¶ 4.03 Charitable Bequests

An additional tax-planning opportunity that is available in the preparation of an estate plan is the possible inclusion of a charitable bequest in the last will and testament. The charitable bequest can provide an effective means of reducing a testator's estate taxes and, at the same time, enable that individual to support the philanthropic organization of his or her choice. Thus, the charitable bequest has a good deal of utility to the highly compensated, most particularly for those who are either in an extremely high estate tax bracket or who have no (or a limited number of) heirs or other natural recipients of their estate.

¶ 4.03[1] Estate Taxation of Charitable Bequests

Section 2055 provides an unlimited charitable deduction for bequests, legacies, devises, or transfers made to qualified charities that are made in the manner that is set forth in the Code. An individual could, in theory, leave his or her entire estate to a qualified charitable organization and receive a deduction (subject to a few limitations to be discussed) for the entire bequest. Unlike the income tax charitable deduction, there are no percentage limitations on the amount that can be deducted.

¶ 4.03[1][a] Eligible Recipients

The Code **141** specifies five particular types of recipients that would qualify for the charitable deduction. These are:

1. Governmental units for exclusively public purposes;
2. A corporation, trust, or community chest organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual and which is not disqualified for exemption under **Section 501(c)(3)** by reason of attempting to influence legislation and which does not participate or intervene in any political campaign on behalf of any candidate for public office;
3. A trust or fraternal society, order, or association operating under the lodge system if the

contribution is to be used by such recipient exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, which similarly does not engage in the activities prescribed in item 2;
4. Any veteran's organization incorporated by an act of Congress or its departments or local chapters or posts, no part of the net earnings of which inures to the benefit of any private shareholder or individual; and
5. To an employee stock ownership plan if such transfer qualifies as a qualified gratuitous transfer of qualified employer securities within the meaning of **Section 664(g)** .

As a review of this list should indicate, the eligible recipients of charitable transfers that qualify for the estate tax deduction are essentially, with minor differences in wording, similar to those qualified for the income tax deduction under **Section 170** .

The Service periodically publishes a list of charitable organizations that have been given tax-exempt status. If an organization is removed from the list, a formal revocation is supposed to be published. A contribution will not qualify for the charitable deduction if it is made to an organization removed from the list at the time of the contribution. In *Clopton v. Commissioner* **142** an estate transferred the corpus of an inter vivos charitable remainder trust to a charitable organization removed from the list. The estate argued that it should still receive the charitable deduction, because the Service did not properly issue a revocation of the charity's tax-exempt status. The Tax Court disagreed, because a new cumulative list, omitting the charity's name, was published prior to the date of transfer. The executor had a duty to review the new list. He could not rely on the old list, nor solely on the charity's affidavit of its tax-exempt status.

This case demonstrates the need for careful drafting of a charitable instrument.It would be advisable when making provisions for a charitable bequest to insert alternate takers in case the first charity loses its tax-exempt status. One may also want to include a clause that states that a charity that loses its tax-exempt status prior to distribution holds the bequest it receives in a constructive trust for other tax-exempt entities.

In *Estate of Levin v. Commissioner*, **143** the Tax Court determined that an estate's payments to charities pursuant to a decedent's informal pledges were not deductible as claims against the estate because they were not enforceable under state law. The pledges were made by decedent when he announced to party guests that he would establish a $10,000 charitable trust for each of the twenty charities that attended his party. While decedent later wrote a letter reaffirming his intent to make these gifts, he did not have the opportunity to establish the trusts before he died. The decedent's personal representative paid the twenty charities the promised $10,000 each, and claimed a $200,000 **Section 2053** estate tax deduction for payment of these claims against the estate.

The Service argued, and the Tax Court agreed, that the decedent's pledges were not enforceable under Florida state law. Under Florida law, enforceable charitable pledges arise as a result of the application of the doctrine of promissory estoppel, and in this case there was no indication that the decedent expected to induce the donee organizations to take or forbear from taking any action in response to his promises.

This case is a reminder to estate planners that a particular state's law must always be considered in evaluating the enforceability of charitable pledges. Because mere expressions of charitable intent will rarely be sufficient to support deductible claims against the estate, it is important that estate planners have the donor execute the necessary documents to make a charitable pledge enforceable under state law. The donor should also insert language in his or her will requiring the executor to honor any written charitable pledges made during his or her lifetime.

Similarly, an estate will not be entitled to a **Section 2055** charitable deduction when there is discretion as to whether the estate can distribute it to a qualified charitable organization. For example, in *Lockett Estate v. Commissioner*, **144** an estate was held not entitled to a charitable deduction for the transfer of the decedent's home to a charity for preservation purposes, because the estate was not required to distribute it to the charity. In this case, the governing trust instruments stated that the homestead shall, "insofar as possible, be set aside by the Trustees as a historical site." This left to the trustees the designation of the transferee and did not require it to be a qualified charitable organization. In order to obtain legal access to this land, the trustees ultimately entered into an agreement with a local water district by which they made a bargain sale of the homestead to that district in return for legal access to the property over water district's land. The water district then agreed to maintain the homestead as an agricultural museum. The estate claimed a charitable deduction under **Section 2055** for the gift element of the bargain sale of the homestead. On this set of facts, the Tax Court held that the estate was not entitled to a charitable deduction. The court noted that the trust language gave the trustees broad discretion to dispose of the property. Nothing required the trustees to transfer the property to an organization that qualified under **Section 2055(a)** . Consequently, the transfer was held not to meet the requirements of **Treas. Reg. § 20.2055-2(a)** that the charitable interest be presently ascertainable at the time of the decedent's death.

Care must also be taken when foreign charities are involved. This was illustrated by *Estate of Silver v. Commissioner*. **145** In *Silver*, the estate of a Canadian citizen who was not a U.S. resident, but who owned assets in the United States, was not entitled to a charitable deduction for the full amount of his charitable contributions. Although **the treaty between the United States and Canada** treats a contribution to a foreign charity as if it were a local charity, the assets used to make the contribution must be U.S. assets in order to claim a deduction. In *Silver*, both the assets and the charities were located outside the United States, so the Service allowed only a minimal proportionate deduction.

The decedent was a citizen and resident of Canada. He died in October 1997, leaving an estate valued in excess of $100 million. The bulk of his gross estate was located outside the United States. In the United States, the decedent owned 252,775 shares of Neuromedical Systems, Inc., which had a value of $516,268 on the alternate valuation date.

The Tax Court found that various reports and technical explanations made it clear that the estate of a Canadian citizen and resident is entitled to a charitable deduction on a U.S. federal estate-tax return only if the assets bequeathed are subject to U.S. estate tax. The court also determined that **the convention with Canada** , as amended by **the protocol** , did not conflict with the provisions of

Section 2106 , and, therefore, its limitations applied. Because, in *Silver* all parties agreed that the charitable bequests were made foreign organizations solely from funds located outside the United States, the court sustained the decision by the Service to allow a charitable deduction for only $1,615-a proportionate part of the total charitable contributions computed by comparing the value of the U.S.-held assets to the decedent's total worldwide estate.

¶ 4.03[1][b] Allowable Methods of Charitable Transfer

In addition to the requirement that the charitable transfer be made to a statutorily specified recipient, the transfer must also be made in the prescribed manner. Quite obviously, a direct bequest of property to charity will qualify. A qualified disclaimer by a primary beneficiary may also result in a direct bequest to charity if the charity had been named as alternate beneficiary. The transfer that causes the most difficulty in regard to qualification, however, relates to the so-called split-interest transfer where the transferee or other individuals retain some form of interest in the property that is transferred to charity. The Tax Reform Act of 1969 made a number of changes that strictly limited the types of transfers that would be considered deductible in those instances where a private individual retained an interest in property that was transferred to an exempt organization. **146** The regulations denominate these qualifying transfers as "deductible interests." **147** The following qualify as deductible transfers. **148**

¶ 4.03[1][b][i] Undivided portion of decedent's interest.

The regulations take the position that such an interest must consist of a fraction or percentage of each and every substantial interest or right owned by the decedent in the property and must extend over the entire term of the decedent's interest in the property. For example, if the decedent transfers his interest in an office building to his spouse for life and retains a reversionary interest in that building, the bequest by the decedent of one half of that reversionary interest to charity would not be considered a deductible transfer because interest in the same property has already passed from the decedent for private purposes and the reversionary interest will not be considered the decedent's entire interest in the property. If, on the other hand, he had been given a life estate in property for the life of his wife and if the decedent had no other interest in the property, the bequest by the decedent of one half of that life estate to charity would be considered a transfer of a deductible interest because he would have transferred a percentage or fraction of his entire interest. A transfer to a charitable organization of nonvoting stock in a company, while the voting shares are held in trust for the benefit of noncharitable beneficiaries, will not be considered a distribution of interests in the same property passing for both charitable and noncharitable purposes, even though the nonvoting stock is convertible into shares of voting stock. **149**

¶ 4.03[1][b][ii] Remainder interest in personal residence or farm.

This transfer typically involves a devise of a life estate to a spouse with the remainder to charity. The regulations take the position that a personal residence is any property that was listed by the decedent as a personal residence even though it was not his principal residence. **150** A farm is defined to mean any land used by the decedent or his tenant for the production of crops, fruits, or other agricultural products, or for the sustenance of livestock. **151**

¶ 4.03[1][b][iii] Charitable lead trusts.

A charitable lead trust gives a charitable organization an irrevocable right to receive a guaranteed annuity or unitrust interest for a specified period of time with the remainder interest assigned to the grantor or, more typically, another non-charitable beneficiary. See **Rev. Proc. 2007-46** **152** for the Service's model form for testamentary charitable lead annuity trusts.

The annuity payment must be "determinable," which means that the exact amount that must be paid under the terms of the trust is ascertainable as of the date the gift is made. The amount must be paid annually and can either be for a specified term or for the life or lives of an individual or individuals living at the date of the gift. If the charitable lead trust generates income in excess of the annuity amount, the additional income may be paid to the charity. However, the charitable deduction allowed for the trust shall be limited to the FMV of the guaranteed annuity interest.

If a trust does not meet all the requirements found in **Section 2522** and **Treas. Reg. § 25.2522(c)-3** , the estate will not be allowed to receive the charitable deduction. In **Rev. Rul. 88-27** **153** the deduction was denied because the trust gave the trustee discretion to prepay the annuity. This provision violated the requirement that the trust make periodic payments of an exact amount for a specified period of time. Any amounts prepaid were to be adjusted to compensate the trust for the loss of income due to the early decrease in principal. Therefore, the total amount distributed to the charity and the total amount retained by the trust would not change. Nonetheless, the terms of the trust did not adhere to the form required by the Code; therefore, it was not a valid charitable lead trust for purposes of the charitable deduction.

This ruling was distinguished in **Ltr. Rul. 8945004** , where a deduction was allowed for a charity's interest in a charitable lead trust even though the charity actually received a lump-sum payment under a settlement agreement with other beneficiaries. The Service said that if the settlement was of a bona fide will contest that somehow disqualified or reduced the charity's interest in the estate, then pursuant to **Rev. Rul. 89-31** , **154** the amount paid in the settlement would have been deductible, even if the charity's interest in the trust was not. In this case, the controversy was not considered a bona fide will contest, therefore the settlement payment was not deductible. However, the charity's interest in the trust created under the will was deductible at the time of the decedent's death. Events occurring after the decedent's death did not affect the charitable qualification of the trust, nor the estate's ability to take a deduction for the contribution. **155**

In *Rebecca K. Crown Income Charitable Fund v. Commissioner*, **156** the taxpayers established a charitable lead trust providing for specified annuity payments to unnamed qualified charities with the remainder interest passing to noncharitable beneficiaries. The trust agreement provided that the charities would receive an annuity of $975,000 annually for forty-five years. The trust also provided that the charitable annuity may be paid in advance of the stated forty-five year term if "as a matter of law" income in excess of the $975,000 annual amount might be paid in commutation of future annuity amounts without adversely affecting the maximum charitable deduction under the trust. The trustees actually paid amounts to charities that exceeded the annuity amount but did not commute future annuity payments. The trust claimed charitable deductions under **Section 642(c)(1)** with respect to all amounts paid to the charities, including the amounts paid in excess of the annual annuity. The Service contended that the trust was not entitled to deductions for charitable contributions for the amounts paid to charities in excess of the annual annuity amount because those amounts were not paid under the terms of the governing trust instrument. The Service contended that the trust instrument's phrase, "the maximum charitable deduction otherwise available," refers solely to the charitable deduction for the purposes of the gift tax under **Section 2522(c)(2)(B)** and that the commutation of future annuity payments was necessary before the disputed payments could be characterized as having been made pursuant to the terms of the trust as required for deduction under **Section 642(c)** .

The Tax Court agreed with the Service's finding that the amounts paid to charities in excess of the annuity amount were not made under the terms of the trust. The court agreed that commutation of future annuity payments was necessary before the disputed payments could be characterized as having been made under the terms of the trust. In affirming, the Seventh Circuit held that the trust instrument precluded the trustees from commuting the charitable obligations. According to the court, the language of the trust instrument which authorized commutation only if, as a matter of law, the charitable deduction would not be jeopardized, required the trustees to obtain before commuting either a letter ruling from the Service or a judicial ruling at the appellate level establishing the propriety of commutation by the charitable lead trust to a reasonable certainty.

¶ 4.03[1][b][iv] Charitable remainder trusts and pooled income funds.

The charitable remainder trusts that qualify for the estate tax charitable deduction are CRATs, as defined in **Section 664(d)(1)** , and CRUTs, as defined in **Section 664(d)(2)** . In essence, a CRAT is a trust from which a certain sum (which is not less than 5% of the initial net FMV of all property placed in a trust) is to be paid, not less than annually, to one or more persons who are not a charitable organization living at the time of the creation of the trust for a term of years not in excess of **157** twenty or for the lives of such individuals, from which no amount other than the previously described payments may be paid to or for the use of a person other than a charitable organization and following the termination of which, the remainder interest will be transferred to a charitable organization. **158**

In drafting an annuity trust (and indeed, a unitrust), the draftsman should take care to follow the language of the IRS model forms, **159** which sets forth the Service's requirements as to what should be contained in such a vehicle. The major advantage of the annuity trust as opposed to other charitable remainder trusts is that the amount of income paid to the noncharitable beneficiary is fixed and is not affected by fluctuations in the principal value. Consequently, if the decedent's concern is ensuring that a surviving spouse or other individual receive a fixed amount of income annually, the annuity trust may be the preferable form.

A CRUT is a trust for which a fixed *percentage*, not less than 5% of the net FMV of the assets, will be paid to an individual who is not a charitable organization for his life or a term not in excess of twenty years and from which no other payment will be made to a noncharitable individual and following the termination of which the remainder interest is transferred to a charity. **160** A unitrust may provide for the payment of the lesser of the net income of the trust or the unitrust amount to the noncharitable beneficiary and may make up the deficiency (if the income is less than the unitrust amount) in later years. **161** This frequently is referred to as the net income unitrust (with a makeup provision, if applicable). The Service has ruled that in a case of a succeeding life interest that will give rise to federal estate or state death taxes, and where state law requires apportionment, the governing instrument must provide for the payment of the tax attributable to the succeeding life interest by the succeeding life interest beneficiary or, alternatively, the donor's will should provide for the payment of these taxes from other assets. Without either of these foregoing provisions, the estate tax or charitable deduction may be lost. **162** In other words, the trust will be disqualified if the possibility exists that federal or state death taxes will be paid out of the trust corpus. **163**

There are several advantages to the unitrust concept as opposed to the annuity trust. First, an increase in the principal value in the trust assets will be reflected in the distribution to the beneficiaries because the income is stated as a percentage of the asset value. Thus, the life beneficiaries can benefit from corpus growth. It must be noted, however, that the converse is also true. The life income beneficiaries will share in the risk of a decrease in the value of the assets. If the unitrust is established under the net income concept, it does have the ability to accept unique assets such as nonincome producing real estate or a closely held business. It can then pay the net income to the life beneficiary until this asset is sold and reinvested to yield higher income.

The pooled income fund, which is defined in **Section 642(c)(5)** , is a trust that is frequently created by a public charity from which an income interest is paid to a private beneficiary and on the extinction of which, the remainder interest in the property so transferred is severed from the trust corpus and either paid or retained for the use of the designated public charity. **164** All these vehicles have the common trait of attempting to precisely define the value of the interest bequeathed to charity. In each case, a specified portion or percentage of either the income or assets are paid to the noncharitable lifetime beneficiary with the remainder bequeathed to charity on termination of this private use.

Various cases have arisen regarding whether a charitable deduction can be taken in a split-interest trust. The issue arose in a 1991 case, *Estate of Johnson v. United States*, **165** In this case, the decedent's will created a trust which had three purposes: (1) to support his surviving sisters; (2) to perpetually maintain the family cemetery; and (3) to create a charitable trust to provide funds for educating future Catholic priests and nuns. Subsequent to filing the estate tax return in which it did not take a charitable deduction, the estate asked the chancery court to grant the estate authority to establish the charitable foundation and transfer over $235,000 in assets to it. The court granted this request and a request to interpret the decedent's will as creating three separate trusts.

The estate submitted a claim for an estate tax refund based on a charitable contribution deduction for the funds transferred to the charitable foundation. The Service denied the claim, but its decision was reversed on appeal. The Fifth Circuit disagreed ruling in favor of the government. It said that the will unambiguously created one trust to serve three separate purposes, only one of which would qualify as a charitable bequest. The trust did not qualify for any of the methods of reforming a split-interest trust as found in **Section 2055(e)(3)** ; therefore, the estate tax charitable deduction was denied under **Section 2055(e)(2)** . The court distinguished *Oetting v. United States*, **166** a case in which a deduction was allowed in a split-interest trust. In *Oetting*, the value of the bequests to the noncharitable beneficiaries could be determined with reasonable certainty ($100 per month for life) and an annuity purchased to provide the funds needed. In *Johnson*, no one knew how much money would be needed to care for the decedent's impoverished, elderly sisters, therefore, for tax purposes, the single trust could not be effectively divided into three separate trusts.

In*Estate of LaMeres v. Commissioner* , **167** no charitable deduction was allowed for a split-interest trust that had been reformed by the probate court. In this case, the decedent established a trust during his lifetime for the benefit of both charitable and noncharitable beneficiaries. After his death, the trustees created a separate trust for noncharitable beneficiaries and transferred a sum of money to it. The trustees then petitioned the state probate court, requesting that it make findings and issue instructions with respect to a so-called BETA trust that was created by the trustee to purge the revocable trust of its noncharitable beneficiaries so that it would qualify for the estate tax charitable deduction under **Section 2055** . The probate court allowed the trustees to create the BETA trust because the estate would not otherwise be entitled to an estate tax charitable deduction because of **Section 2055(e)** , which forbids split-interest gifts.

The Service determined that no estate tax charitable deduction was allowable, and the Tax Court agreed. The court held that the revocable trust was a nonqualifying split interest under **Section 2055(e)(2)** and that modification of the trust was done solely to circumvent the requirements of that section. The court rejected the estate's argument that establishing the BETA trust purged the revocable trust of the noncharitable interest, thereby eliminating the split interest. The court pointed out that nontax considerations provided part of the explanation for the post-date-of-death events, which separated the charitable and noncharitable interests.

Reformation was allowed in *Wells Fargo Bank v. United States*, **168** where the decedent created a testamentary trust that paid a monthly sum to a long-time employee and gave him a life estate in the decedent's residence. The trustee also had authority to pay "all taxes, maintenance, repairs or improvements" on the house, as well as "all unusual and exceptional expenses" of the employee, such as hospital, medical and dental bills, and all income taxes.

The will was reformed by the state court after the decedent's death, eliminating the payment of medical expenses, taxes, and house maintenance and improvements, in order to qualify for the estate tax charitable deduction under **Section 2055** . The Service challenged the estate's right to reformation and claimed that a charitable deduction should not be allowed because the amount passing to charity was not ascertainable at the time of the decedent's death. The district court ruled in favor of the estate. This ruling was affirmed by the Ninth Circuit.

The court of appeals found that the will was eligible for reformation under **Section 2055(e)(3)(C)(iv)** , because it was executed prior to January 1, 1979. The fact that the decedent executed a codicil subsequent to that date, which codicil stated that the decedent confirmed and republished the original will, did not change the court's position. The court determined that Congress did not intend the "publication" of a will to be synonymous with "execution" of a will, nor that a testator's estate would lose the right to reform a will simply because the testator executed a codicil making a fairly minor change in the terms of the will. **169**

On the question of ascertaining the size of the charitable deduction, the court found the language in the will sufficiently limiting and predictable. The provisions for upkeep of the house were limited to maintaining it in its condition as of the decedent's death. The trust could not be used to substantially change the residence at the whim of the life beneficiary or the trustee, unless medically necessary for the beneficiary. The court found that the provisions in the will referring to payment of the life tenant's medical expenses and taxes were as ascertainable as other common phrases such as "comfort" or "reasonably necessary expenses." The provisions did not give the trustee power to invade corpus for just any reason, as would be found if the provisions were for the life tenants' "happiness," "desire," or "pleasure."

In *Zabel v. United States*, **170** an estate was held not entitled to a charitable deduction for a trust with a charitable remainder because the split interests were not in the form of a unitrust, annuity, or pooled income fund. The court noted that the split interest trust in this estate created split interests in the same property between charitable and non-charitable beneficiaries and that the estate failed to reform the trust within the nine-month-and-90-day period allowed under **Section 2055(e)(3)(C)** .

In *Estate of Atkinson v. Commissioner*, **171** the Tax Court held that a decedent's estate was not entitled to deduct a remainder interest in a charitable remainder annuity trust because it failed to make the required annual distributions to the beneficiaries and because a settlement with the beneficiary required the corpus to be invaded for the benefit of non-charitable beneficiaries. Thus, the operation of the trust caused it to fail.

The Eleventh Circuit upheld the Tax Court decision in *Atkinson*, again noting that the trust never made annuity payments during the decedent's lifetime.

In *Jackson v. United States*, **172** the United States District Court for the Northern District of West Virginia held that an estate was entitled to an estate tax charitable deduction resulting from the termination of a nonqualifying charitable split interest trust.

Mildred Jackson created a revocable trust that provided her with income and principal from the revocable trust during her lifetime. The trustees of the revocable trust were an individual and a trust company. The revocable trust provided that on Jackson's death, her residuary trust estate would be held in trust and would pay one fourth of the trust's annual accounting income to Jackson's nephew and three nieces. The trust provided that on the death of each of the nephew and three nieces, one fourth of the trust corpus would be distributed to a specified church. The investment committee of the trust company included two individuals who were members of the church and were also members of two of the church's committees. The individual trustee was a member of the church and was married to one of the three nieces.

On Jackson's death, the attorney administering the estate became concerned about potential conflicts of interest arising from the nieces' and nephew's dissatisfaction with the diminished income from the trust and the fact that the individual trustee was married to one of the three nieces. To avoid possible disputes arising from such conflicts, the attorney suggested that the trustees and beneficiaries terminate the trust. The trustees, the nephew, the three nieces, and the church signed an agreement terminating the trust. A distribution was made to the nephew and the three nieces from the trust for their income interest based on life expectancy calculations derived from IRS actuarial tables. The church received the remaining trust property. Jackson's estate filed an estate tax return and claimed a charitable deduction for the distribution to the church. The IRS denied the deduction.

Section 2055(a)(2) permits a charitable estate tax deduction for bequests, legacies, devises, or transfers to charitable organizations. However, **Section 2055(e)(2)** provides that an estate tax charitable deduction is not allowed for property in which both a charitable and a noncharitable beneficiary have an interest unless the property passes to either a charitable remainder trust or a pooled income fund. **Section 2055(e)(3)** allows an estate tax charitable deduction with respect to a trust that does not initially satisfy the requirements of a charitable remainder trust if such trust is timely reformed to comply with the requirements of a charitable remainder trust. The parties agreed that the trust neither satisfied the requirements of a charitable remainder trust nor was the trust reformed so as to qualify as a charitable remainder trust. The issue before the court was whether the estate was nevertheless allowed an estate tax charitable deduction solely on account of the terminating distribution.

The IRS argued that the denial of an estate tax charitable deduction can only be avoided if the nonqualifying charitable remainder trust is terminated pursuant to settlement of litigation or to avoid an imminent breach of fiduciary duty. The court rejected the IRS's position as inconsistent with the history and purpose of **Section 2055(e)** . The court held that the purpose of **Section 2055(e)** was to insure that the amount claimed as an estate tax charitable deduction more closely corresponds to the amount that the charity actually receives. The court noted that in determining whether a terminating distribution from a nonqualifying split interest trust qualifies for an estate tax charitable deduction, courts have generally focused on four factors: (1) whether property is directly transferred to the charitable beneficiary; (2) whether a noncharitable beneficiary maintains an interest in the property transferred to the charitable beneficiary; (3) whether the deduction claimed is for the actual amount received by the charitable beneficiary; and (4) whether the estate was concerned solely with avoiding the application of **Section 2055(e)** and obtaining a charitable deduction.

The court found that each of these four requirements was satisfied. First, the church received an outright distribution of money pursuant to the termination agreement. Second, the nephew and the three nieces had no interest in the property distributed to the church after the distribution. Third, the estate tax charitable deduction sought by the estate equaled the amount received by the church. Finally, the court found no evidence suggesting that either the trustees or the beneficiaries were aware of the requirements of **Section 2055(e)** before the execution of the termination agreement. Instead, the court found that the trustees believed in good faith that conflicts of interest threatened to compromise their ability to impartially administer the trust. Therefore, the court concluded that the terminating distribution renders **Section 2055(e)** inapplicable, particularly in light of the trustees' good-faith termination of the trust.

The holding of this case may be rather limited in light of the court's reliance on the fact that the trustees and their advisors were not aware of the applicability of **Section 2055(e)** or its consequences to the estate. It would appear that this lack of knowledge ultimately saved the estate and the beneficiaries from potentially adverse tax consequences. The fact of the matter is, however, that the funds actually went to the charitable institution and the estate received a corresponding deduction.

A charitable deduction was disallowed in *Galloway* **173** for a split-interest trust created at decedent's death because the trust did not meet any of the exceptions found in **Section 2055(e) of the Code** . The trust gave charitable and non-charitable beneficiaries equal interests in the trust, which would be distributed to each beneficiary in two installments. This arrangement did not qualify as a charitable remainder trust, pooled income fund, or similar type entity which are generally the only split-interest trusts entitled to a charitable deduction.

The decedent created a revocable trust in 1991, which he amended several times. He was the initial trustee. His son became trustee after decedent's death. At his death, on July 22, 1998, decedent's estate was to continue in trust for the benefit of his son, granddaughter, and two charitable entities. As amended in 1996, the trust awarded each beneficiary a one quarter share in the trust. Each beneficiary was to be paid one half of its one quarter share on January 1, 2006. A second and final payment was to be made on January 1, 2016. The trust agreement provided that if one of the individual beneficiaries predeceased the time of distribution, his or her share was to be distributed equally among the remaining beneficiaries.

After decedent's death, his attorney asked the Commonwealth of Pennsylvania Department of Revenue to determine the value of the residuary interest. The entire interest was valued at $690,476, with the charitable portion valued at $399,079. The estate claimed this latter amount as a charitable deduction on the federal estate tax return. This produced a taxable estate of $1,059,851, resulting in a $168,637 estate tax, which it paid in three installments.

In April 2000, the Service notified the estate that its federal estate tax return was being audited. The Service disallowed the charitable deduction. It had determined that the trust created was a split-interest trust that did not meet the requirements of **Section 2055(e)** . This increased estate tax to $306,605. The estate paid the additional tax, then filed a claim for a refund in July 2002. The claim was denied in February 2003. The estate filed a complaint with the U.S. District Court for the Western District of Pennsylvania. Both parties filed motions for summary judgment. The government's motion was granted, while the estate's was denied. The district court found that the plain language of **Section 2055(e)** required that the Service deny the charitable deduction. The estate appealed this ruling to the Third Circuit.

The main issue was whether the Service was properly interpreting **Section 2055(e)** . **Section 2055(a)** allows an estate to take a deduction for "all bequests, legacies, devises or transfers" to a qualifying charitable organization. Before the Tax Reform Act of 1969 was enacted, a charitable deduction was allowed when a trust had both charitable and non-charitable beneficiaries, if the value of the charity's interest was readily ascertainable. **174** If the non-charitable beneficiary was receiving a life estate, with the remainder passing to charity, the charitable interest was calculated using the actuarial life expectancy of the non-charitable beneficiary and an assumed interest rate. **175**

Section 2055 was enacted when Congress determined that the benefits received by the charities were often less than the amounts deducted. Trust assets were being invested in ways that maximized the income beneficiary's share and decreased the amount passing to the remaindermen. **Section 2055(e)** disallows a charitable deduction when there is a split-interest gift (to a charitable and non-charitable beneficiary) unless the gift is in the form of a charitable remainder annuity trust or unitrust, or a pooled income fund, or some other trust format which provides for a guaranteed annuity or yearly fixed percentage.

The estate agreed that the trust created by the decedent does not meet any of the exceptions noted in **Section 2055(e)** . However, the estate believed that the statute is "inherently ambiguous" in that it fails to clearly define what Congress considered to be a "split-interest" trust, and what it meant when it describes the charitable and non-charitable interests as being "in the same property." The estate asked the court to look at the legislative history of **Section 2055(e)** to determine Congress's intent when it passed the law.

The Court of Appeals did not find any ambiguity in the statute. It said that "it is a well-established precept of tax law that, in interpreting statues, the literal meaning of the statute is most important, and we are always to read the statute in its 'ordinary and natural sense.'" **176** Courts are only supposed to allow deductions if they are clearly specified in the statute. **177**

According to the court, the statute clearly states that if an interest in the same property passes to charitable and non-charitable beneficiaries, a charitable deduction is not allowed unless one of the exceptions is met. In the present case, the decedent's revocable trust created one new trust which clearly allocates the property interests in equal shares between two charitable entities and the decedent's two children. Under this format, all the beneficiaries have an interest in the same property. Therefore, the Service was correct in applying **Section 2055(e)** to the trust, and in disallowing the charitable deduction.

Because the exceptions in the statute refer to annuity and unitrust interests, the estate argued that the statute only applied to trusts that created a life estate in a non-charitable beneficiary and which left the remainder to a charity. The Third Circuit disagreed. Though abuse of such types of trusts was the impetus for the creation of **Section 2055(e)** , its application is clearly not limited to such trusts.

If the meaning of a statute is not ambiguous, then the court cannot look at legislative history to narrow or change the interpretation. **178** It does not want to create ambiguity where none exists. The court recognized that its ruling would put the estate in a difficult position. It was aware that the way this trust was structured, it was unlikely that the charities' interests would or could be abused. Because both types of beneficiaries held identical interests, both would be affected by any investment or administrative changes. The court cited other cases that reached similar conclusions. **179** In one such case, *Zabel*, **180** the U.S. District Court for the District of Nevada stated that the terms of the trust protected it from the types of abuse that **Section 2055(e)** was designed to prevent. In spite of this, the court denied the charitable deduction because the language in the statute was unambiguous and the trust did not meet the exceptions.

The estate tried to support its position by citing several cases in which a charitable deduction was allowed when the interest that passed to the charity came via a settlement between the parties, so there was also no opportunity for abuse. **181** The court distinguished these cases. In each instance, the charitable entity had already completely received its interest in the trust, therefore it did not actually share an interest in the trust with the non-charitable beneficiaries. This was different from the present case in which all beneficiaries held the same interest in the trust until it terminated.

The language of **Section 2055(e)** is unambiguous. It is also obvious that the trust in *Galloway* does not meet the statutory exceptions. The court had little choice but to affirm the order of the district court. This case reminds practitioners how important it is, when drafting a will or trust and planning to claim a charitable deduction, to be sure that all pertinent requirements of **Section 2055(e)** are met. If a client insists on drafting the provision in a different or nonstandard manner, the tax practitioner needs to explain and document to the client the tax consequences of such a strategy.

Practitioners should also take note of *Tamulis*, **182** where the Seventh Circuit upheld a Tax Court decision to the effect that the doctrine of substantial compliance does not apply to a charitable remainder trust reformation that failed to satisfy **Section 2055(e)(3)(C)(iii)** . In this case, the trustee of a clearly defective charitable remainder unitrust had failed to initiate a court proceeding to reform the trust even though a complaint had been prepared. The trustee did administer the trust as if it were qualified. The court held that the trust did not meet the substantial compliance test because the trustee, who was represented by counsel, knew that a substantial deduction was at stake and had no excuse for not starting the required judicial proceeding to reform the trust. The court stated that the **Section**

2055(e)(3)(C)(iii) reformation requirements "protect against efforts to bend trust law to get a tax benefit." If good faith was sufficient, the court noted that Congress would have so legislated.

¶ 4.03[1][c] Additional Requirements for Charitable Bequests

In addition to the requirements that the charitable transfer be made to a specified beneficiary and in the proper form, the Code imposes certain other limitations on the charitable deduction. First, it is specifically provided that the deduction under **Section 2055** may not exceed the value of the transferred property required to be included in the gross estate. **183** This requirement merely follows the fundamental concept that before a deduction is allowable, the property must be included in the decedent's gross estate. **184** The Code also provides that where either by terms of the will or by operation of law, any state succession, legacy, or inheritance taxes are payable out of the charitable bequest, the charitable deduction will be correspondingly reduced. **185** Consequently, in those instances where it is required that the charitable bequest proportionately bear part of the state inheritance taxes, the charitable deduction will be decreased accordingly. If there is an intention to maximize the charitable deduction, the drafter should provide that the taxes will be paid disproportionately by other beneficiaries or allocated to other portions of the estate. Similarly, the charitable deduction may be reduced by administrative expenses chargeable against the bequest. **186** These requirements are generally aimed at limiting the charitable deduction to the amount actually received by the qualified beneficiary and prohibiting a double deduction for the same item. As such, they represent relatively logical and easily understood concepts. From a drafting standpoint, they create the necessity of inserting carefully drawn allocation clauses in the will or trust instrument.

A case illustrating the importance of tax allocation clauses relating to charitable bequests is *Estate of Bradford v. Commissioner*. **187** The tax clauses in decedent's will and trust in *Bradford* overrode the state apportionment statute, and provided for payment of all death taxes out of assets in the residue. Contrary to the estate's position, the Tax Court interpreted these clauses to require that death taxes be deducted before the charitable gift was calculated. This reduced the charitable gift, and hence the charitable deduction.

Marion P. Bradford, a resident of North Carolina, died on April 3, 1996, at the age of 86. He had recently executed a new will in which he named his friend and caregiver, Lizette L. Pryor, executrix of his estate. Bradford's will provided for the payment of his debts, administration expenses, and death taxes. After distribution of certain personal property to his sister and Pryor, the balance of Bradford's estate was to be transferred to Pryor as successor trustee of a revocable trust executed by Bradford on March 21, 1996.

The revocable trust also provided for the payment of debts, expenses, and taxes, as well as the distribution of certain tangible property in the trust. The balance of the trust was to be split into two shares. One share would be used to establish a private charitable foundation for the benefit of Pryor's church. Funds were to be distributed to the church at the discretion of the foundation's trustee, for a period of five years. The foundation would terminate at the end of the fifth year, when all remaining assets would be distributed outright to the church.

The federal estate tax return was filed on February 3, 1997, one month late, listing a gross estate of $2,778,746. The estate paid estate tax of $254,051. The return showed a charitable deduction of $1,346,060, for the gift to the church. In July 1997, the estate filed an amended Form 706. The gross estate was reduced to $2,697,404, and the estate tax liability dropped to $239,165.

The IRS issued a deficiency notice. It claimed that the gross value of the estate was $3,057,009, that the charitable deduction was only $800,752, and that additional estate tax of $309,448 was owed. The estate had allocated assets to the charitable foundation before taking a deduction for death taxes. The IRS said that the taxes must be deducted first, before calculating the charitable gift, which reduced the gift and the deduction.

The estate challenged the IRS's position and the case went to the U.S. Tax Court. The main issues before the court were whether (1) death taxes were to be apportioned to the charitable beneficiary, and (2) death taxes paid by the revocable trust would reduce the size of the charitable bequest, and consequently the charitable deduction.

Citing *Riggs v. Del Drago* **188** and other cases, the Tax Court said that state law generally determines the allocation of death taxes among beneficiaries. **189** In *Bradford*, the Tax Court looked at **N.C. Gen. Stat. Sec. 28A-27-2 (2001)** . North Carolina law generally apportions taxes among all beneficiaries. There are several exceptions in **N.C. Gen. Stat. Sec. 28A-27-5** , including one for bequests to charitable organizations that qualify for the charitable deduction. If applicable, the full amount of the bequest can be deducted on the estate tax return. North Carolina also provides, in **N.C. Gen. Stat. Sec. 28A-27-2(b)** , that if a decedent's will specifies a different method of paying death taxes, that method would supersede state law.

The tax clause in the will provided that all death taxes were to be paid out of the residue of the estate, without any right of apportionment. To the extent there were not sufficient assets in the estate to cover all debts, expenses, and death taxes, the executrix was authorized to request funds from Bradford's revocable trust. The tax clause in the will reads as follows:

> **Payment of Death Taxes.** All death taxes (other than death taxes which are paid from property passing outside of this Will pursuant to the terms of the governing instrument) shall be paid out of my Residuary Estate as an administration expense and shall not be charged against or recovered from any recipient or beneficiary of the property taxed, except that my Executor shall recover as provided by law any death tax attributable to property over which I have a power of appointment or in which I have [a] qualifying income interest for life to the extent that any death tax recoverable by law is not otherwise paid out of such property.

The clause in the will defining "death taxes" reads as follows:

> **Death Taxes.** The term "death taxes" means inheritance, estate, supplemental estate, generation-skipping, transfer and succession taxes, and any interest and penalties on these taxes, imposed by reason of my death by any jurisdiction with respect to property passing under or outside of the provisions of this Will or any codicil to it which is includable in my estate for the purpose of determining such tax, including, but not limited to, any tax on property includable under **section 2041** (relating to life insurance proceeds), **section 2042** (relating to powers of appointment), or **section 2044** (relating to qualified terminable interest property) of the Internal Revenue Code, or any comparable provision of state law, but excluding, however, any tax imposed by **section 2032A(c)** (relating to qualified real property) or Chapter 13 (relating to generation-skipping transfers) of the Internal Revenue Code, or any comparable provision of state law, for which my estate is not liable.

Article V of Bradford's revocable trust provided for the distribution of trust assets. Paragraph 5.01 of the trust instructed the trustee to pay the grantor's debts, expenses of last illness, and burial expenses, to the extent not paid out of probate assets. Paragraph 5.02 provided for the distribution of certain items of tangible property. Paragraph 5.03, titled "Creation of Charitable Foundation," stated that "[u]pon the death of the Grantor, the Successor Trustee shall allocate one half of the remaining Trust assets or property for the establishment of a private charitable foundation…."

Paragraph 5.04, "Allocation of Remaining Trust Property," stated:

> Upon the death of the Grantor, the Successor Trustee shall distribute the remaining Trust property which remains after providing for all previous distribution and for payment of all expenses of administering such Trust in accordance with provisions of paragraph 6.02 herein for bequests, debts, expenses, and taxes of Grantor's estate to Lizette Lewis Pryor in fee, discharged of Trust if she survives Grantor.

Paragraph 6.02, referred to above, provides for payment of debts, expenses, and taxes from trust assets. It reads as follows:

> **6.02. Payment of Bequests, Debts, Expenses and Taxes of Grantor's Estate.** Notwithstanding the directions previously given as to the disposition of the Trust after the Grantor's death:***
>
> > **B. Payment of Bequests, Debts, Expenses and Taxes Certified by Personal Representative of Grantor's Estate.** The Successor Trustee shall pay those amounts to Grantor's estate or to the persons or authorities eligible to receive the same which are certified by the personal representative of Grantor's estate as being required to pay (i) any bequest in Grantor's Last Will, (ii) any of Grantor's debts, health care expenses, funeral expenses and administration expenses…(iii) any death taxes

> imposed by reason of Grantor's death, including any inheritance, estate, supplemental estate, generation-skipping, transfer or succession taxes and any interest and penalties payable in connection with such taxes. Such amounts shall be paid first from the Trust property which is subject to allocation under Article V."

The Bradford estate had several arguments why death taxes should not be allocated to the charitable gift. First, the estate said that the language in the will and trust indicated that Bradford intended for all taxes to be paid from trust assets. Second, it argued that the tax clauses in Bradford's documents did not differ from the North Carolina apportionment statute, so the charitable exception in the statute would still apply. Last, the estate claimed that language in a will or trust that opts out of the state statute must be clearly stated, and that the language in the Bradford documents was ambiguous, so by default, the North Carolina apportionment statute must apply.

The IRS countered by arguing that Bradford's estate plan provided that taxes would be paid from the probate estate, but that trust assets would be available if needed. According to the Service, Bradford also clearly opted out of the state apportionment statute, and thus lost use of the exception for charitable gifts. The IRS said that the estate could turn to the trust for funds to pay the death taxes either under the provisions in the will, or pursuant to **Section 2207B(a) of the Code** , which applies to property that is transferred but a life estate is retained.

The Tax Court said the dispute was essentially over the meaning of the will and trust, and consequently the decedent's intent. The court cited numerous cases supporting the position that determining the intent of the decedent was paramount. **190** The court disagreed with the positions taken by the estate. It concluded that Bradford did intend to pay taxes out of probate assets, with trust assets available to cover any shortfall. The court agreed with the IRS that the tax clauses in the will and trust did not allow for apportionment, and that they overrode the North Carolina apportionment statute, so the estate could not take advantage of the exception for charitable bequests. All taxes were to be paid from the residuary estate.

The court also felt that the trust agreement provided that death taxes were to be paid from trust property before half of it was allocated to the charitable foundation. The court said that the estate failed to see the distinction between the provision for payment of death taxes in Paragraph 6.02B, and the manner in which the distribution to the non-charitable beneficiary was to be computed. By taking into account the payment of debts, expenses, and taxes when making the calculation in Paragraph 5.04, the trust prevents overpaying the non-charitable beneficiary. The court noted that the non-charitable beneficiary receives her bequest five years before the charity does.

A different section, Paragraph 6.02B, controls the actual payment of debts, expenses, and taxes. The court focused on the provision in that section which said that the payments were to be "paid first from the Trust property which is subject to allocation under Article V," and the statement at the beginning of Paragraph 6.02, "Notwithstanding the directions previously given as to the disposition of the Trust after the Grantor's death." The Tax Court interpreted these provisions to mean that any death taxes certified by the executrix were to be paid before the trust property was allocated between the charitable and non-charitable beneficiaries, which consequently reduces the charitable gift.

It is not so clear, however, that the allocation to the charitable foundation was to occur after the payment of death taxes. Although there is some clarifying language in Paragraph 6.02 of the revocable trust, it is difficult to reconcile that section with Article V in the trust. The statement at the end of Paragraph 6.02 that debts, expenses, and taxes are to be paid first from assets subject to distribution under Article V, seems to be subject to interpretation and seems to conflict with the distribution provisions in Article V.

Another case where poor tax allocation clauses reduced the charitable bequest is *Green v. Commissioner*. **191** In *Green*, the decedent's will attempted to alter the allocation of estate and generation-skipping transfer (GST) tax payments in a manner that affected the charitable tax deduction, but did not clearly state which funds should pay the tax. On review, the Tax Court allocated death taxes to the charitable residuary beneficiary and GST taxes to the non-charitable residuary beneficiary.

Mildred Green was a resident of St. Louis, Missouri when she died on September 26, 1997. She owned 3,276 shares of privately held Royal Bancshares, Inc. (RBI) at her death. She was the fifth largest shareholder, with a 5.09% interest in the company. No one held more than 14.38% of the corporation. At the time of her death, RBI had total assets of almost $173 million.

RBI owned a local bank, Royal Banks of Missouri (Royal Banks), which had five branches around St. Louis. Royal Banks earned approximately $1.7 million in the year prior to Mrs. Green's death. In April 1996, Royal Banks loaned $1.6 million to two individuals. The loan was guaranteed by a printing company, which gave the bank a security interest in real property. The borrowers made payments on the note through July 1997, but then defaulted. In August 1997, its creditors forced the printing company into bankruptcy. It ultimately converted its involuntary bankruptcy to a voluntary bankruptcy, at which time Royal Banks formally entered its appearance in the bankruptcy proceeding.

Mrs. Green left half of the residue of her estate to the Lubin-Green Foundation and half in trust for her three grandchildren. In her will, she stated that her estate should pay all death taxes, but that the taxes were not to be deducted from any gift or property generating the tax. The will also stated that any GST taxes incurred were not to be paid from or reduce the direct skip gift that generated that tax. Nothing in the will explicitly stated from where taxes were supposed to be paid.

The federal estate tax return was filed on November 9, 1998. It stated that Mrs. Green had a gross estate of $3.3 million at her death. Her RBI stock was valued at $163,000 ($50 per share). The estate claimed a charitable deduction of $1,565,678 for the portion of the residue that was bequeathed to the Lubin-Green Foundation. The same amount was transferred to the grandchildren's trust. This was reported as a direct skip on Schedule R for GST purposes.

In 1999, the IRS issued the estate a deficiency notice for $1,205,541 in estate and GST tax. The Service valued Mrs. Green's RBI stock at $320 per share, for a total value of $1,048,320, rather than the

$163,000 claimed by the estate. It also reduced the charitable deduction for the gift to the foundation to $1,565,678, because it said that 50% of the estate taxes and all of the GST taxes should have been deducted from the charitable bequest.

There were three issues before the court: the proper allocation of federal and state estate taxes, the proper allocation of GST tax, and the fair market value of Mrs. Green's shares of RBI.

If a will does not specify the assets from which estate taxes are to be paid, one must look to state law. If, as in Missouri, there is no apportionment statute, the courts look at the decedent's intent. **192** If intent is not clear, the court must decide what the decedent's intent was. If the intent is not discernable, estate taxes are allocated in accordance with the equitable apportionment doctrine, under which they are taken only from assets that generate the tax.

Initially, the Service claimed that the federal and state estate taxes should be paid equally from the charitable bequest and the grandchildren's trust. When the issue came before the Tax Court, the Service altered its argument to claim that 100% of the estate taxes should be paid from the charitable funds. The estate argued that Mrs. Green's intent was not clear, with the consequence that taxes should be allocated 100% to the trust under the equitable apportionment doctrine. The court did not find the language in the will plain or unambiguous, or find any clear guidance as to what funds should be used to pay the taxes. However, it also did not believe that the decedent's intent was to deduct all taxes from the charitable gift. The Tax Court held that equitable apportionment applied. All estate taxes were to be paid from the trust assets.

The Tax Court found decedent's intent clearer when it came to allocation of GST tax. The will specifically stated that the tax was not to be deducted from a bequest that was a direct skip. The court said that a clear statement of intent was enough to elect out of the general apportionment scheme found in **Section 2603(b)** . **193** It ruled that all GST taxes would be charged against the assets going to the foundation.

Generally, estate and other death taxes are payable from taxable assets in the residue, while GST taxes are payable from the bequest generating that tax. This usually prevents the allocation of taxes against charitable gifts, preserving the charitable deduction. However, such a scenario can produce significant reductions in bequests to other beneficiaries.

By changing the tax provisions in her will, the decedent clearly indicated that she did not want to shortchange her grandchildren in order to enhance the benefit to the charity. Although her will stated what she did not want to happen, it did not clearly specify from what funds the taxes should be paid. When altering standard tax or other provisions in a will or trust, a legal advisor needs to be sure that the procedure has been completely thought out *and* clearly explained in the document. Otherwise, controversy over the apportionment of taxes such as that in *Green* will continue to arise.

Finally, the charitable bequest should be drafted in such a manner so as to not be contingent on the occurrence of some event or the actions of a third person. Generally speaking, a contingent bequest to charity will not qualify for the deduction unless the possibility that the charity will not take is so remote as to be negligible. **194** For example, the Service has ruled that no deduction is allowable for a testamentary bequest to charity contingent on the approval of a third party. **195** No deduction was allowed for a charitable remainder contingent on the life tenant's death without children in a situation where it was biologically possible that the life tenant could have children. **196** No deduction was allowed for a charitable bequest to a university contingent on a daughter's death before age 50. **197** Although there are instances where the Service has found that the possibility of the charity's not taking the bequest is so remote as to be negligible, **198** these cases and rulings are the exception and are difficult to predict. As a general rule, if there is a desire to obtain the charitable deduction, the bequest should not be contingent.

It should also be noted that, according to **Ltr. Rul. 8948023** , it is possible for the beneficiaries of a charitable remainder trust to terminate the trust early if all the beneficiaries agree. The Service assumed, though, that the early termination would not violate state law, that it would be pursuant to a court proceeding in which the state attorney general was a party, and that the trustee had considered all relevant factors before agreeing to the early termination. Unfortunately for the noncharitable beneficiaries, the Service also ruled that the termination of the trust was a sale of their interests in the trust to the charitable beneficiaries and not a distribution of trust corpus under **Section 664** . Therefore, the distributions were taxable transactions. Furthermore, because they had term interests in the trust, their basis in the property was zero, rather than the FMV of the property when their interest was created. Therefore, the entire distribution constituted taxable gain to the noncharitable beneficiaries.

An estate that took an estate tax charitable deduction on its estate tax return, in accordance with **Section 2055** , cannot also take a **Section 642(c)** income tax deduction for that same payment according to a ruling by the U.S. District Court for the eastern district of Virginia. An estate is allowed only one deduction for a charitable gift. If the gift is to be made from estate corpus, the deduction is taken under **Section 2055** . If the will states that the payment is to be made from estate income, then the deduction is pursuant to **Section 642(c)** . Though the estate in *Crestar Bank v. Commissioner* **199** argued otherwise, there is no statutory or case law supporting a double deduction.

The decedent, James A. Linen, IV, died in 1989. In his will, he gave one half of his stock in the Des Plaines Publishing Company (the stock) to the Des Plaines Publishing Charitable Trust (the trust) created in 1985. The stock, valued at $1,005,754, was transferred to the trust on December 15, 1989. The estate claimed a charitable deduction from the gross estate, in accordance with **Section 2055** , for the amount of the gift on the estate's federal estate tax return, which was timely filed in 1990. The Service allowed the deduction.

The estate's fiduciary income tax return for the year ended June 30, 1990, was filed on December 17, 1990. The estate reported income of $2,340,465, none of which was related to the donation of the stock. The estate paid federal income tax of $512,900. On December 17, 1993, the estate filed an amended fiduciary income tax return for 1990 in which it claimed a refund of $281,604. The estate claimed that under **Section 642(c)(1)** it was entitled to an income tax deduction for the stock that was donated to the trust. The requested refund was denied by the Service on May 28, 1996. The estate appealed the matter.

The tone of the District Court's opinion was set by its opening paragraph in which it summed up the matter at hand:

> Notwithstanding that the estate claimed and received a deduction from the gross estate for the same gift under **IRC Section 2055** , the estate now argues that it is entitled to the deduction under **Section 642(c)** because the total income reported by the estate on its original Form 1041 for the 1990 Tax Year exceeded the amount of the estate's donation to charity that year. The estate has cited no authority for the construction of **Section 642(c)** upon which it bases its claim for this deduction. Instead, the estate contends that an entitlement to the deduction may be divined from certain facets of the decision in *Old Colony Trust Co.*, **200** as well as from assorted IRS statements and regulations. The IRS disagrees, arguing that neither *Old Colony Trust Co.* nor IRS statements and regulations permit, under **Section 642(c)** , that which the plain language of the statute does not: the deduction from gross income of amounts donated to charity from an estate's principal and deducted from the taxable estate.

The District Court then proceeded to refute all the estate's arguments. It began by reviewing **Section 642(c)(1)** , which states as follows:

> (c) Deduction for amount paid or permanently set aside for a charitable purpose.
>
>> (1) General rule. In the case of an estate or trust, there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by **section 170(a)** , relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in **section 170(c)** ….

In order to prove that it was entitled to the charitable deduction under **Section 641(c)** , the estate in *Crestar* had to show that "(1) the estate paid (2) an amount of its gross income (3) pursuant to the terms of the will (4) for a purpose specified in **Section 170(c)** ." Everyone agreed that the estate gave stock to the Trust for a purpose specified in **Section 170(c)** , in accordance with the terms of the decedent's will. However, the facts clearly showed that the stock was owned by the decedent prior to his death, and that it was not income earned by the estate. Because the stock was not estate income, the estate could not meet the second requirement of **Section 642(c)** and, therefore, could not claim the charitable deduction. The court found that the Service was correct in rejecting the income tax deduction.

Next the court reviewed the "conduit principle" of taxing estates found in Subchapter J, by which an estate is treated as a separate taxable entity, taxed only on accumulated income that is not distributed to beneficiaries. It discussed the provisions of **Section 661(a)** that allow an estate an income tax deduction, up to the amount of the estate's distributable net income, for any amounts of income that are required to be paid out, and any other amounts paid or distributed during the taxable year. The income that is not taxable to the estate under **Section 661(a)** must be reported as income on the beneficiary's tax return, in accordance with **Section 662(a)** . The reason for the conduit principle was to avoid taxpayers having to trace the source of amounts distributed, and to avoid having the income taxed at both the estate and the beneficiary level.

As is often the case with the Code, there are exceptions to the conduit theory. One exception is found in **Section 663** , which says that "[a]ny amount paid or permanently set aside or otherwise qualifying for the deduction provided in **section 642(c)** " shall not be "included as amounts falling within **section 661(a)** or **662(a)** ." According to the Fifth Circuit in *United States Trust Co.*, **201** the reason for the exception is that "Congress intended that the benefit for a charitable bequest be conferred only once-either as an offset against gross value of the estate or as an offset against income." **202**

In the *Crestar* case the court pointed out that the estate tax charitable deduction in **Section 2055** is limited to the payment of assets in the decedent's estate on the date of death, while the income tax charitable deduction in **Section 642(c)** is for payments made pursuant to the governing instrument and out of income earned by the estate. Under the conduit principle found in **Sections 661(a)** and **662(a)** , for distribution to non-charitable beneficiaries, it does not matter whether the payments are actually made from income or principal, as long as the deduction under **Section 661(a)** does not exceed the income earned that year.

The estate argued that the conduit theory applied to **Section 642(c)** because it presumes that any qualifying payment is made out of income regardless of where it actually comes from. The court dismissed this argument, finding that it ignored the statutory scheme discussed above. The court then cited rulings by other courts which supported its position.

In *Van Buren*, **203** the Tax Court said that it was necessary to trace the source of contributions deducted under **Section 642(c)** because the statute specifically requires that such payments be made from gross income. In *United States Trust Co.*, where an estate wanted to take an income tax deduction under **Section 661** for amounts paid to a charity and previously deducted under **Section 2055** , the Fifth Circuit ruled that, in accordance with the framework established by **Sections 661** - **663** , any income tax deduction for a charitable contribution made by an estate must qualify under **Section 642(c)** . **204** The Fifth Circuit pointed out that in 1960, Congress rejected a House bill which would have eliminated **Section 642(c)** and its tracing requirement by allowing charitable contributions to be deductible under **Section 661** . **205** This clearly indicated that there was a distinction between the rules under **Section 642(c)** and those under **Section 661** .

The estate then argued that a decision by the Supreme Court in *Old Colony Trust Co.* **206** allowed the estate to claim the income tax deduction. Once again the District Court disagreed. In *Old Colony Trust Co.*, trustees had authority to make payments to charities whenever the income earned by the trust was equal to or greater than twice the amount of certain annuity payments being made from the trust. The trustees took an income tax deduction under the predecessor to **Section 642(c)** for payments to charities up to the amount of the year's income. No payments were made from trust principal. The

Supreme Court allowed the deduction, holding that the deduction could be taken even though the trustees' right to make payments was discretionary. It was also unnecessary to show that payments had been made only out of current year's income.

The estate in *Crestar* argued that this decision deleted the requirement in **Section 642(c)** that the governing instrument must specify that payment be made from income. The District Court disagreed, finding that the Supreme Court approved only the trustee having discretion over whether or not to make the payment, not where it came from. Then the estate said that by removing the requirement that payments be traced to current year's income, the Supreme Court allowed the deduction for all payments regardless of whether they were from income or principal. Because the *Old Colony Trust Co.* case was concerned only with payments from income, and the Supreme Court had no reason to consider payments from principal, the District Court did not find that argument persuasive, either.

The estate also claimed support from **Rev. Rul. 83-75** , **207** which allowed a trust to take a **Section 642(c)** deduction for the gain recognized when an annuity payment is partially paid from trust corpus due to an insufficient amount of income. The court noted that nothing in the ruling allowed a deduction for the portion of the payments that came from trust corpus, only for the amount of the capital gain. The estate also cited **Treas. Reg. § 1.642(c)-3** which includes income in respect of a decedent (IRD) in gross income for purpose of **Section 642** . The court said that the inclusion of IRD in gross income did not indicate a loosening of the rules such that a specific gift of principal was deductible under **Section 642(c)** .

¶ 4.03[2] Planning for the Charitable Deduction

Because the estate tax charitable deduction is unlimited in scope, it obviously provides a great potential for the reduction of estate taxes. For example, if one half of the decedent's adjusted gross estate was left to the surviving spouse and the remainder to charity, the combination of the charitable and the marital deduction would mean that no taxes would be paid by the decedent. If the surviving spouse then left her entire estate to charity, the transfer would again be nontaxable. It is a fundamental concept, however, that a gift to charity ultimately means a complete relinquishment of ownership of the asset and a transfer outside the family situation. In essence, a decision to transfer property to charity (with perhaps a retained life interest) means that the decedent has made a decision to turn the assets over to a designated charitable institution rather than pay a percentage of it to the federal or state government by means of an estate or inheritance tax. The decedent must make a decision whether he or she wishes to pay a specified percentage of the value of the property to state and federal governments or completely transfer control of that property over to a designated charity. Thus, the charitable deduction will save forty cents on the dollar in federal estate taxes. **208**

One vehicle that might prove especially popular in a situation where a couple has no lineal descendants would be to leave a life income interest to the surviving spouse with the remainder to charity. If the will were drafted in the proper manner, the interest passing to the spouse would be free of tax because of the marital deduction, with the charitable remainder similarly being free of tax. In such a situation, the surviving spouse would be provided for during his or her lifetime and no estate tax would be payable on either spouse's death. A bequest of this type could take one of two forms.

The first such means of accomplishing this goal would be to establish a qualified terminable interest property (Q-Tip) trust with the surviving spouse as income beneficiary and the remainder being directly left to charity on that spouse's death. Prior to the Technical Corrections Act of 1982 (the 1982 Act) an issue did exist as to whether the distribution of the corpus to the charitable remainderman might not actually be a "bequest, legacy, devise or transfer" within the meaning of **Section 2055(a)** . The 1982 Act did, however, enact a new **Section 2044(c)** , which provides that if property is included in a surviving spouse's estate because of the provisions of **Section 2044(a)** , it shall be treated as passing from the decedent for all estate tax and generation skipping tax purposes. This means that a remainder interest in such a situation would be considered as passing from the surviving spouse and is eligible for the estate tax charitable deduction on his or her succeeding death.

The other means of making such a transfer which combines lifetime bequests to the spouse with a charitable remainder would be to have the life interest granted to the spouse as part of a charitable remainder trust. **Section 2056(b)(8)** provides that if the surviving spouse is the only noncharitable beneficiary of a charitable remainder trust, that trust will not be considered a terminable interest and will qualify for the estate tax marital deduction. **209** To qualify under **Section 2056(b)(8)** , the charitable remainder trust must be a qualified one. Under this section, a qualified remainder trust is a CRAT or a CRUT, both as described in **Section 664** . **210** Consequently, it should be noted that the marital deduction under **Section 2056(b)(8)** is not available for other charitable gifts with a retained life interest, such as a pooled income fund or a gift of a personal residence or farm with a retained life estate.

In comparing whether to use a Q-Tip trust with the remainder to charity or a charitable remainder trust as authorized by **Section 2056(b)(8)** , one primary advantage may be the flexibility of the Q-Tip arrangement. Under a Q-Tip trust, the trustee can have the discretion to pay principal over to the surviving spouse, whereas this type of provision cannot be inserted in the charitable remainder trust.

The Q-Tip trust may be more flexible to administer, because it is not subject to the strictures of **Section 664** or the private foundation rules that are generally applicable to charitable remainder trusts. If there is an invasion of corpus, however, fewer funds will be available to the ultimate charitable beneficiary. Consequently, if the decedent has the concern that excessive corpus invasion not occur, or that a specific amount be ultimately passed to the charity, the charitable remainder trust may be preferable. **211** In addition, if the charitable remainder trust is invested for capital growth, income receivable by the beneficiary may, under the trust distribution rules, be taxable as capital gain rather than ordinary income. Consequently, all these factors must be weighed when choosing between these two forms of trust that combine a lifetime interest with a spouse and a remainder interest to the charitable beneficiary. Both do accomplish the same basic goal, however. Each results in a charitable deduction for the ultimate gift to the charity as well as a marital deduction for the interest that passes to the surviving spouse.

If a decision is made to use charitable bequests as a means of estate tax reduction, the drafter must use care to ensure that the objective of obtaining the deduction will be met. **212** It first must be determined that the potential charitable recipient or recipients qualify for the deduction and that, particularly if a split interest is contemplated, the method of transfer chosen complies with the requirements for that transfer. The apportionment of taxes and other expenses must be considered so that the bequest, and hence, the deduction, is not reduced by these items. If there is a desire to make a charitable bequest but the individual is unsure as to whether his or her surviving spouse or other beneficiaries will have the economic need for certain assets, one possible approach would be to make a bequest to the beneficiary with an alternate bequest to charity. If the beneficiary, at the time of the decedent's death, did not require or desire those assets, a qualified disclaimer could then be made that would entitle the estate to the charitable deduction. Of course, such an approach is dependent on the beneficiary's actually making the disclaimer subsequent to the decedent's death and is beyond the control of the decedent. By drafting the will or appropriate trust instrument in such a manner, however, the decedent can make possible use of the disclaimer if it is either appropriate or desired.

An illustration of the tax consequences of an estate leaving an individual retirement account (IRA) to a qualified charity can be found in **Ltr. Rul. 9723038** . In this ruling, the Service allowed a **Section 2055(a)** deduction for the value of an IRA passing to a charity after the decedent's death reduced by any tax on excess retirement accumulations (which no longer exists) and a **Section 2053(c)** deduction for the amount of the excess retirement accumulation tax. In this situation, the taxpayer funded an IRA with a rollover distribution from a pension plan. The taxpayer designated his spouse as the primary beneficiary and, if the spouse did not survive, qualified charities as contingent beneficiaries. On this set of facts, the Service ruled that the estate of the survivor of the taxpayer and his spouse will be entitled to an estate tax deduction under **Section 2055(a)** equal to the value of the balance of the IRA that passes to the charities, reduced by the amount of federal estate tax attributable to the decedent's excess retirement accumulations imposed by Section 4980A(d). Finally, it should be noted that the Service concluded that the proceeds of the IRA that would have been items of gross income to the taxpayer and his spouse if the proceeds had been distributed to them will be items of income in respect of a decedent to the charities under **Section 691(a)(1)(B)** when distributed to the charities.

141 IRC § 2055(a) .

142 Clopton v. Comm'r, 93 TC 275 (1989) .

143 Estate of Levin v. Comm'r, 1995-81 TCM .

144 Lockett Estate v. Comm'r, 49-1 TC Memo. 1998-50 .

145 Estate of Silver v. Comm'r, 120 TC 430 (2003) .

146 If the charitable contribution is not made under one of the statutorily required forms, a charitable deduction will not be allowed. An estate can reformat a bequest so that it does qualify as a deductible transfer in trust, but this must be done within ninety days after the estate tax return is due. See **Estate of Hall v. Comm'r, 93 TC 745 (1989), aff'd without pub. op., 941 F2d 1209 (6th Cir. 1991)** , where a charitable deduction was denied because reformation was attempted too late.

See also Estate of Burdick v. Comm'r, 96 TC 168 (1991), aff'd, 979 F2d 1369 (9th Cir. 1992) , where an estate terminated a nonqualifying split-interest trust, giving a charity a cash payment in lieu of its remainder interest in the trust. The court said that the estate had the opportunity to reform the trust under **Section 2055(e)(3)** , but did not do so. It would not allow the estate to circumvent the restrictions on such gifts in **Section 2055(e)(2)(A)** by terminating the trust and making a cash payment solely to be able to take the charitable deduction.

147 Treas. Reg. § 20.2055-2(e)(2) .

148 In addition, the 1981 Act added **Section 2055(e)(4)** , which treats a contribution of a work of art with a retention of its copyright as separate interests for purposes of the charitable deduction. Consequently, a deduction will be allowed for a transfer of a work of art without a transfer of its copyright, provided the use of the property by the organization is related to its function.

149 Ltr. Rul. 9022010 .

150 Treas. Reg. § 20.2055-2(e)(2)(ii) . The personal residence exception does not extend to furnishings in the decedent's residence. **Rev. Rul. 76-165, 1976-1 CB 279** .

151 The Service has ruled that a charitable deduction under **Section 2055(a)** is allowed for the value of a charitable remainder interest in the proceeds from the sale of a decedent's personal residence if under local law the charity has the option to take the residence instead of the sales proceeds. **Rev. Rul. 83-158, 1983-2 CB 159** . See also **Treas. Reg. § 20.2055-2(e)(2)(iii).**

152 Rev. Proc. 2007-46, **2007-29 IRB 102** .

153 Rev. Rul. 88-27, 1988-1 CB 331.

154 Rev. Rul. 89-31, 1989-1 CB 277.

155 See also **Terre Haute First Nat'l Bank v. US, 91-1 USTC ¶ 60,070 (D. Ind. 1991)** , where an estate settled a will controversy by giving a charity $250,000 in cash in lieu of a remainder interest in a trust. The charitable deduction was limited to the actuarial date-of-death value of the remainder interest. The balance received by the charity under the settlement agreement was given by the heirs, not the decedent.

156 Rebecca K. Crown Income Charitable Fund v. Comm'r, 98 TC 327 (1992), aff'd 8 F3d 571 (7th Cir. 1993) .

157 In **Rev. Rul. 89-31, 1989-1 CB 277** , a trust did not meet the requirements for a charitable remainder trust and its validity was challenged by the noncharitable beneficiary who had a life income interest. In a bona fide settlement the noncharitable beneficiary received a cash payment and the balance of the residuary estate went to the charity. The Service allowed the estate to take a charitable deduction under **Section 2055** , because the actual distribution to the charity was an outright payment and not a nondeductible split interest. In making this holding, the Service revoked an earlier contrary decision in **Rev. Rul. 77-491, 1977-2 CB 332** , and modified **Rev. Rul. 78-152, 1978-1 CB 296** , which supported **Rev. Rul. 77-491** .

158 IRC § 664(d)(1) .

159 In 1989, the Service issued **Rev. Proc. 89-20, 1989-1 CB 841** ; and **Rev. Proc. 89-21, 1989-1 CB 842** , which make available sample forms of declarations of trust that meet the requirements for charitable remainder unitrusts and annuity trusts, respectively. If these sample provisions are followed and the trust declaration specifically refers to the appropriate revenue procedure, then it will not be necessary for a taxpayer to request a ruling from the Service on whether or not a trust similar to the sample meets the qualifications for a charitable remainder trust.

The IRS model forms for charitable remainder unitrusts have been updated. See **Rev. Proc. 2005-52, 2005-34 IRB 326** ; **Rev. Proc. 2005-53, 2005-34 IRB 339** ; **Rev. Proc. 2005-54, 2005-34 IRB 353** ; **Rev. Proc. 2005-55, 2005-34 IRB 367** ; **Rev. Proc. 2005-56, 2005-34 IRB 383** ; **Rev. Proc. 2005-57, 2005-34 IRB 392** ; **Rev. Proc. 2005-58, 2005-34 IRB 402** ; and **Rev. Proc. 2005-59, 2005-34 IRB 412** .

160 IRC § 664(d)(2) . A trust otherwise qualifying as a unitrust will fail where a portion of a specified trustee's fee will be charged against the unitrust. **Rev. Rul. 74-19, 1974-1 CB 155** . A trust also will not qualify as a charitable remainder unitrust if the property contributed to the trust is subject to a mortgage for which the grantor is personally liable, because the grantor will be treated as the owner of the trust. **Ltr. Rul. 9015049** .

161 IRC § 664(d)(3) .

162 Rev. Rul. 82-128, 1982-2 CB 71 .

163 The trust may also be disqualified if its assets include shares of an S corporation. In **Rev. Rul. 92-48, 1992-1 CB 301** , an individual shareholder of an S corporation transferred some of his shares to a charitable remainder unitrust. The beneficiary of the unitrust filed an election under **Section 1361(d)(2)** to qualify the unitrust as a qualified subchapter S trust (QSST). The Service denied the election because the rules in **Sections 661-664** governing charitable remainder trusts are incompatible with the QSST rules found in **Section 1361** and, by cross-reference in **Sections 671-679** . **Section 664(a)** requires that a charitable remainder trust operate exclusively under **Section 664** , which precludes any application of **Section 1361** . Furthermore, there are unreconcilable differences on how distributed and undistributed income is taxed, how much income is to be distributed, and who the trust assets should be distributed to on termination of the trust.

164 The full text of that section reads as follows:

> (5) Definition of pooled income fund-For purposes of paragraph (3), a pooled income fund is a trust-
>
> (A) to which each donor transfers property, contributing an irrevocable remainder interest in such property to or for the use of an organization described in **section 170(b)(l)(A)** (other than in clauses (vii) or (viii)), and retaining an income interest for the life of one or more beneficiaries (living at the time of such transfer),
> (B) in which the property transferred by each donor is commingled with property transferred by other donors who had made or make similar transfers,
> (C) which cannot have investments in securities which are exempt from taxes imposed by this paragraph,
> (D) which includes only amounts received from transfers which meet the requirements of this paragraph,
> (E) which is maintained by the organization to which the remainder interest is contributed and of which no donor or beneficiary of an income interest is a trustee, and
> (F) from which each beneficiary of an income interest receives income, for each year for which he is entitled to receive the income interest referred to in sub-paragraph (A), determined by the rate of return earned by the trust for such year.

For purposes of determining the amount of any charitable contribution allowable by reason of a transfer of property to a pooled fund, the value of the income interest shall be determined on the basis of the highest rate of return earned by the fund for any of the three taxable years immediately preceding is the taxable year of the fund in which the transfer is made. In the case of funds in existence less than three taxable years preceding the taxable year of the fund in which a transfer is made, the rate of return shall be deemed to be 6% per annum, except that the Secretary of the Treasury may prescribe a different rate of return. See **Rev. Rul. 72-196, 1972-1 CB 194** , and **Rev. Rul. 82-38, 1982-1 CB 96** , for the Service's requirements for pooled income funds. The Service has also provided guidance as to the provisions that may be inserted in the trust instrument for the selection of an alternate charitable remainderman in the event the designated public charity goes out of existence or loses its qualification. **Rev. Rul. 85-57, 1985-1 CB 182** .

In 1988, the Service issued **Rev. Proc. 88-53, 1988-2 CB 712** , which provides a sample form of declaration of trust and instruments of transfer that satisfy the requirements in **Section 642(c)(5)** for a pooled income fund. If these provisions are followed and this revenue procedure is specifically referred to, then the taxpayer will not have to ask the Service to rule on the validity of the pooled income fund documents.

165 Estate of Johnson v. US, 941 F2d 1318 (5th Cir. 1991), rev'g 742 F. Supp. 940 (SD Miss. 1990) .

166 Oetting v. US, 712 F2d 358 (8th Cir. 1983) .

167 Estate of LaMeres v. Comm'r, 98 TC 294 (1992) .

168 Wells Fargo Bank v. US, 1 F3d 830 (9th Cir. 1993) .

169 The court did not address the effect of a codicil that makes a substantial change in a will.

170 Zabel v. US, 995 F. Supp. 1036 (D. Neb. 1998) .

171 Estate of Atkinson v. Comm'r, 115 TC 26 (2000) , aff'd, **309 F3d 1290 (11th Cir. 2002)** .

172 Estate of M. Jackson v. US, 2005-2 USTC ¶ 60,513 (D.W. Va. 2005) .

173 Galloway v. US, 492 F3d 219, 99 AFTR2d 2007-3412 (3d Cir. 2007) .

174 Rev. Rul. 89-31, 1989-1 CB 277 .

175 Oetting v. US, 712 F2d 358, 360 (8th Cir. 1983) .

176 Estate of Cassidy v. Comm'r, TC Memo. 1985-37 (Jan. 22, 1985) (citing US v. Merriam, 263 US 179, 187-188 (1923)); **DeGanny v. Lederer, 250 US 376, 381-382 (1919)** .

177 INDOPCO, Inc. v. Comm'r, 503 US 79, 84 (1992) ; **Deputy v. Du Pont, 308 US 488, 493**

(1940) .

178 Exxon Mobil Corp. v. Allapattah Servs., Inc., 545 US 546, 548 (2005) ; Morgan v. Gay, 471 F3d 469, 473 (3d Cir. 2006) .

179 Estate of Johnson v. US, 941 F2d 1318 (5th Cir. 1991) ; **Esate of Edgar v. Comm'r, 74 TC 983, 987 (1980)** .

180 Zabel v. US, 995 F. Supp. 1036, 2047 (D. Neb. 1998) .

181 See **Oetting v. US, 712 F2d 358 (8th Cir. 1983)** ; **First Nat'l Bank of Fayetteville v. US, 727 F2d 741, 746 (8th Cir. 1984)** ; Strock v. US, F. Supp. 1334, 1338-1340 (WD Pa. 1987) ; **Northern Trust Co. v. US, 41 AFTR2d 78-1523 (ND Ill. 1977)** .

182 Estate of Tamulis v. Comm'r, TC Memo. 2006-183 , aff'd 509 F3d 343, 100 AFTR2d 6837 (7th Cir. 2007) .

183 IRC § 2055(d) .

184 Treas. Reg. § 20.2055-1(a) .

185 IRC § 2055(c) . These taxes may qualify for the deduction for state death taxes under **IRC § 2058** . The Service used to claim that the charitable deduction also had to be reduced by an estimate of any post-death interest on deferred estate taxes that was payable out of the residuary estate. The Service has reversed its position in **Rev. Rul. 93-48, 1993-2 CB 270** . See discussion **¶ 15.02[1][f]** .

186 Alston v. US, 349 F2d 87 (5th Cir. 1965) ; **Rev. Rul. 73-98, 1973-1 CB 407** . In **Estate of Warren v. Comm'r, 981 F2d 776 (5th Cir. 1993)** , the Fifth Circuit allowed a portion of the administrative expenses to be offset against income rather than principal, squashing the Service's attempt to reduce the charitable deduction. The decedent's estate incurred substantial expense defending against numerous claims filed against the estate and in managing certain gas and oil properties held by the estate. The estate requested instructions from the probate court on how to allocate the administration expenses. Because the gas and oil properties constituted a substantial portion of the estate, the court allocated 72.5% of the expenses to income and 27.5% to principal, in accordance with Texas law. The Service claimed that all the administrative expenses should be deducted from principal as stated in the will, and it imposed a deficiency of $34.3 million. The Fifth Circuit reversed, finding that in this matter state law was binding. The court noted that the litigation arose from nontax, bona fide disputes, therefore, the judgment was not obtained simply to gain a tax benefit. Relying on **Rev. Rul. 89-31, 1989-1 CB 277** , the court also felt that the estate tax deduction should be computed based on the amount the charitable beneficiaries will actually receive under the will pursuant to the order of the probate court.

187 Estate of Bradford v. Comm'r, TC Memo. 2002-238 .

188 Riggs v. Del Drago, 317 US 95, 97-98 (1943) .

189 See also **Estate of Leach, 82 TC 952, 963 (1984)** , aff'd without published opinion, 782 F2d 179 (11th Cir. 1986) ; **Estate of Fagan, TC Memo. 1999-46** ; **Estate of McKay, TC Memo. 1994-362** .

190 See Pittman v. Thomas, 299 SE2d 207, 211 (NC 1983) ; In re Wilson's Will, 133 SE2d 189, 191 (NC 1963) ; Harroff v. Harroff, 102 SE2d 224, 226 (NC 1958) ; Coppedge v. Coppedge, 66 SE2d 777, 778 (NC 1951) .

191 Green v. Comm'r, TC Memo. 2003-348 .

192 Estate of Boder v. Albrecht Art Museum, 850 WE2d 76, 78 (Mo. 1993) .

193 Cf. **Monroe, 104 TC 352, 363-365 (1995)** , rev'd and remanded on another ground, **124 F3d 699 (5th Cir. 1997)** .

194 Treas. Reg. § 20.2055-2(b) .

195 Rev. Rul. 64-129, 1964-1 CB (Part 1) 329 .

196 Rev. Rul. 71-442, 1971-2 CB 336 . See also **Rev. Rul. 59-143, 1959-1 CB 247** , where a charitable bequest contingent on a fifty-four-year-old daughter remaining childless was allowed.

197 Underwood v. US, 407 F2d 608 (6th Cir. 1969), aff'g 270 F. Supp. 389 (ED Tenn. 1967) .

198 See, e.g., **Rev. Rul. 67-229, 1967-2 CB 335** .

199 Crestar Bank v. Comm'r, 47 F. Supp. 2d 670, 83 AFTR2d 99-2555 (ED Va. 1999) .

200 Old Colony Trust Co. v. US, 301 US 379 (1937) .

201 US Trust Co. v. IRS, 803 F2d 1363 (5th Cir. 1986) .

202 US Trust Co., 803 F2d 1366 (5th Cir. 1986) .

203 Van Buren v. Comm'r, 89 TC 1101 (5th Cir. 1986) .

204 US Trust Co., 803 F2d 1363, 1367 . See also **Mott v. Comm'r, 462 F2d 512, 518 (Ct. Cl. 1972)** (en banc) (tracing of charitable distributions is required under **Section 642(c)**); **Estate of Bedford, 39 BTA 1039, 1042 (1939)** (when a charity is given a specified sum of money under a will, the estate can not take an income tax deduction for payment of that sum).

205 US Trust Co., 803 F2d 1363, 1368 (citing HR Rep. No. 86-1231, at 9-10 (1960)).

206 Old Colony Trust Co. v. US, 301 US 379 (1937) .

207 Rev. Rul. 83-75, 1983-1 CB 114 . There has been considerable litigation as to whether a charitable or non-charitable gift made by check prior to the death of a decedent are includable in a decedent's gross estate when the check does not clear the bank until after the decedent's death. This issue, which is discussed extensively in **¶ 11.03** , generally relates the charitable gift back to the sending of the check by using the so-called relation-back theory. Courts have been disinclined to apply this theory to non-charitable gifts. For example, in **Rosano v. US, 67 F. Supp. 2d 113 (EDNY 1999)** , the gifts to non-charitable beneficiaries made by checks dated before, but paid after, the decedent's death were held to be incomplete gifts so as to make the relation-back doctrine inapplicable. Accordingly, the value of the checks was included in the decedent's gross estate. In this particular case, the estate also raised a constitutional argument that treating charitable and non-charitable gifts differently violates the protection clause of the Fourteenth Amendment. The court followed the case of **Newman v. Comm'r, 111 TC 81 (1998)** , in holding that the relation-back doctrine was inapplicable in this particular situation.

208 This tax rate is applicable to estates above the exclusionary amount. It may also save additional state estate taxes.

209 See also **IRC § 2523(g)** , which creates an equivalent rule for the gift tax marital deduction.

210 See **IRC § 2056(b)(8)(B)(ii)** .

211 There is no necessity to permit an invasion of corpus in a Q-Tip trust.

212 Sloppy draftsmanship can sometimes negate the charitable deduction. For example, in **Estate of Marine v. Comm'r, 97 TC 368 (1991), aff'd, 990 F2d 136 (4th Cir. 1993)** , a codicil to the decedent's will provided that his personal representatives could select in their sole discretion persons who had contributed to the well-being of the decedent during his lifetime. A bequest to any person so selected was limited to one percent of the decedent's gross estate, but the number of the bequests that could be made to such individuals was unlimited. The residue of the estate was left to charitable beneficiaries. The Service disallowed a deduction claimed under **Section 2055** on the ground that the value of the charitable bequests was not ascertainable at the time of the decedent's death. The Tax Court agreed with the Service, stating that the power granted to the personal representatives was too broad and too uncertain to qualify an interest that is subject to the exercise of such power for the estate tax charitable deduction. As the court pointed out, the exercise of the discretionary power could consume the entire residuary estate that otherwise would have gone to the charitable interests. The Tax Court's decision was affirmed by the Fourth Circuit, which said that ascertainability at the date of death of the amount going to the charity is the test. Citing **Merchant's National Bank of Boston (Field Est, Ozro Miller), Executor v. Comm'r, 320 US 256 (1943)** , the court said that to be presently ascertainable, the trustee's power to divert assets elsewhere must be restricted by a fixed standard. The lack of any definite standard in Dr. Marine's will made the charitable bequest uncertain and unascertainable. Placing some form of definitive limitation on the number of such noncharitable bequests could have effectively preserved the charitable deduction in this situation. This deduction might also have been saved if the executors had asked the court to either reform or construe the will in a manner that limited the noncharitable bequests to a specified number or a specific dollar amount. The drawback with this is that there is no guarantee that the Service will accept a court's interpretation of the will, even if the court agrees to give it.

The Service took a similar position in **G. Buder III v. US, 70 AFTR2d 92-6189, 92-2 USTC ¶ 60,105 (ED Mo. 1992), aff'd, 7 F3d 1382 (8th Cir. 1993)** but this time the provisions of the will survived the court's scrutiny. After making certain bequests, Article V of the decedent's will divided 25% of the balance of his estate among thirteen named charitable organizations or entities. In paragraph D of Article V, one of those entities was a trust that was to be established to foster and promote patriotism, loyalty, and fundamental constitutional government. The trustees were given discretion to use the income and principal in the manner most advisable and effective to accomplish these objectives. The Service claimed that the trustee's discretion was too broad; that they were not limited to using the funds for a charitable purpose. The court disagreed, finding instead that the instructions to the trustees in paragraph D simply explained how the funds were to be used in a particular charity. They did not alter the general provision in Article V that the funds be used for a charitable purpose.