Northwest Planned Giving Roundtable

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GOVERNMENT RELATIONS REPORT
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What's Holding the Wealthy Back?

The April issue of Trusts & Estates in an article by David Leibell reported the results of a survey, "Philanthropy: Barriers to Giving" by Barclays Bank PLC. The survey focused on the attitudes towards philanthropy of 500 high-net-worth individuals in the United States and the United Kingdom, to gain a better understanding of what's holding the wealthy back from giving more to charity.

Bottom line: wealthy individuals should be able to give significantly more than they are presently giving to charity. The survey identified four barriers that restrict increased giving: 1) the current economic uncertainty; 2) a large percentage of potential donors lacking one of three key motivators: the desire to give for familial, societal or religious reasons; 3) concerns about the way charities are run; and 4) the complex relationship between the tax and welfare policies of government and individual philanthropy.

More on the survey also at www.barclayswealth.com/insights/philanthropy-barriers-to-giving.htm.

Federal Activity

Federal Estate Tax

Summary – Estate taxes are still in limbo.

Estate Tax Rates

Year	Federal Estate Tax Exemption	Top Federal Estate Tax Rate	Oregon Inheritance Tax Exemption /Top Rate
2009	$3.5 million	45%	$1 million / 16%
2010	N/A	0	$1 million / 16%
2011 & thereafter	$1 million	55% (+5%)	$1 million / 16%

Here are generally three possibilities for the federal estate tax circulating in the halls of Congress:

1. Congress will pass legislation that would retain the estate tax with a 45% top bracket and a $3.5 million exemption. Make the estate tax retroactive to January 1, 2010. This would eliminate the free year for 2010.
2. Congress will do nothing and the estate tax will revert to a tax rate of 55% with $1 million exemption. If Congress has done nothing by the summer recess, it may be too late and too easy to just let the old rates return. (The revenue is needed and this is a good way to get it.)
3. A coalition of labor unions, women's groups, religious and public-interest organizations has put forth a proposal to reinstate the federal estate tax with an exemption of $2 million, a top tax rate of at least 45% and with an additional 10% tax on estates exceeding $10 million. In their proposal this group cited the estate tax as an incentive for charitable giving.
4. Another proposal calls for a 35% tax on estates worth more than $5 million.

In March Senate Majority Leader Harry Reid made a decision to move a scaled-back jobs bill threw a bipartisan deal to reduce the impact of the estate tax into doubt. Discussion had been underway to do something to reduce the tax hike coming in 2011. In exchange, the Republicans would agree to support the job bill created by Finance Committee Chairman Max Baucus and the panel's ranking member, Senator Chuck Grassley. But then Reid went another direction with the jobs bill and the possibilities for bipartisan agreement on the estate tax issue may have taken a back seat also.

As a result – in March there were no plans to move forward on the estate tax issue.

The House has already passed legislation that permanently maintains the estate tax at 2009 levels, a $3.5 million exemption and a top tax rate of 45%. The bill passed by a narrow margin of 225-200. This was expected to be the starting point for action in the Senate.

The following comments are from the April 28, 2010 Texas Will and Trusts Law Online newsletter.
Most estate planning attorneys never believed that Congress would let the estate tax expire. And when they did, most expected that Congress would act quickly to revive the estate tax, possibly making it retroactive to the beginning of the year.

As April quickly draws to an end, Congress has not passed any new estate tax legislation, leaving the estate planning world in a continued state of turmoil.

In 2009, only 5,500 estates were large enough to incur any estate tax liability. If the exemption amount reverts to $1 million, more than 44,000 would face estate taxes, according to estimates by the Urban-Brookings Tax Policy Center.

A recent report indicated that a new proposal has surfaced that imposes a 35% tax on estates worth more than $5 million. This proposal would need to work its way through the House.

House Speaker Nancy Pelosi has indicated that permanent estate tax relief is making its way through Congress. How long will it take? Kevin Staker at the Estate Tax News Blog believes that Congress won't act until after the November election.

And this brings us back to "do nothing" and the tax reverts to $1 million.
[And you thought sausage making was boring?]

Sources: Planned Giving Design Center
The Hill, online newsletter published by Capitol Hill Publishing Corporation, February 13, 2010
Estate Tax Update, Texas Will and Trusts Law Online, April 28, 2010

Expansion of Charitable IRA Rollover
The ability to make charitable gifts from IRA funds has been in effect for four years, but it has expired.

The Senate and House have both approved separate versions of HR 3213, the Tax Extenders Act of 2009, and both these bills include a provision that would retroactively extend the IRA Charitable Rollover through December 31, 2010. There are, however, a number of significant differences between the Senate and House bills that need to be reconciled, including how to offset the cost of the legislation. Senate and House leaders have indicated a desire to avoid a formal conference committee on HR 4213, and key tax writers have already begun meeting to try and work out the differences.

No legislation has landed on President Obama's desk yet.

Government Relations Report, Partnership for Philanthropic Planning, April 9, 2010

Health Care Reform & Nonprofits
On March 30, 2010, President Obama signed into law HR 4872, the Health and Education Reconciliation act of 2010. This massive overhaul of the U.S. health care system will affect nearly all taxpayers, most employers, and many elements of the health care industry. The Reconciliation Act modified legislation signed into law on March 23 that contains the bulk of the health reform law, HR 3590, the Patient Protection and Affordable Care Act. [Confession – I have not read the 2,700 page legislative bill. At a recent workshop I asked one of the presenters if he had read it. He said he was up to page 1300 at that time. It was his bedtime reading.]

Who is subject to employer mandate: Only an "applicable large employer," defined as someone who employed an average of at least 50 full-time employees during the preceding calendar year, is subject to the requirement to offer coverage. Most small organizations, since they have fewer than 50 employees, are thus exempt from the employer requirement.

Employers will be able to avoid some of the law's requirement by keeping their coverage the same after the law's requirements by keeping their coverage the same after the law's effective date. Unfortunately, it is very unclear at this time what kind of minor changes will alter coverage, or keep it the same; this will be clarified in later regulation.

[Make sure your HR department is on top of this legislation. It will affect all of us.]

Take Note! One important change made by the Health Care Reform Act unrelated to health benefits requires employers beginning in 2012 to provide an **IRS Form 1099 to all corporate service providers** receiving more than $600 per year for services or property. Currently 1099s need only be generated for non-corporate service providers and only on services. This means that a 1099 will also need to be issued to an organization's landlord.

Bulletin from Evangelical Council for Financial Accountability
Workshop on Healthcare Reform Legislation provided by Aldrich, Kilbride, Tatone

State Activity
State Inheritance Taxes
Uncertainty surrounding the federal estate tax is certainly producing uncertainty among donors and they professional advisors, but state estate or inheritance taxes are another area of complexity that must not be neglected. [As gift planners we need to at least be aware of situations in other states where our donors may be located.]

There are 21 states, plus the District of Columbia, that impose an inheritance tax, a free-standing state estate tax, or a "decoupled" remnant of the former credit estate tax. Two of the states (Illinois and North Carolina) have estate taxes that are "hibernating" during the 2010 federal estate tax repeal. Under the Economic Growth and Tax Relief Reconciliation Act of 2001, the credit estate tax has been phased out, but is scheduled to reappear in most states in 2011 unless Congress acts.

States generally apply inheritance and estate taxes to their residents and to nonresidents' real and tangible personal property located within the state. All states provide exemptions or deductions for transfers to qualified charitable organizations, including charitable remainder trusts.

Sample of states with estate/inheritance taxes.

State	Type of Tax	Exemptions	Tax Rates
Oregon	Estate tax	Estates under $1 million	Top rate of 16%
Washington	Estate tax	Estates under $2 million	10% to 19%

Gift Planning Tips, R&R Newkirk Company, May 2010

IRS, Court Cases, & Regulatory Matters

Update on the Section 2511(c) **Related to Completed Gifts in Charitable Remainder Trusts**
A time capsule buried in the 2001 Economic Growth and Tax Relief Reconciliation Act of 2001 [IRC §2511(c)] took effect on January 1, 2010. This could create gift tax issues for charitable remainder trusts funded in 2010. [Already had to disclose and explanation the potential gift tax implications associated with a recent charitable trust that had income interest for children.]

IRC Section 2511(c)

> Treatment of Certain Transfers in Trust: Not withstanding any other provision of this section and except as provided in regulations, a transfer in trust is treated as a transfer of property by gift unless the trust is treated as wholly owned by the grantor of the grantor's spouse (under the grantor trust rules, except as provided by regulations.)

Section 2511(c) provides that "a transfer in trust shall be treated as a transfer of property by gift, unless the entire trust is treated as wholly owned by the donor or the donor's spouse (under the grantor trust rules, except as provided by regulations." Effective January 1, 2010, affected trusts may be liable for federal gift tax, although the gift tax marital and charitable deductions still apply. The law sunsets after 2010, along with the rest of the 2001 Act.

Legislative history for §2511(c) indicates that 2010 trust transfers will be treated as gifts, even though the transfer would have been "incomplete" and nontaxable under prior law (i.e. the grantor retained the right to revoke a beneficiary's interest). Furthermore, the taxable amount will be the entire value of the transfer in trust.

How do charitable remainder trusts become affected? Clearly, charitable remainder trusts are not wholly owned by the donor or the donor's spouse, so §2511(c) applies. A CRT that provides survivorship payments to a nonspouse successor beneficiary (son or daughter, for example) could generate a taxable gift. Historically, the donor would retain the right to revoke the survivor's income interest by will, making the future transfer of a survivor income interest incomplete and nontaxable. But that strategy would not be available under §2511(c).

Jonathan Tidd remarks that §2511(c) was only intended to come into play once the federal estate tax was repealed in 2010. The purpose of this part of the legislation was to plus a hole that existed in the gift tax law prior to 2010, with respect to arrangements that a) were incomplete for gift tax purpose, but b) were within reach of the estate tax.

Understanding the implications. In an article from Trusts and Estates:

> In Notice 2010-19, the IRS stated that the substantive provisions of Chapter 12 were not amended by EGTRRA and continue to apply to all transfers made by donors during 2010. In its view, IRC §2511(c) doesn't mean what it says and, despite the plain language of the stature, transfers to grantor trusts are taxable gifts.
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> The Service then went one step further and stated that IRC §2511(c) broadens the types of transfers subject to gift tax so as to include certain transfers to trusts that, prior to 2010, would have been treated as incomplete gifts. Accordingly, under IRC §2511(c), as interpreted by Notice 2010-19, incomplete gifts are taxable gifts.
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> **This turns gift planning on its head.**
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> The IRS's interpretation of IRC §2511(c) conflicts with the plain meaning of this statute which is obvious, transfers to trust are gifts unless they are taxable to the grantor or the grantor's spouse. That means that transfers to trusts are not gifts if the trust is wholly owned by the grantor the grantor's spouse.

Notice 2010-19 is the Service's attempt to have taxpayers ignore the plain meaning of IRC §2511(c) in spite of the straightforward language of the statute.

In other words, unless the Service clarifies its position with specific reference to CRTs, the donor will be deemed to either have made (1) a taxable gift of the entire interest to himself, or (2) a taxable gift (eligible for the gift tax charitable deduction) of the entire interest to the charitable remainderman.

Several national recognized authorities in charitable gift planning have approached the IRS regarding this issue. Jonathan Tidd speculates that the IRS may withhold further guidance on this matter and Congress sometime this year (2010) will re-enact the estate tax retroactive to January 2, 2010. This will make any further consideration of §2511(c) moot.

We trust this issue gets resolved soon.

Trusts & Estates, March 24, 2010
Planned Giving Design Center, March 15, 2010 and April 15, 2010.

<u>CRTs and Capital Gain from ESOP</u>
One of the most attractive aspects of charitable remainder trusts is their ability to liquidate highly appreciated assets without loss, from capital gains taxes – a fact that may have growing importance if capital gains rates increase next year.

The IRS has ruled that shareholders of a corporation that maintains an ESOP (employee stock ownership plan under IRC §4975(e)(7) could avoid recapture on the transfer of shares of qualified replacement property (QRP) to a unitrust. The shareholders sold shares of the company's stock to the ESOP, reinvesting the proceeds in qualified replacement property, as permitted under IRC §1042(c)(4). They elected not to recognize the long-term capital gain in the shares they sold. The couple created a charitable remainder unitrust, funding it with the qualified replacement property. The trustee was under no obligation, express or implied, to sell the QRP. The IRS ruled they will not recognize deferred gain on the transfer of the QRP to the trust.

Gift Planning Tips, R&R Newkirk Company, May 2010.

<u>Trustee Not Liable for Loss</u>
Key question for everyone or every entity that serves as trustee of a trust on behalf of a beneficiary – what happens when things don't work out as expected? What is the liability of the trustee?

A charitable remainder trust is a split interest trust, the trustee has a fiduciary duty in connection with making investment decisions regarding the assets of the trust, and this fiduciary duty extends to both the noncharitable and the charitable beneficiaries of the trust.

This issue was raised in the recent case of Merrill Lynch Trust Company v. Campbell (Ct. of Chancery, DE, No. 1803 September 2, 2009). In this case the trustee of a charitable remainder unitrusts was charged by the settler of the CRUT, who was also a noncharitable beneficiary, with breaching a fiduciary duty in investing the assets of the trust. The trust was formed at the recommendation of a Merrill Lynch financial advisor in 1996 by Mary Campbell, a 74 year-old woman, whose husband was fighting Parkinson's disease.

The advisor recommended that the Merrill Lynch Trust Company (MLTC) serve as the trustee and the woman agreed. She then placed most of her life savings, consisting of approximately $840,000, in the CRUT, which provided for a 10% annual unitrust payout. The payments were to go to Mrs. Campbell for life, then to her husband, if he survived her, and then, upon the death of the survivor of either Mrs. Campbell or her husband, payments would be allocated among, and for the benefit of, the couple's three children. Upon the death of the last surviving child, the Trust would terminate and the remainder would be distributed in equal shares to five designated charities.

Given this payout regime, the CRUT was not expected to terminate for at least half a century [**50 years]**. Merrill Lynch had been using the investment allocation of 60-70% equities, when it was contacted by the settler (Mrs. Campbell), who said that she needed more current income from the trust due to rising health care costs for her husband's worsening condition. As a result, the trustee changed the investment allocation to a riskier mix of 90% equities [huge understatement of risk – only a slightly higher risk]. The CRUT increased from an initial amount of $840,000 to $943,000 in 1999, but decreased to $356,000 in 2002 following the post 9/11 financial downfall. As a result of the significant decline in the value of the assets of the CRUT and the attendant reduction in the 10% unitrust payout (as the trust values fell, so did the 10% unitrust payout), Campbell went to NASD arbitration against the broker, but was unsuccessful. She then sought relief in the courts.

The court held that the issue regarding improperly advising Mrs. Campbell to enter into the CRUT was barred by the stature of limitations and that there was no breach of a fiduciary duty, because the MLTC, as trustee, had fulfilled its duty to invest in a manner that allowed the trust to deliver reasonable payments, and it was unable to predict the 2002 financial fall.

Further, the court said:

1. MLTC cannot be held liable for failing to anticipate the precipitous drop in the market, and it cannot be held liable merely because market forces have proven that its investment decisions were poor ones.
2. A 10% charitable remainder unitrust with an expected life of fifty years is rarely formed; however, that does not here indict MLTC in an actionable manner, as claims surrounding the decisions embodied in the Trust Agreement are time-barred.
3. The Trust Agreement set a nearly unreachable standard. MLTC had few, if any good options when setting an investment course for the Trust.
4. MLTC made reasonable decisions in light of the circumstances it faced. The fatal flaw of this unhappy tale is found in the Trust Agreement itself. Fiduciary duties, always contextual, might not allow for an investment strategy so heavily weighted in equities but for the unusual constraints embodied in the Trust.

Bulletin 2010-1, Charitable Giving – Taxation, Planning, & Strategies, WG&L, Thomson Reuters.

Lessons for all of us:

1. Be aware of the fiduciary duties borne by the trustee for the income and remainder beneficiaries of a life income gift plan.
2. Be aware of how the proposed gift plan relates to the donor's overall financial standing. All or substantially all of a donor's assets should not be placed into an irrevocable gift plan leaving no resources for the donor to fall back on.
3. Explain and disclose and document all the factors related to a gift plan.
4. Don't overpromise the projections associated with a gift plan.
5. Just because the regulations allow a high trust payout rate, don't think you have to offer that high rate. Understand the rationale for choosing/offering a reasonable and achievable payout rate.
6. Explain to the donor the rationale for the payout rate and the trust investments. If the donor understands the implications of the trust and investment decisions, they will support your actions. If the donor does not understand or the expectations are unrealistic – reality will bite hard.
7. Make regular and systematic reports to the donor / income beneficiaries of what is happening to the gift plan over time.
8. Realize the responsibilities that are borne by the person or entity that serves as trustee.

That's it for issue #13. Please feel free to comment, send tips, or provide questions.