Northwest Planned Giving Roundtable

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GOVERNMENT RELATIONS REPORT
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Federal Activity

Uncertainty Continues – Major Financial Decisions Stymied

So much has happened in the last moments before the summer recess – and so little has been resolved.

- Debt limit crisis resolved temporarily.
- S&P downgraded the credit standing of the U.S. government.
- Upheaval among the European governments and markets.
- Federal Reserve has indicated that it will hold the line on interest rates.

President Obama signed SB 365, the Budget Control Act of 2011, into law raising the federal debt ceiling. The bill raises the debt limit by $2.5 trillion in two stages, which will provide enough borrowing authority to last until 2013. This increase is paid for by an immediate $1 trillion in cuts from defense and discretionary spending. A 12-member bi-partisan Congressional committee is tasked with recommending an additional $1.5 trillion in savings by November 23rd (see below).

Tax changes were not incorporated in this legislation. However, the Administration and Congressional Democrats expect revenue increases and tax reform, and that will likely include the charitable deduction, among others.

Two items particularly generate interest on the Federal level:

1. Joint Select Committee has been named to determine the $1.5 trillion in deficit reductions that is to occur as the next stage in the debt limit issue resolution. This special committee is co-chaired by Jeb Hensarling (R-TX) and Patty Murray (D-WA) will hold its first meeting in September.

   Any bill that is supported by seven or more of the 12 committee members will be voted on by the House and Senate with no amendments. [Now that is Congressional power.]

   If the committee fails to make recommendations or if Congress fails to pass the recommendations, then automatic reductions to defense, domestic programs, and Medicare will be triggered. But it is important to note that these cuts bill not take effect until one year later, January 1st, 2013.

2. Presidential campaign has been launched, but it is still over a year until the election. The list of Republican candidates grows and shrinks week-by-week. The question is who will capture the interest of the party faithful and be capable of capturing the White House. Romney, Bachman, Huntsman, Paul, and now Perry. The horse race is on!

   Meanwhile, President Obama toured the Midwest in a campaign bus to press the flesh and capture the news spotlight before going on vacation. Mistake – that was not a campaign bus and it was not a campaign trip – it was a report to the voters in the Midwest.

The result of this activity in Washington and spilling over the rest of the country is more indecisiveness. The markets remain unsettled, and donors remain unsettled.

- Evangelical Council for Financial accountability, 8/8/2011

Possibility for Increased Deduction for Ordinary Income Property

In the interest of letting everyone know of things that might come to pass – Representative Aaron Schock (R-IL) has introduced legislation (HR 2592) that if enacted would increase the limitation on the amount of charitable contributions of ordinary income property taken into account in determining the charitable contribution deduction for any trade or business. The bill's title is interesting in itself: Charitable Contribution Parity and Enhancement Act. This is done by striking the word corporation and substituting the words "trade or business of the taxpayer."

- Planned Giving Design Center, 7/29/2011

State Activity

Oregon Inheritance Tax is now the Oregon Estate Tax

HB 2541 became the bill that brought some changes to the Oregon inheritance tax, but not what many hoped would occur. Oregon's exemption amount is much lower than the federal exemption. Federal estate tax exempts estates worth less than $5 million – at least for 2011 and 2012. Oregon's exemption amount is $1 million.

Perhaps the most noticeable change was the change in name from the Oregon Inheritance Tax to the Oregon Estate Tax. This reflects the reality that it is the estate that pays the tax, not the heirs. It also brings the thinking as identified by the name into alignment with the nomenclature for the tax itself.

When the legislative year began there were hopes of raising the exemption amount (Washington's exemption amount is $2 million). There are only about 1,000 estate tax returns in Oregon in any year, and only about 30 estates worth more than $10 million file returns in Oregon each year. The number of returns is not great. However as the ongoing transfer of wealth occurs and the "usual and customary" rise in asset values occurs, it is likely that more estates will be subject to the Oregon inheritance tax.

HB 2541 did not raise the exemption amount – it is still $1 million. However, the bill did simplify the state's tax rate and lowered the high estate tax on estates valued between $1 million and $1.1 million. Strange as it seemed – estates worth $1.1 million had to pay $38,800 in tax under the former law. Estates below $1 million paid nothing. Those valued at $1.2 million paid only $6,400. It seemed to be difficult to explain this math, so when you can't explain the math, change it.

Under the new Oregon estate tax law, $1.1 million estates will pay only $10,000. Estates worth less than $1.95 million will pay lower taxes overall, wealthier estates will pay higher taxes. To make the changes "revenue neutral" in the bill, the rate was lowered from 19 percent to 16 percent, and the exemption amount remained at $1 million.

Intangible personal property now handled differently. It was confusing to determine the taxability of intangible personal property of non-residents, so to correct that confusion; such intangible personal property held by non-residents will no longer be subject to estate tax. Intangible personal property of Oregon residents remains subject to Oregon estate tax unless it is taxed in another jurisdiction.

Natural resource property rules were clarified. ORS 118.140 was amended to include within the statute the various types of property that qualify as natural resource property. Rather than using the current rate table, the new credit will be determined as a fraction of the Oregon estate tax based on the value of the natural resource property proportional to the adjusted gross estate.

Family members who inherit natural resource property must continue to use the property for farm, forestry or fishing business for five out eight calendar years following the decedent' death. If natural resource property is sold or its use ceases prior to satisfying the five-out-eight-years requirement, a disposition tax will be due six months after the disposition event.

A number of procedural changes occurred because of HB 2541:

- Internal Revenue Code tie-in date is amended from December 31, 2000 to December 31, 2010.
- There be no more confusing Table A/Table B calculations, adjusted taxable gifts will no longer be relevant.
- A single tax rate table is adopted with the tax rates starting at the first dollar of an Oregon taxable estate over $1 million.
- In order to determine the Oregon estate tax, all decedent estates, both resident and non-resident, start by determining the Federal taxable estate increased by the state death tax deduction under IRC 2058 and any allocable state marital property included in the decedent's estate, and reduced by any state marital deductions and any other exclusions or deductions to determine the Oregon taxable estate.
- If a non-resident has real or tangible personal property located in Oregon then the Oregon estate tax will be based on a ratio of the value of real and personal property located in Oregon (the numerator) over the value of the gross estate (denominator).
- Elections taken on the Oregon estate tax return can be different from elections on the Federal estate tax return.

The current law applies for 2011 decedents. Except for the revisions to the disclaimer statute, all of the other provisions apply to estates of decedents who die on or after January 1, 2012.

Oregon and non-taxable lifetime gifts. Lifetimes gifts are not taxed under Oregon law. After 2011 Oregon does not "add back" gifts made while a person is alive in determining the Oregon estate tax. As long as the Federal exemption remains higher than $1 million, there is an opportunity for taxpayers to reduce their Oregon estate tax exposure without incurring Federal gift taxes.

Each gift reduces the Oregon estate tax. Example: if Joe dies holding assets valued at $2.5 million with no deductions, his estate will pay an Oregon estate tax of approximately $152,500. But if Joe had given away $1.5 million before his death, his estate tax would have been zero, and his Federal gift tax would have been zero.

Many Oregon decedents will never pay Federal estate tax but quite a few will have to pay Oregon estate tax. With the relatively low exemption of $1 million, many Oregon residents will continue to have to include Oregon estate tax planning in their estate plans.

- Oregon's New Inheritance Tax Law: What it Means for You.
  Oregonian, 6/25/2011
- Jeffrey Cheyne (Samuels Yoelin Kantor, LLP) in Oregon State Bar, Estate Planning &
  Administration Section Newsletter, July2011

Bill on Bad Charity Crackdown (SB 40) did not pass

This bill would allow the Attorney General to disqualify a charity from receiving tax-deductible contributions for Oregon income tax purposes if the Attorney General finds that the charity has failed to expend at least 30% of its total annual functional expenses on program services when those expenses are averaged over the most recent three fiscal years. This bill did not pass during the most recent legislative session.

Transfer on Death Deeds – New Way to Transfer Property

SB 815 has created a new way to transfer real estate – Uniform Real Property Transfer on Death Act, effective January 1, 2012. The Act allows people to transfer real property to beneficiaries using a Transfer on Death Deed, which is recorded while the transferor is still living, but does not take effect until after the transferor's death. This new process acts somewhat like a gift of a residence with a retained life estate.

Some individuals look for ways to transfer their property at death without having to go through probate. Oregon law currently provides "pay-on-death" designations for securities and bank accounts. Prior to this bill there was no way to transfer real property in Oregon with a "pay-on-death" designation. Joint tenancy, tenancy by the entirety and life estate deeds vested in named beneficiaries with unintended property rights are subject to redistribution through divorce, bankruptcy, torts, and creditor claims. Also, these transfers could have unintended gift tax consequences and transfer disputes.

Most of the provisions of SB 815 were taken from the Uniform Real Property Transfer of Death Act. One of the goals of this bill is to provide a reliable and inexpensive probate-avoidance tool to allow a person to execute and record a Transfer on Death Deed (TODD), which will transfer title to the designated beneficiary when the owner dies. The owner's capacity to execute a TODD and to make a will is the same.

While a TODD represents an effective way to transfer property without needing a probate, creditors and claimants have 18 months following the owner's death to set aside the TODD. If the probate or small estate has insufficient property to pay allowed claims and allowances, creditors can recover from the property. Other claimants can set aside the TODD on the grounds of capacity, fraud or undue influence. As a result, the property will be difficult to sell or transfer to a bona fide purchaser for a period of 18 months following the owner's death.

Possible benefits of Transfer on Death Deeds:

- Avoids probate if done effectively.
- Avoids numerous problems of granting joint ownership during life.
- Offers a way for grantors of a revocable living trust to keep title in their names during their lifetime, but transfer the property to their trustee only after their death.

Possible issues with Transfer of Death Deeds:

- May be easily prepared and recorded without receiving competent legal advice.
- Statute of limitations for claims against the property by creditors under the act is 18 months, instead of the 4 months allowed in probate proceedings.
- Property may not be able to be sold until 18 months after the death of the grantor because of title insurance problems.
- Title insurance premiums may be more expensive.
- Deeds may cost more in legal fees because of attorney time spent answering questions that multiple beneficiaries and their attorneys may have.
- Since the deeds lack the formalities required by wills, there is a potential for fraud.
- Grantor may not specify any personal goals for the future of the property.
- If there are joint grantors, a surviving grantor may revoke the deed after the other has died, which may be inconsistent with the deceased grantor's wishes and intentions.

It is expected that TODDs will be useful to avoid probate, avoid gift taxes and avoid prematurely creating interests in beneficiaries while the owner is alive.

This is a new planning vehicle. It will take some time for the marketplace and the legal system to adapt to this new means of property transfer. It will work through in time as it works through the system. The key to the effective use of this and any other planning tool is the assistance of competent legal counsel.

As gift planners, we may encounter this planning tool with donors or as a beneficiary. Be prepared to handle the possibilities.

- Oregon State Bar, Estate Planning & Administration Section Newsletter, July2011
- Law Change Alert

Court Cases & Regulatory Matters

Charity Maintaining Property Could Mean Additional Gift to Donor

What are the tax results where a donor contributes a slice of real estate to charity and wants the charitable done to maintain the property interest that was retained? What happens if part of a life estate agreement calls for the charity to maintain the property?

In PLR 7930101, the IRS ruled that the agreement by a charity to maintain property owned by a donor constituted a benefit to the donor, thereby reducing the amount of the charitable deduction.

The donor gave an undivided 3/7 interest in certain land to a charity. The charity in return agreed to maintain the **entire tract of land**. The reason for the charity's agreement apparently was that the donor had stated his intention to leave his retained 4/7 interest to the charity in his will.

The IRS ruled that the amount of the donor's contribution had to be reduced by the value of the maintenance agreement (although it did not say how such value was to be established). An issue not discussed in the ruling was whether the whole transaction amounted to a bargain sale, which would have resulted in some reporting of capital gain by the donor. Logically it would seem so, given that the IRS essentially equated the maintenance agreement to a payment to the donor.

An alternative would have been for the donor to pay the charity annually for the cost of his share of the upkeep.

- Gift Planning Tips, R&R Newkirk Company, 8/21/2011.

Determining Value – What is a good appraisal? Who decides?

In Estate of Natale B. Giustina et al. v. Commission; T.C. Memo 2011-141; No. 10983-09, the Tax Court favored the valuation of the IRS in determining the appropriate taxable value of a partnership interest. The decedent and other family members had been involved in the lumber industry for seven decades. They had owned and operated several lumber mills and acquired substantial tracts of timberland.

The estate valued the ownership interest of the timber partnership at $12,678,117. The IRS valued that same interest at $35,710,000. It issued a deficiency of $12,657,506 and an accuracy-related penalty of $2,531,501.

The Court reviewed the appraised values and the decisions of both the estate and the IRS appraisers. The IRS appraiser valued the Giustina Land & Timber Company estimated cash flows at approximately $65 million. He estate appraiser hired by the family estimated cash flows to be approximately $33 million.

As a result of the future cash flow and determination of the appropriate discounts, the Court valued the total partnership at approximately $76 million. This was greater than the claimed estate value of $48 million, but below the IRS $123 million value. Based on the recalculated discounts, the Court determined that the discounted value of the partnership was approximately $66 million. The 41.128% interest therefore was held to have value of approximately $27.4 million.

The Court determined that the executor (son of the decedent) had obtained legal counsel and a credible appraisal in determining the value. The appraisal capitalized cash flows, capitalized distributions and compared market values of other companies. Therefore, the appraisal met the Sec. 664(c)(1) reasonable cause for underpayments standard. No penalty was applied.

- GiftLaw, Crescendo, June 27, 2011

Charitable Payroll Plan – Companies can Help Their Own People

Facts: An international sales operation arranged to have a public charity provide grants and loans to its employees. Under the plan, the recipients are selected by an independent committee (or by an adequate substitute procedure). Grants are awarded on the basis of financial hardship that is "unexpected, temporary and extreme." Only five percent off the employees eligible for assistance can hold management positions. Contributions from participating employees, expected to be primarily those in management positions, are deducted through a payroll plan.

The IRS made the following determinations:

- No adverse tax consequences for the firm. There are no tax complications relating to the corporations' receipt or temporary custody of the funds.
- Charitable write-offs for the generous donors. The charitable donations made by contributing employees through the payroll deduction plan are tax deductible (subject to the usual limitations).
- The transfers are treated favorably. The recipients of the generosity – needy employees of the same company – walk away with tax-free cash.
- Furthermore, the grants and loans are not subject to information reporting, withholding or employment taxes. (IRS PLR 2003070804)

This plan was approved because the corporation did not have control over the distribution of funds and a legitimate charitable purpose was being furthered.

- Delap CPA newsletter, 5/6/2011

Expressed Desire Language in Will may be a Mandatory Bequest

In Technical Advice Memorandum 201126030, the decedent's will stated:

> To the extent that I own any equity interest at my death in any of the following closely held investments, (assets named), it is my **desire** that such equity interests be retained and that each of them be distributed so that all such equity interests are ultimately owned in equal shares by named children. If any of them are deceased, it is my **desire** that the decedent's share of such equity interests be owned equally by such decedent's children.

At issue was whether this provision was a mandatory bequest, thereby reducing the marital deduction and increasing the taxable estate, or merely a precatory statement that doesn't legally affect the passage of the assets.

The IRS determined that the language "it is my desire" wasn't precatory, but mandatory. While some bequests in the will used the words "I give" and "I direct," other parts of the will gave the executor discretion by using the words "I further requests, but not require" and "I suggest." The IRS cited the rule of construction requiring it to construe instruments to give effect to all provisions so that no provision is rendered meaningless.

> A wish directed to a beneficiary is generally regarded as precatory, unless the words clearly express the testator's intention to the contrary; but where the words are addressed to an executor, they are more often regarded as mandatory, or at least prima facie mandatory.

The taxable estate was increased by the amount of the bequests.

[Words must clearly express what is intended. It may be hard to determine the intent of the donor after he/she has deceased.]

- Trusts & Estates, August 2011

Other Information

US Savings Bonds – Challenging Assets

US savings bonds can be an excellent choice for bequests to tax-exempt organizations, given the fact that, in most cases, taxable interest will carry over into the hands of beneficiaries at death. Charitable gifts of bonds at death require a will or revocable living trust to accomplish, even though other transfer techniques, such as joint ownership and beneficiary designations are available with human beneficiaries.

Savings bonds cannot be issued with a charity as co-owner or death beneficiary (unless the charity is the US Treasury). Bonds can be bequeathed to charity, but what if the donor has no will or is unlikely to change an existing will? Series EE and I bonds may be issued or reissued in the name of a trustee of a revocable trust, if the donor is the lifetime (income) beneficiary. For example, an EE bond could be registered to "ABC Church, trustee under agreement with Mary Jones, dated 12/1/2000." Mary situation, for tax purpose, would be the same as if the trust never existed. But her church or other charity could be the remainder beneficiary of the trust and thus receive bonds at her death.

Any unreported increment in the value of the bonds is considered income in respect of a decedent (IRC) and is subject to income tax. The IRD tax is avoided when savings bonds are bequeathed to charity, and the estate is entitled to an estate tax charitable deduction for the value of the bonds. But the bonds themselves must be specifically bequeathed. If the bonds are merely used by the executor or trustee to satisfy a specific dollar bequest to charity, any unreported increment will be subject to income tax, although a charitable deduction will be available (PLRs 9315016, 9507008). Where charity receives a pecuniary bequest that the executor satisfied with bonds, the bonds will be treated as if they were redeemed and the proceeds distributed to charity. The estate would owe income tax on the proceeds.

But where bonds were included in the residue of an estate that passed to four named charities, the transfer of the bonds to one of the charities was not a disposition that triggered tax on the IRD for the estate (PLR 9537011).

- Gift Planning Tips, R&R Newkirk Company, 8/1/2011

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That's it for issue #17. Please feel free to comment, send tips, or provide questions.