

# Advisor Update

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A professional advisor resource courtesy of Advocate Charitable Foundation

## ■ Latest rulings from the courts and the IRS

*IRS Allows Estate's Allocation of IRAs and Deferred Annuity Contracts to Charity to Satisfy Residual Bequest Without Triggering IRD, Ltr. Rul. 200452004*

In this brief ruling the IRS approved an executor's request to allocate IRAs and deferred annuity contracts to a charity to satisfy a residual bequest. The IRAs and deferred annuity contracts were payable to the estate and would normally be taxed as income in respect of a decedent (IRD) on the estate's fiduciary income tax return. In these facts, the IRAs and deferred annuity contracts had not yet begun making payments at the decedent's date of death, and the estate had obtained a court order allowing a non-pro rata distribution of estate assets to satisfy the charity's residual share. The IRS held the assignment of the IRAs and deferred annuity contracts would not trigger taxable income to the estate.

*Deduction Denied for Split-Dollar Insurance Contribution; David C. Roark, et al. v. Commissioner, T.C. Memo. 2004-271, Docket Numbers 9231-02, 5105-03*

The Tax Court denied a donor's charitable deduction in yet another case involving a split-dollar life insurance plan. Split-dollar life insurance plans — allowing donors to purchase insurance benefits for family with largely deductible charitable contributions — were widely promoted prior to February, 1999 when Congress imposed 100 percent penalties on charities purchasing insurance on a donor's life. In these facts, the donors made a series of gifts in 1998 to the National Community Foundation (NCF) to create a donor-advised fund called the "David C. Roark Foundation." NCF issued a substantiation statement for the gifts stating "no goods and services were provided." In the same year, Mr. and Mrs. Roark created the David Roark Revocable Life Insurance Trust, applied for a \$2.2 million insurance policy in the trust and offered NCF an option in a portion of the insurance policy's death benefit. NCF purchased and exercised the option. The IRS subsequently issued deficiency notices to the Roarks for the portions of the NCF contributions used to cover insurance premium payments and related administrative costs citing improper substantiation. The Tax Court agreed, denying the deductions.

*Trust Allowed Extension to Make Election for Payments to Charitable Beneficiaries Made After the Close of the Tax Year, Ltr. Rul. 200444003*

In the facts of this ruling, a trust terminating at the grantor's death was to be distributed to ten beneficiaries (eight of which were charities) following payment of taxes and expenses. The trust remained intact during estate administration awaiting determination of those costs. The trust made no income or principal distributions in year one; it distributed all accumulated income in year two. Although the trust could have made an IRC §642(c) election for year one (allowing the year two distribution to be treated as made in year one), it failed to do so, missing both the election date and the extension date. In this ruling request, the trustee asked the IRS to extend the period for the purpose of making the election; the request was granted.

## **Nurse attorney named new president of Advocate Charitable Foundation**

Susan J. Ell was named President of Advocate Charitable Foundation and Chief Development Officer of Advocate Health Care on January 24 by Advocate Health Care's President and Chief Executive Officer, Jim Skogsbergh. Ell is both a registered nurse and an attorney.

Ell brings to her presidency 20 years of fundraising experience — much of it in planned giving. Before serving Advocate Charitable Foundation for the past five years in two executive positions, Ell held key leadership roles with Children's Memorial Foundation, Lake Forest College and the Salvation Army. She holds a BA with honors in biological sciences from The University of Chicago and a JD from Washington University School of Law.

## ■ Items of interest to planners

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### *New Form 1023 Now Available; Practitioners Must Use New Form for Exemption Applications Filed After April 30, 2005*

The IRS published a revised Form 1023 (Application for Tax-Exempt Status) in October 2004 to replace the prior version dated September 1998. The new Form 1023 is designed to solicit detail in areas of potential abuse. For example, it includes questions about the amount paid to third parties for help in establishing the new charitable entity, detail about individuals (officers, directors, trustees, employees and independent contractors) who will receive more than \$50,000 annually, as well as family and business relationships with the charity. The application process is also designed to promote proper operation. The instructions provide sample conflict of interest language, state by state guidance on organizational language and a glossary of terms. The IRS encourages entities to use the new form for current applications; it will require the new form for applications filed after April 30, 2005. Form 1023 and instructions can be downloaded from the IRS website at [www.irs.gov](http://www.irs.gov).

*IRS Publishes 2005 Rates for Individual Income, Estate and Gift Tax Returns and Inflation Adjusted Figures, Rev. Procs. 2004-71, 2004-50 I.R.B. 1 (inflation adjustments), 2004-64, 2004-49 I.R.B. 1 (mileage); Rev. Rul. 2005-2, 2005-02 IRB 1 (new pooled income fund rate).*

The IRS has published the 2005 inflation-adjusted exclusions and exemptions for gifts, estates and generation-skipping transfers and posted the tax rates and miscellaneous deduction limits applicable to individual taxpayers. Selected figures are set out below.

#### **Individual income tax**

Individual income tax brackets	10%, 15%, 25%, 28%, 33%, 35%
Earned income threshold, children under age 14 subject to "kiddie tax" rules	\$1,600
Standard deduction, married individuals filing jointly or surviving spouses	\$10,000
Standard deduction, heads of households	\$7,300
Standard deduction, unmarried individuals (other than surviving spouses and heads of households)	\$5,000
Standard deduction, married individuals filing separate return	\$5,000
Personal exemption	\$3,200
Gross income threshold for phase out of itemized deductions (unmarried)	\$145,950

#### **Gift, estate and generation-skipping exclusion amounts and rates**

Annual exclusion amount under IRC § 2503	\$11,000
Annual non-citizen spouse gift limit	\$117,000
Generation-skipping exemption (no longer adjusted for inflation)	\$1,500,000
Gift tax exclusion amount	\$1,000,000
Estate tax exclusion amount	\$1,500,000
Highest tax rate for gifts, estates and generation skipping	47%

#### **Miscellaneous charitable rules**

Deemed rate of return for pooled income funds less than 3 years old	4.0%
Insubstantial benefit limits (for items received by the donor when making a charitable gift)	\$8.30, \$41.50, \$83
Mileage rate for charitable work	14¢

## ■ Legislative developments

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### *Waiting for the Other Shoe to Drop — Anticipated Charitable Reform Legislation in 2005*

The 109th Congress, sworn in on January 4, 2005, begins its year with an eye on tax, charitable giving and nonprofit governance reforms. Since the 109th Session has just begun, there is little to report in the way of completed bills. However, it is possible to get a sense of the Congressional charitable agenda through statements made by staffers. Top charitable legislative priorities appear to include:

- Additional valuation legislation affecting conservation and façade easements;
- Regulations restricting the use and operation of donor-advised funds;
- Requirements for charitable governance to ensure active, independent nonprofit boards;
- Reforms for credit counseling organizations; and
- Penalties for exempt organizations that enable corporate tax shelters.

Early reports indicated these provisions would be attached to popular legislation on a piecemeal basis in a manner similar to the method used to create limitations on intellectual property gifts and vehicle donations in The American Jobs Creation Act of 2004.

However, the latest word from inside the Senate Finance Committee indicates support for a charitable giving bill that combines these reforms with legislation allowing lifetime rollovers of IRAs for charitable gift purposes and the non-itemizer's deduction. In addition to this charitable legislation, the Republican legislative agenda will likely include another attempt to repeal the estate tax permanently .

*Charities Rush to Get Clarification of New Vehicle Donation Rules, The American Jobs Creation Act of 2004, Public Law 108-357, 118 Stat. 1418.*

The American Jobs Creation Act of 2004 instituted dramatic changes in the way donors value (and charities substantiate) charitable deductions for vehicle donations. Effective January 1, 2005, deductions for vehicles valued at more than \$500 are limited to the charity's sales price except when the vehicle is intended for charitable use, when the vehicle is materially improved by the charity or when vehicle sales by the charity "are in direct furtherance of such organization's charitable purpose..." Since this "direct furtherance" exception is available only after the Treasury publishes regulations, many charities dependent upon donated vehicle revenue have written to the Treasury requesting immediate guidance. Practitioners should ensure donor-clients understand the new rules and get appropriate substantiation for vehicle donations, and that charity-clients review vehicle donation practices to bring them into line with the new law.

**Charitable mid-term federal rates**

The charitable mid-term federal rates under IRC § 7520 for gifts made in February 2005 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 Elizabeth Roghair, Vice President of Planned Giving, or Marilyn Schaffer, Director of Planned Giving, for illustrations of planned gifts, including deduction calculations.

<b>February 2005</b>	<b>4.6%</b>
<b>January 2005</b>	<b>4.6%</b>
<b>December 2004</b>	<b>4.2%</b>

■ **Charitable planning in practice**

*Getting the Details Straight: The Case for Carefully Crafted Gift Documents*

On December 13, 2004, the Court of Common Pleas of Montgomery County, Pa., Orphans' Court Division granted the request of the Trustees of the Barnes Foundation to move the foundation's art gallery from Lower Merion Township, Pa., to a new location in downtown Philadelphia. Earlier in the year, the same court approved the foundation's request to expand the number of trustees. While the court's published opinion reveals these requests were prompted by the foundation's precarious financial condition, the decisions ran counter to donor directives for the location and operation of the foundation set out in its 1922 charter and amendments made before Dr. Barnes' death.

The Barnes case highlights two issues for donors and gift planners: the practicality of placing narrow, binding restrictions on gifts and the need for flexibility when economic, social or environmental factors make the original gift terms impractical. An increasing number of donors choose to restrict their lifetime or estate gifts for a particular use or purpose. These restrictions may involve an agreement to place the donor's name on a building, to offer a specific program or major at a university, to award scholarships to a specified group of students or similar charitable purposes. Lawsuits alleging violation of these gift agreements are also increasing as charities find the promises they made are no longer possible (or appropriate) to keep. A gift agreement detailing the gift terms and providing guidance for modification protects both the donor and the charity.

State law — specifically, the state's version of the Uniform Management of Institutional Funds Act (UMIFA) — may provide some relief for frustrated donor objectives. However, the more effective solution is a gift document that provides a method for addressing problems. Consider these six recommendations for drafting a restricted gift document.

*Continued on page 4*

**Chronicle of Philanthropy reports growth in nonprofit entities in Illinois**

The IRS reported 964,418 §501(c)(3) active charitable entities in its 2003 Data Book ([www.irs.gov](http://www.irs.gov)), with 66,580 new entities approved in that year alone. Growth figures for Illinois from 1999-2003, drawn from data published by the Urban Institute's National Center for Charitable Statistics and reported in the January 6, 2005 issue of the Chronicle of Philanthropy, are shown below.

<b>Metropolitan Area</b>	<b>Number of Nonprofits</b>	<b>New Nonprofits 1999-2003</b>	<b>Percentage Growth Over Period</b>
Bloomington/Normal	508	37	7.9%
Champaign/Urbana	623	39	6.7%
Chicago/Gary/Kenosha	25,955	2,991	13.0%
Decatur	369	24	7.0%
Peoria/Pekin	997	59	6.3%
Rockford	967	89	10.1%
Springfield	810	62	8.3%

## Charitable giving in practice *Continued from page 3*

1. Clarify the donor's goals at the outset. Donors should think through the gift's goals and long-term outcome. In some cases, the donor's vision may not be realistic. Help him think about the gift's impact not only five years later, but 20, 50, or even 100 years into the future.
2. Incorporate the donor's goals and vision in the transfer document. Include language that includes the donor's motivation in creating the gift and the broad impact envisioned in the planning stage to provide guidance to later generations.
3. Include a "Plan B" and a "Plan C." Anticipate roadblocks and draft alternatives. For example, if the gift's purpose is valid, but the recipient charity simply fails to honor the gift terms, the document should provide for a transfer of funds to a charitable entity that will honor the agreement. If the gift's purposes are no longer appropriate or possible to achieve, the document should provide a method for applying the gift to as similar a purpose as possible or a different charitable purpose designated by the donor.
4. Before finalizing the gift, check with the charity to ensure it can accommodate the gift's form and purpose. A restricted gift must fit within the charity's mission, comport with its gift acceptance policies and fall within its administrative abilities. If the donor prefers to remain anonymous until the gift is complete, take the gift concept to the charity without revealing the client's name.
5. When making an endowed gift, provide direction on use of income and/or principal. For example, the donor may limit spending to accounting income, set a spending policy based on a percentage of market value or use a state-defined endowment distribution standard.
6. Provide a mechanism for non-judicial change. Unless court supervision is important to the donor, provide a mechanism for non-judicial changes to the agreement if the original gift purpose is no longer applicable or appropriate. Without such a mechanism for reform, an expensive court proceeding may be the only available option.

Change is inevitable. Even with planning, some gifts may ultimately be used for purposes beyond the donor's intent. It is more likely the gift purposes will be fulfilled if donors are counseled on this reality and plan for alternatives when that change takes effect.

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### Contact information

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

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