, which in turn would lease the land and buildings to the hospital for a 25-year term on a net-net basis. The IRS ruled favorably on four additions to the sample declaration of trust published in Revenue Procedure 88-53, 1988-2 C.B. 712: the fund donor's right to retain the power to revoke non-personal fund income interests under will, the trustee's direction to prorate the final beneficiary income payment through date of death, the trustee's ability to set up and maintain depreciation reserves for the property, and the hospital's right to amend the document in any way that did not jeopardize the fund's qualification. The hospital also sought approval to depreciate the buildings over a 40-year period on a straight line basis, to allocate depletion or depreciation deductions to the income beneficiaries to the extent those deductions exceeded the income set aside for the depreciation reserves, and to characterize the fund income as passive to fund beneficiaries. The IRS ruled favorably on those requests, too.

Tax Court Adjusts Deduction for Bargain Sale of Closely Held Stock, Ian G. Koblick et ux. v. Commissioner, T.C. Memo. 2006-63, No. 13808-04

This appeal before the Tax Court involved a valuation dispute in the bargain sale of a 45 percent interest in Sealodge International, Inc., a closely held company, to Maine Resources Development Foundation, a tax-exempt organization. Sealodge's primary asset was the Jules Undersea Lodge, a submersible vessel designed to house researchers undersea for periods up to a week. The Court focused on the valuation of the Jules Undersea Lodge and the discount required for the donor's minority interest. The valuation issue was complicated by conflicting appraisals submitted by the taxpayers' expert at trial and on the taxpayers' return. The substantiation appraisal established the replacement cost of the vessel at $1.97 million while the trial expert, apparently unaware of the original appraisal, set that value at $4.25 million. The court began with the appraisal submitted with the return, but then reduced that value for depreciation and a minority discount. However, the discount was limited because the taxpayers acted with all the other shareholders to simultaneously transfer 100 percent of the Sealodge stock to the foundation.

Items of Interest to Planners

IRS Cites "Abuse of Charitable Organizations and Deductions" as One of the Top Twelve Tax Scams for 2006, IR-2006-25

The IRS recently published its "Dirty Dozen" list of top tax scams to alert taxpayers and preparers to areas of concern which will receive scrutiny. Once again, abuses of charitable organizations and charitable deductions are on the list. The notice singled out concerns about transactions in which taxpayers transfer assets or income to supporting organizations/donor-advised funds while maintaining control, as well as inflated deductions for historic facade easement contributions.

IRS Reports Drop in Percentage of Decedents With Taxable Returns from 1997 to 2002, Winter 2005/2006 Statistics of Income Bulletin, Historical Tables and Appendix, Table 17, Estate Tax Returns as Percentage of Adult Deaths

The IRS tracks the numbers, amounts and percentages of decedents required to pay estate tax, reporting cumulative figures in its Statistics of Income Reports. The percentage of the subject population has varied widely over the period tracked, 1934 to 2002, from a low of .78 percent in 1935 to a high of 7.65 percent in 1975. Table 1 reflects the results for 1999 through 2002, showing a dramatic decline from 2001 to 2002 as the gross filing threshold rose from $675,000 to $1,000,000. The percentage of estates subject to tax will certainly continue to decline through 2010 as the filing threshold increases to $3.5 million in 2009 and then disappears in 2010.

TABLE 1: *Deaths and Taxable Estates, 1997-2002*

Year	Gross Estate Filing Threshold	Number of Deaths	Number of Taxable Returns	Percentage of Decedents with Taxable Returns
1997	$600,000	2,258,366	47,800	2.12
1998	$625,000	2,282,055	49,913	2.19
1999	$650,000	2,336,840	53,819	2.30
2000	$675,000	2,349,361	51,159	2.18
2001	$675,000	2,363,100	49,911	2.11
2002	$1,000,000	2,389,533	28,074	1.17

Legislative Developments

Charitable Provisions in S. 2020 Do Not Survive Conference on H. 4297, Now Titled the "Tax Increase Prevention and Reconciliation Act"

On May 9, 2006, Senate Finance Committee Chairman Charles Grassley (R-Iowa) and House Ways and Means Committee Chairman Bill Thomas (R-Calif.) announced agreement on H.R. 4297, the "Tax Increase Prevention and Reconciliation Act." H.R. 4297 then passed the House on May 10 and the Senate on May 11. The bill will now go to President Bush for his signature. Unfortunately, the final version of the bill did not include the charitable giving incentives reported in previous issues of this newsletter such as tax-free distributions from IRAs to charity, a non-itemizer's deduction, an expanded conservation easement deduction cap and a deduction for art contributed by the artist. Other charitable provisions removed from the final version of the bill included reforms imposing penalties for exempt organization participation in tax shelters, increasing excise taxes on private foundation prohibited transactions, restricting distributions from donor-advised funds/supporting organizations to donors and related parties, and permitting the IRS to communicate with state officials about IRS action taken with exempt organizations. Most observers believe the charitable incentives — which were passed but not enacted in 2003 and 2005 — will reappear in subsequent bills.

Five Simple Ways to Maximize Impact of Charitable Estate Gifts to Charity and the Donor's Family

Any planner who has struggled with difficult assets or fact situations in creating charitable remainder trusts, charitable lead trusts or even formula-driven divisions of property to charity in an estate plan can appreciate the potential complexity of charitable gift planning. Sometimes the simplest planning ideas generate the most profound results. Consider these five easy charitable estate planning ideas that can be employed for any client with charitable intent.

1. Name a charity as the beneficiary of an IRA or retirement plan. This strategy has several benefits. It's quick, it's easy, and it has the potential to create a double tax benefit. IRAs and retirement assets, except for Roth IRAs and retirement plans, are subject to the Income in Respect of a Decedent (IRD) rules, because income was generated during the decedent's lifetime, but no income tax has been paid. Those assets are subject to income tax (up to 35 percent in 2006) on the unpaid income and estate tax (up to 46 percent in 2006) on the asset. To name a charity as the beneficiary, have your client sign a new beneficiary designation provided by the plan. Other IRD assets which may have these double tax benefits include savings bonds with accrued interest, deferred compensation, accounts receivable for professional services, remaining installment sale payments, accrued stock or bond income or any asset with accrued but untaxed income.
2. Create a testamentary charitable gift annuity for a surviving spouse funded with an IRA. If a client is concerned that gifting the IRA to charity will unduly reduce the surviving spouse's income, consider using the IRA to create a testamentary charitable gift annuity. This charitable gift also avoids income and estate tax on the transfer to charity and provides the surviving spouse a lifetime supplemental income stream.
3. Name a charity as beneficiary of an insurance policy or annuity death benefit. It's also easy for donors to make testamentary charitable gifts by naming a charity as the primary (or even secondary) beneficiary of a life insurance policy or annuity death benefit. This easy gift requires only a change in the policy's beneficiary designation form. The gift creates a charitable deduction for the estate, and generally moves the gift to the charity more quickly than the probate process.
4. Use a "pay on death" provision with financial accounts. Another easy way to make a charitable gift at death is to use a "pay on death" or "transfer on death" designation naming the charity as beneficiary on the client's checking, savings, brokerage or other financial accounts. Such a designation can be established when the account is created or later instated by contacting the account's representative. If the client wants to ensure a certain minimum gift and is unsure how much will remain in the account at death, include a provision in the will to take care of any underpayment.
5. Accelerate planned estate gifts in non-taxable estates. The 2006 estate tax credit shelters $2,000,000 of estate assets, meaning most decedents will not have taxable estates. Why not make testamentary gifts today to generate a charitable income tax deduction? Classic examples include transferring insurance policy ownership to a charity named as beneficiary, making a transfer of all or part of a valuable art collection to the museum named as intended beneficiary (especially if the client is concerned about the ongoing cost of insuring and safeguarding the assets), or creating a retained life estate in a home destined for charity. For a client in retirement, convert a charitable bequest to a current charitable gift annuity to generate supplemental retirement income.

The goal with each of these plans is to create a simple, tax-effective way to make a gift to a charity, while maximizing the tax benefits to the donor and his or her family. The next time a client expresses charitable intent, look at these five options first. You may find gift planning is simpler than you thought.

Suggested Wording for Making a Bequest

If your or your client would like to make a bequest to a program or hospital of Advocate Health Care, please make the bequest to Advocate Charitable Foundation for the benefit of the hospital or program. For example:

When making a specific bequest: "I give Advocate Charitable Foundation, Park Ridge, Illinois, 60068, the sum of $_________ [to be used by the (insert name of hospital or program) for its general purposes or according to a letter of intent previously agreed to by the Foundation and me].

When making a residual bequest: "I give Advocate Charitable Foundation, Park Ridge, Illinois, 60068, _______ percent of the residue of my estate [to be used by the (insert name of hospital or program) for its general purposes or according to a letter of intent previously agreed to by the Foundation and me].

For further information, please contact the Office of Gift Planning at 847.384.3418. Our staff would be pleased to assist you.

Charitable mid-term federal rates

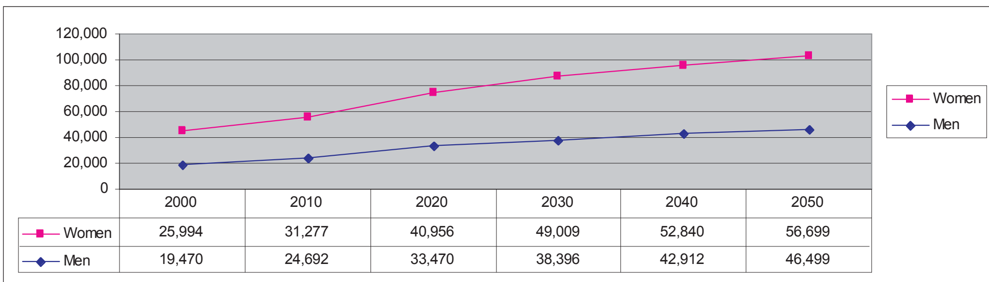
The charitable mid-term federal rates under IRC § 7520 for gifts made in May 2006 are set out below. These rates are used to determine the present value of an annuity, an interest for a life or term of years, or a remainder or reversionary interest. Call Donald Gottesman, Manager of Gift Planning, at (847) 384-3418 if you need current rates for your calculations.

June 2006	6.0%
May 2006	5.8%
April 2006	5.6%

Census Study Projects Explosion of Seniors Over Next Forty-Four Years, U. S. Census Bureau, www.census.gov/ipc/www/usinterimproj/.

In 2006, the 3.4 million U.S. baby boomers born in 1946 will turn 60 at the rate of 330 per hour or 7,918 per day. Based on figures gathered in the 2000 Census and projected life expectancies, there will be a dramatic increase in the number of seniors in each decade through 2050. Table 2 sets out Census Bureau estimates for male and female populations age 60 and above for 2000 through 2050.

Table 2: *Male and female population totals for age 60+ 2000-2050 (in thousands)*



	2000	2010	2020	2030	2040	2050
Women	25,994	31,277	40,956	49,009	52,840	56,699
Men	19,470	24,692	33,470	38,396	42,912	46,499

Contact information

For assistance in structuring gifts to Advocate Health Care hospitals, sites and programs, contact the Office of Gift Planning at Advocate Charitable Foundation.

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Also, visit our Web site at
www.advocatehealth.planyourgift.org/

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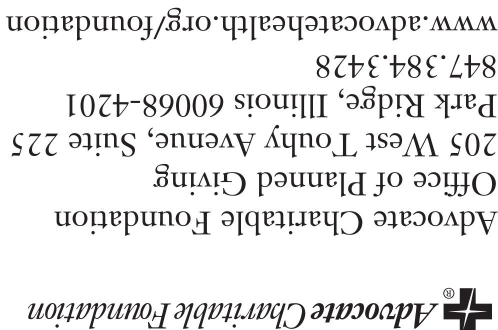

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